

Baron Asset Fund

DEAR BARON ASSET FUND SHAREHOLDER:

PERFORMANCE

Baron Asset Fund's Retail Shares gained 9.49% during the quarter ended December 31, 2011. This result trailed that of the Russell Midcap Growth Index, which gained 11.24%, and the S&P 500 Index, which gained 11.82% during this same period.

The stock market closed an exceptionally volatile year with a widespread recovery, making up for a large portion of the losses incurred during the third quarter. Throughout the year, the most significant factors shaping the market's gyrations were uncertainty surrounding the sustainability of the fragile U.S. economic recovery and the political system's apparent inability to address the country's long-term budgetary imbalances. In addition, the ongoing European financial crisis caused concerns about the entire Continent falling into recession, with possibly significant spillover effects across the global economy. Against this backdrop, investors were generally fearful of equities, and the slightest whiff of "bad news" caused many to flee the market, with little concern for underlying valuations.

Table I.
Performance (Retail Shares)[†]
Annualized for periods ended December 31, 2011

	Baron Asset Fund ^{1,2}	Russell Midcap Growth Index ¹	S&P 500 Index ¹
Three Months ⁴	9.49%	11.24%	11.82%
One Year	-2.94%	-1.65%	2.11%
Three Years	15.74%	22.06%	14.11%
Five Years	0.23%	2.44%	-0.25%
Ten Years	5.38%	5.29%	2.92%
Since Inception (June 12, 1987)	10.52%	8.90% ³	8.42%

Performance listed in the above table is net of annual operating expenses. Annual expense ratio for the Retail Shares as of September 30, 2011 was 1.33%. *The performance data quoted represents past performance. Past performance is no guarantee of future results. The investment return and principal value of an investment will fluctuate; an investor's shares, when redeemed, may be worth more or less than their original cost. The Fund's transfer agency expenses may be reduced by expense offsets from an unaffiliated transfer agent, without which performance would have been lower. Current performance may be lower or higher than the performance data quoted. For performance information current to the most recent month-end, visit www.BaronFunds.com or call 1-800-99BARON.*

[†] If the Fund's historical performance was impacted by gains from IPOs and/or secondary offerings, there is no guarantee that these results can be repeated or that the Fund's level of participation in IPOs and secondary offerings will be the same in the future.

¹ The Russell Midcap Growth Index and the S&P 500 Index are unmanaged. The Russell Midcap Growth Index measures the performance of medium sized companies classified as growth. The S&P 500 Index measures the performance of large cap U.S. equities in the stock market in general. The indexes and the Baron Asset Fund are with dividends, which positively impact the performance results.

² The performance data in the table does not reflect the deduction of taxes that a shareholder would pay on Fund distributions or redemption of Fund shares.

³ For the period June 30, 1987 to December 31, 2011.

⁴ Not annualized.



ANDREW PECK
PORTFOLIO MANAGER

These concerns faded during the fourth quarter, as improved domestic economic data (most notably a modest decline in the unemployment rate) and generally positive third quarter earnings results caused stocks to jump.

Baron Asset Fund's objective is to be a long-term investor in a diversified portfolio of *high-quality* businesses. We believe quality businesses possess several characteristics, including open-ended growth opportunities, substantial and sustainable competitive advantages and leading management teams. According to one third-party analysis, the Fund's stake in companies with "economic moats" – another proxy for quality companies – was exceptionally high relative to other funds in its category.* (See endnote on Page 17.)

We believe that investing in high-quality businesses will lead to strong results over an extended timeframe. In looking back over the Fund's performance during the past eight years, there are a couple of periods worth noting. During the period from 2004 through late-2008, stocks rose broadly, and quality companies performed well. Then, in September 2008 as the financial crisis began in earnest, almost every stock fell dramatically – though quality companies fell relatively less. This was a favorable five-year period for the Fund, and its relative performance was quite strong.

However, the market environment during the two-year period 2009-2010 was less favorable for the Fund's investment style, and its relative performance was poor. As the worst effects of the financial crisis began to subside in early-2009, the market began its substantial two-year rebound. In our view, the types of stocks that surged during this rally included a disproportionate number of cyclical, lower-quality companies. Many of the Fund's investments lagged in this environment.

The Fund's performance was also penalized during this period by its investments in two private companies, Kerzner International Holdings Ltd. and John Nuveen (now known as Windy City Investments Holdings, L.L.C.), which represented



approximately 2.7% of assets at the beginning of 2009. Both these investments had been successful long-term investments for the Fund. We chose to invest alongside their management teams and private equity firms when these two companies pursued leveraged buyouts. These investments both detracted from performance, and we have no intention of again investing in leveraged private companies.

We believe the market began again to reward fast-growing quality companies in 2011, as lower-quality, more cyclical companies generally trailed. The Fund's relative performance improved meaningfully in this environment. We remain optimistic that the Fund's investment style will continue to perform well in the current market environment as we begin 2012.

Table II.

Top contributors to performance for the quarter ended December 31, 2011

	Year Acquired	Percent Impact
Fastenal Co.	2006	0.94%
Helmerich & Payne, Inc.	2006	0.57
SBA Communications Corp.	2007	0.55
Concho Resources, Inc.	2010	0.45
IDEXX Laboratories, Inc.	2006	0.40

Given the market's ongoing concerns about the future health of the European economy, companies with well-defined domestic growth prospects and limited sales exposure to Europe, such as **Fastenal Co.**, **SBA Communications Corp.**, and hotel and resort companies like **Choice Hotels International, Inc.**, **Hyatt Hotels Corp.** and **Vail Resorts, Inc.**, generally outperformed. The Fund's Energy sector investments did especially well, as spot market oil prices jumped sharply on renewed optimism about the rate of future global economic growth. In addition, information services companies with highly recurring and visible revenue streams, such as **Verisk Analytics, Inc.** and **Nielsen Holdings N.V.**, saw their shares move higher. The three most significant contributors to performance are discussed in more detail below.

Shares of **Fastenal Co.**, the leading industrial supplies distributor, performed well, as demand from manufacturing and commercial construction clients improved. Sales across the company's 2,500 branches strengthened throughout 2011. This broad-based strength reflected a growing rebound in domestic factory production, the success of a new initiative to sell its products through sophisticated vending machines located on factory floors, and market share gains stemming from a diminished competitive set following the 2008-2009 industrial downturn. Fastenal's customers relied on the company to help reduce their supply costs, cut working capital and improve productivity. Fastenal successfully converted this renewed demand into faster profit growth, a result of healthy operating leverage from its fixed occupancy and overhead costs. (Matt Weiss)

Helmerich & Payne, Inc. is a leading land-drilling contractor in the U.S., which has the highest proportion of new generation land rigs among its major oilfield competitors. The company's shares rebounded from third-quarter declines, as demand for oil-related land drilling in the U.S. continued to expand. We believe the shares remain attractively valued and that the company continues to have attractive growth prospects over the next several years. We expect this growth to be led by oil companies' ongoing investments in unconventional oil and gas

development, spurring the U.S. rig fleet to be retrofitted to include more modern, high-specification rigs from Helmerich. (Jamie Stone)

Shares of cellular tower owner and operator **SBA Communications Corp.** moved higher. Concerns about the possible negative impact from consolidation among cellular carriers faded, as the AT&T/T-Mobile merger was first challenged, then officially aborted. In addition, major carriers took steps to add cellular spectrum to enhance the rollouts of their 4G networks – notably, Sprint extended its commitment to Clearwire, and Verizon acquired spectrum held by cable companies. Consumers' demand for mobile broadband services remained insatiable, with smartphone sales rising yet again, and a range of new tablets being launched – notably, the Kindle Fire from Amazon.com and the Nook from Barnes and Noble. Fundamentally, tower leasing demand by carriers remained solid. (Rich Rosenstein)

Table III.

Top detractors from performance for the quarter ended December 31, 2011

	Year Acquired	Percent Impact
HomeAway, Inc.	2011	-0.26%
Polypore International, Inc.	2011	-0.24
LinkedIn Corp.	2011	-0.17
Cerner Corp.	2010	-0.13
Green Mountain Coffee Roasters, Inc.	2011	-0.07

Although the large majority of the Fund's holdings moved higher, there were several laggards. These included some of the Fund's higher beta investments, which generally carry aggressive near-term valuations, but we believe offer attractive upside based on their longer-term earnings potential.

HomeAway, Inc. is the leading online marketplace for vacation rental listings that came public earlier in 2011. Despite reporting 36% EBITDA growth for the third quarter, the stock fell meaningfully, the result of heightened volatility among Internet-related stocks, concerns about the health of the European travel market, and expiration of a trading lockup on 90% of its outstanding shares. We continue to hold the stock, given the company's long-term strategy to significantly grow its listing inventory, its revenue per listing, and its profitability metrics. (Catherine Chen)

Shares of **Polypore International, Inc.**, a leading manufacturer of critical separators used in lithium and lead-acid batteries, dropped during the quarter. Third quarter earnings were good, and management indicated that its lithium-ion separator business (the company's chief growth product, used in electric vehicles and consumer electronics) was continuing as planned. However, several developments spooked investors about the electric vehicle market, including a fire in a GM Volt battery after a severe crash test. Based on our research, we continue to forecast a vibrant future for electric vehicles, which should, in turn, benefit Polypore. (Randy Gwartzman)

LinkedIn Corp. is the leading online professional network with 131 million members worldwide. The stock fell due to heightened volatility among Internet-related stocks coupled with the expiration of a share lockup that meaningfully increased the company's public float. The stock may remain under pressure until the remaining share lockup expires in early-2012. We continue to hold the stock because we believe LinkedIn is a unique "Internet

Baron Asset Fund

platform” in the early stages of penetrating at least two large addressable markets – the \$27 billion dollar talent acquisition market and the \$25 billion dollar business-to-business advertising market. (Catherine Chen)

PORTFOLIO STRUCTURE

At December 31, 2011, Baron Asset Fund held 61 positions. The Fund’s 10 largest holdings represented 31.8% of assets, and the 20 largest represented 54.4% of assets. Relative to the Russell Midcap Growth Index, the Fund was overweight in the Consumer Discretionary sector at 26.1% of assets. This sector includes the Fund’s investments in retailers, casinos, hotels and resorts, broadcasters and for-profit education firms. The Fund was also overweight in the Financials sector at 12.9% of assets. The Fund was underweight in the Information Technology sector at 14.7% of assets. It was also underweight in the Materials sector at 1.6% of assets.

RECENT ACTIVITY

During the past quarter, the Fund established three new positions and added to nine others. The Fund also sold nine positions and reduced its holdings of 20 others.

Table IV.
Top net purchases for the quarter ended December 31, 2011

	Quarter End Market Cap (billions)	Amount (millions)
Oil States International, Inc.	\$ 3.9	\$13.5
Liberty Media Corp.	9.7	7.8
CARBO Ceramics, Inc.	2.8	6.4
Fossil, Inc.	5.0	4.7
Michael Kors Holdings Ltd.	5.2	4.0
CBRE Group, Inc.	5.0	3.2
Perrigo Co.	9.1	2.3
Hyatt Hotels Corp.	6.2	1.9
Cerner Corp.	10.4	1.5
Polypore International, Inc.	2.0	1.3

Oil States International, Inc. is a leading provider of specialty products and services to natural resources companies throughout the world. OIS operates in a substantial number of the world’s active oil and natural gas and coal producing regions, including Canada, onshore and offshore U.S., and Australia. Its customers include many national oil companies, major and independent oil and natural gas companies, and onshore and offshore drilling companies. OIS operates in four principal business segments — accommodations, offshore products, well site services and tubular services — and has established a leadership position for certain products or service offerings in each segment. The company’s strategy is to grow its business lines organically and through strategic acquisitions. It is currently focused on expanding share around oil sands developments in Canada, shale plays in North America, the natural resource market in Australia. It plans to expand

its capabilities to manufacture and assemble deep-water capital equipment on a global basis.

The company’s accommodations segment provides the largest share of its cash flow. OIS operates an integrated lodging business for the oil and mining industries with primary operations in Canada for the oil sands developments and in Australia around coal and iron ore mining developments. In both the oil & gas and mining segments, the development of key resources are occurring in more remote locations that do not have the infrastructure or access to support permanent populations to work on these projects. OIS manufactures, constructs and operates ‘mini cities’ (including hotels rooms, dining and entertainment facilities) on a contract basis for these customers and is the largest player in the business. Currently OIS has just under 10,000 rooms in the oil sands areas and plans to grow those facilities over the next several years to at least 15,000 by 2015. It has the capacity in Canada to manufacture about 1,500 rooms per year. OIS has also noted that it can outsource construction of additional rooms if necessary. In Australia, the company currently services just under 6,000 rooms and also plans to add about 1,500 rooms per year on average over the next several years. (Jamie Stone)

Table V.
Top net sales for the quarter ended December 31, 2011

	Amount (millions)
Rockwood Holdings, Inc.	\$-26.2
Fastenal Co.	-23.8
Ralph Lauren Corp.	-18.4
Molycorp, Inc.	-15.4
SEACOR Holdings, Inc.	-14.2
Stanley Black & Decker, Inc.	-13.6
FactSet Research Systems, Inc.	-11.6
Polycom, Inc.	-10.3
Ritchie Bros. Auctioneers, Inc.	-10.3
Community Health Systems, Inc.	-8.9

During the fourth quarter, the Fund sold its positions in **Rockwood Holdings, Inc.**, which manufactures specialty chemicals and advanced materials, and **Molycorp, Inc.**, which manufactures rare earths. Given the unsettled state of the global economy, we chose to redeploy those funds into companies in which macroeconomic factors have less impact in determining their share prices.

We trimmed the Fund’s holdings in **Fastenal Co.** and **Ralph Lauren Corp.**, which were both among the Fund’s best performers during 2011 to keep their position sizes appropriate.

We exited **SEACOR Holdings, Inc.** and redeployed the proceeds into two other oil services companies, **Oil States International, Inc.** and **CARBO Ceramics, Inc.**

OUTLOOK

Table VI.
Top 10 holdings as of December 31, 2011

	Year Acquired	Market Cap When Acquired (billions)	Quarter End Market Cap (billions)	Amount (millions)	Percent of Net Assets
Gartner, Inc.	2007	\$2.9	\$ 3.3	\$88.7	3.9%
Fastenal Co.	2006	5.8	12.9	82.9	3.7
IDEXX Laboratories, Inc.	2006	2.5	4.3	82.7	3.7
Arch Capital Group Ltd.	2003	0.9	5.0	68.9	3.1
FactSet Research Systems, Inc.	2006	2.5	3.9	67.6	3.0
C.H. Robinson Worldwide, Inc.	2003	3.0	11.5	66.3	2.9
Vail Resorts, Inc.	1997	0.2	1.5	64.5	2.9
SBA Communications Corp.	2007	3.8	4.7	64.4	2.9
Verisk Analytics, Inc.	2009	4.0	6.6	64.2	2.9
Equinix, Inc.	2007	2.7	4.8	63.4	2.8

At the time of this letter, the equity markets were off to a strong start in the new year. As we discussed in last quarter's letter, despite the well-known challenges facing the global economy and the recent uptick in the market,

we believe that stocks remain inexpensive. Investors appear overly-focused on the 'rear view mirror' and the risks inherent in equities' performance. Despite these risks, we believe that equities continue to provide significant opportunities for investors over the long term. We believe this is particularly important to consider given that interest rates, and the income stream associated with most bonds, remain near historically low levels.

We continue to believe that our diversified portfolio of high-quality, competitively advantaged, well-managed and well-financed businesses should prosper going forward.

Thank you for investing in Baron Asset Fund.

Our entire firm and our research department, in particular, are committed to justifying your ongoing confidence and support. I remain a significant investor in the Fund alongside you.

Sincerely,



Andrew Peck
Portfolio Manager
January 18, 2012

For more information about this Fund
please scan this QR code with any
bar code reader on your mobile device.



* Source: Morningstar's most current analysis of Baron Asset Fund, dated May 26, 2010. Every stock covered by Morningstar receives an economic moat rating, which measures the company's competitive position. According to Morningstar, companies with the ability to withstand the competition for a long time receive Wide moat ratings, companies with moderate ability to withstand competitive pressures receive Narrow moat ratings, and companies without meaningful competitive advantage receive None moat ratings.

The Adviser believes that there is more potential for capital appreciation in mid-sized companies, but there also may be more risk. Specific risks associated with investing in mid-sized companies include that the securities may be thinly traded and they may be more difficult to sell during market downturns. Prior to February 15, 2007, the Fund's strategy was to invest primarily in small and mid-sized growth companies. Since then, the Fund's investment strategy has shifted to mid-sized companies. The Fund may not achieve its objectives. Portfolio holdings are subject to change. Current and future portfolio holdings are subject to risk.

The discussions of the companies herein are not intended as advice to any person regarding the advisability of investing in any particular security. The views expressed in this report reflect those of the respective portfolio managers only through the end of the period stated in this report. The portfolio manager's views are not intended as recommendations or investment advice to any person reading this report and are subject to change at any time based on market and other conditions and Baron has no obligation to update them.

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