

DEAR BARON FIFTH AVENUE GROWTH FUND SHAREHOLDER:

PERFORMANCE

Despite significantly higher volatility, the market continued its advance in the second quarter. We kept pace with the Russell 1000 Growth and were roughly 80 basis points behind the S&P 500. We believe, this quarter in particular, the markets were driven more by the comments of various global central bankers than company fundamentals. In his Congressional testimony in late May, Fed Chairman Ben Bernanke suggested that the central bank could begin tapering back bond purchases if the economic data proved to be stronger than expected. The S&P 500 Index declined 7.5% over the next 4 weeks. In early July, the Chairman said that tapering would not begin unless the economic data were stronger than expected. The market rallied sharply to erase the decline. We admit to being dilettantes (or tone-deaf) in reading between the Fed's lines and hence we continued to focus on our companies and their prospects. The portfolio remains largely the same as it was last quarter, and we continue to look for new investment opportunities.

Table I.
Performance (Retail Shares)
Annualized for periods ended June 30, 2013

	Baron Fifth Avenue Growth Fund ^{1,2}	S&P 500 Index ¹	Russell 1000 Growth Index ¹
Three Months ³	2.09%	2.91%	2.06%
Six Months ³	6.99%	13.82%	11.80%
One Year	13.99%	20.60%	17.07%
Three Years	15.08%	18.45%	18.68%
Five Years	5.46%	7.01%	7.47%
Since Inception (April 30, 2004)	4.86%	6.33%	6.53%

Eddie Lampert is the Chairman and CEO of Sears Holdings Corp., and the founder and CEO of ESL Investments. Some years ago, I read an interview that he gave to a publication focused on investing. In it, he described tossing a football with his father in the yard when he was 8 or 9 years old. "Go out 10 steps and turn to your right" his father would instruct. A split second after making the turn the ball would hit Eddie squarely in the chest often before he was ready to make the catch. The elder Lampert explained that if he were to wait and throw the ball after Eddie made his turn, the defensive player would

Performance listed in the table above is net of annual operating expenses. Annual operating expense ratio for the Retail Shares as of September 30, 2012 was 1.55%, but the net annual expense ratio is 1.30% (net of the Adviser's fee waivers). *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 Adviser has reimbursed certain Fund expenses (by contract as long as BAMCO, Inc. is the adviser to the Fund) and 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.*

¹ The indexes are unmanaged. The S&P 500 Index measures the performance of 500 widely held large-cap U.S. companies and the Russell 1000® Growth Index of large-sized U.S. companies that are classified as growth. The indexes and the 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 Not annualized.



ALEX UMANSKY
PORTFOLIO MANAGER

Retail Shares: BFTHX
Institutional Shares: BFTIX

likely have an equal chance to get the ball. His opportunity would be gone. In the article, Eddie credited this idea of anticipation as the key to his future investing success and to the development of his considerable business acumen in general. The top two contributors to the Fund's performance this quarter are good examples of this theme.

Illumina is the leading provider of DNA sequencing instruments and genetic analysis tools, markets, that we believe are poised to experience significant growth over the next five to ten years. We started buying the shares in November of 2011, in the high \$20's. The stock got decimated after missing earnings and revenue expectations in two previous quarters. We believed that the reasons for poor short-term results were macro related and that Illumina's technological lead over its few competitors was in fact growing. In January of 2012, while we were still buying the stock, Roche made an unsolicited offer to acquire Illumina for \$44.50 per share. Management thought the offer was inadequate, and the company decided to fight the takeover. With the shares trading at a 20% premium to the offer price, we had a lively internal debate whether any potential increase in the offer bid justified holding onto the stock, given a strong likelihood of a significant decline should Roche's takeover prove unsuccessful. Instant gratification notwithstanding, we decided to neither tender nor sell our shares on the conviction that fundamentally, Illumina was worth significantly more, given the strength of its competitive advantages and the potential size of market. Five months later, Roche walked away empty handed, and Illumina was one of our worst performers in the 2nd quarter of 2012. We bought more. At the end of 2012, Illumina was our 6th largest holding. The shares were up 38.6% to \$74.84 at the end of this quarter, after rising 82.4% last year.

CME Group is the largest futures exchange in the world, with dominant market share in interest rate, foreign exchange and index futures. We believe that lack of fungibility creates a strong barrier to entry and that CME's proprietary, state of the art clearing operation, which gives clients the ability to cross-margin across various products, is a meaningful and sustainable competitive advantage. In the short-term, the stock's performance is often driven by the trading volumes



Baron Fifth Avenue Growth Fund

generated on the exchange. We initiated the position in late November of 2011 with trading volumes at historically depressed levels in a near-zero interest rate environment. We bought more in early 2012, as the market appeared to price in a scenario where interest rates would *never* go up again. Early this year, investors started to anticipate the implementation of Dodd-Frank, which required moving over the counter bilateral swaps to centrally cleared exchanges and the stock increased 22% in the March quarter. Then the word “taper” fell off of Ben Bernanke’s lips and the already recovering trading volumes surged further, with the stock rising an additional 24.5% in the June quarter. Up 52% year to date, CME is the largest contributor to the Fund’s performance thus far.

We think Eddie Lampert’s father would have approved.

Table II.
Top contributors to performance for the quarter ended June 30, 2013

	Quarter End Market Cap (billions)	Percent Impact
Illumina, Inc.	\$ 9.3	1.33%
CME Group, Inc.	25.4	0.72
priceline.com, Inc.	41.4	0.71
Google, Inc.	292.1	0.64
Starbucks Corp.	49.0	0.44

Now to the section that describes where we may have turned the wrong way...

In the late 1990’s, I was managing the institutional technology strategy at Morgan Stanley Investment Management. I sat in on the meeting that my biotech analyst had with the CEO of a large biotechnology company in our office. For over an hour, they were arguing, sometimes bitterly, over certain drug’s efficacies, where the R&D dollars should be going, and what the company’s overall strategy (in light of the competitive dynamics) should be. Now mind you, this was no ordinary analyst. With a Ph.D. from MIT in molecular biology and a stint as a sheriff somewhere in Massachusetts on his (what was a) three page resume, he would eventually become a CEO of a multi-billion dollar biotech company himself (he has since served on numerous boards of some of the largest and most prestigious biotech companies in the world). The CEO of the company we were meeting with had over 30 years of experience, and, judging by the many letters that followed his name on the business card, hardly lacked in education or accomplishments. I left that meeting with one question and one realization: How could these two seriously bright fellas think so differently and arrive at such different conclusions? Unable to form my own opinion on which one of them was more likely to be correct, I realized that a healthy dose of intellectual humility was received.

Table III.
Top detractors from performance for the quarter ended June 30, 2013

	Quarter End Market Cap (billions)	Percent Impact
Apple, Inc.	\$371.8	-0.51%
Citrix Systems, Inc.	11.3	-0.46
Equinix, Inc.	9.1	-0.37
BM&F BOVESPA SA	10.9	-0.36
Fastenal Co.	13.6	-0.27

“You don’t have an edge on **Apple**. No one has an edge on Apple” – Ron Baron to yours truly in late June of 2013 (and on at least six prior occasions over the last 18 months).

“Apple is not a growth stock. The investment thesis has really become suspect” – Linda Martinson (our President and COO) to yours truly in late June of 2013 (and on at least two prior occasions over the last 6 months).

“Dad, don’t write about Apple anymore. It’s starting to make you look bad” – David Umansky (11 years old) to yours truly a few days ago (he sold his entire Apple position out of his paper portfolio on May 31 of *last year* on the premise that it just couldn’t get much better, especially, without Steve Jobs. I kid you not!).

OK, I admit that seeing Apple at the top of the detractor list for the third consecutive quarter really irks me. I also admit that Ron, Linda and David are likely correct. Our analytical edge on this company and its growth prospects are highly suspect at this point, and the need to write about it (and the possibility of needing to write about it *again*) does little for our credibility or self-esteem. And yet...

There appears to be little doubt now that Apple was over earning in 2011 and 2012. The iPhones and iPads revolutionized a large market, created a new category and were by far the best products on the market. Revenues and profits surged at a pace never seen before from a company of this size, but the market stubbornly refused to award the company even an average multiple. The market, in its collective wisdom, was plainly refusing to believe that Apple’s dominance was sustainable. It has seen many gadgets and “must-have” products go by the wayside – from Sony’s Walkman, to Motorola’s Razor, to Research In Motion’s “crackberry” (and on, and on – with cellphones in particular, fresh on everyone’s mind). So why would this be any different?

Our thesis on Apple is that it is unique as a creator and owner of a platform of connected devices, peripherals, software and services. As a platform company, we expect Apple to benefit from the network effect which, combined with an admired and trusted brand, should allow the company to maintain market share, growth, and profitability. The switching costs for a single device are typically low. The switching costs for a platform tend to be high. We also believe that Apple will be able to use its platform to distribute additional products and services (iCloud, iRadio, iPayments, etc.), and generate additional revenue streams over time.

It is difficult to predict the success of future innovations for any company. It appears to us that the market is willing to assign considerable probability of future successful innovation to companies such as Google and Amazon (and we agree) and even Microsoft (we do not agree), but not Apple. That strikes us as odd given the company’s track record. Innovation takes time. With the shares trading at 11.2% current free cash flow yield (over 16% excluding the cash), we are willing to continue to give the company benefit of the doubt.

PORTFOLIO STRUCTURE

The portfolio is constructed on a bottom-up basis with the quality of ideas and conviction level having the highest roles in determining the size of each individual investment. Sector weights tend to be an outcome of the portfolio construction process and are not meant to indicate a positive or a negative “view.”

During the quarter, compared to the Russell 1000 Growth Index, the Fund was overweight in Information Technology, Consumer Discretionary, and Financials, and underweight in Health Care, Industrials, Consumer Staples, and Energy. This has been the case every quarter since the current management took over in the fourth quarter of 2011.

The top 10 largest positions represented 45.3% of the Fund, top 20 were 76.7% and we exited the quarter with a total of 34 holdings.

Table IV.
Top 10 holdings as of June 30, 2013

	Quarter End Market Cap (billions)	Quarter End Investment Value (millions)	Percent of Net Assets
Google, Inc.	\$292.1	\$4.4	6.4%
Visa, Inc.	144.7	3.3	4.8
Illumina, Inc.	9.3	3.2	4.7
Apple, Inc.	371.8	3.1	4.6
priceline.com, Inc.	41.4	3.0	4.4
Amazon.com, Inc.	126.4	3.0	4.4
CME Group, Inc.	25.4	2.9	4.3
Wynn Resorts Ltd.	12.9	2.8	4.0
Facebook, Inc.	60.1	2.7	3.9
Monsanto Co.	52.7	2.6	3.8

RECENT ACTIVITY

T. Rowe Price was the only new investment we made during the quarter. We like the asset management business and believe T. Rowe is particularly well positioned to benefit from the recent upturn in equity flows. Frankly, we would have bought Baron if it were publicly traded. It's not, so we bought what we thought was the second best choice.

On **Facebook** and **ASML**, we counted off our ten steps and turned right. We'll let you know in the next three to six months if we caught these balls or if they ended up hitting us in the head.

Table V.
Top net purchases for the quarter ended June 30, 2013

	Quarter End Market Cap (billions)	Amount (millions)
T. Rowe Price Group, Inc.	\$19.0	\$1.2
Facebook, Inc.	60.1	1.2
ASML Holding N.V.	33.2	0.7
Golar LNG Ltd.	2.6	0.2
CME Group, Inc.	25.4	0.2

Qualcomm, Cetip, Precision Castparts and Salesforce.com were all smaller positions in the portfolio and were eliminated to create space for T. Rowe Price and to build up our investments in Facebook and ASML Holding. We sold roughly a quarter of our position in **Equinix**, as the price moved closer to our estimate of the company's intrinsic value after more than doubling in 2012 and rising an additional mid-single digits in the first quarter.

Table VI.
Top net sales for the quarter ended June 30, 2013

	Quarter End Market Cap or Market Cap When Sold (billions)	Amount (millions)
QUALCOMM, Inc.	\$110.9	\$-1.5
Cetip SA – Mercados Organizados	3.1	-1.0
Precision Castparts Corp.	27.0	-0.9
salesforce.com, Inc.	22.0	-0.6
Equinix, Inc.	9.1	-0.5

OUTLOOK

At its most basic, our goal is to maximize long-term returns without taking significant risks of permanent loss of capital. We continue to focus on identifying and investing in unique companies with sustainable competitive advantages and the ability to redeploy capital at high rates of return.

Over the years, Ron has written frequently about his belief in America's resiliency. We get knocked down, and we get up. Terrorism, financial crisis, political upheavals – we have seen it all. This habit of resiliency or the ability to bounce back strong again and again is one of the reasons why we continue to be optimistic about the long-term prospects for our economy and the companies that we have invested in.

Thank you for investing in the Baron Fifth Avenue Growth Fund.

Sincerely,



Alex Umansky,
Portfolio Manager
July 23, 2013

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



Investors should consider the investment objectives, risks, and charges and expenses of the investment carefully before investing. The Baron Family of Funds is described in prospectuses which contain this and other information about the Funds. You should carefully read the prospectus before investing. You can obtain a copy of the prospectus by contacting the Funds' distributor, Baron Capital, Inc., at 767 Fifth Avenue, New York, New York, 10153, or by calling 1-800-99BARON, or by going to our website at www.BaronFunds.com.

The Fund invests primarily in large-cap equity securities which are subject to price fluctuations in the stock market. The Fund may not achieve its objectives. Portfolio holdings are subject to change. Current and future portfolio holdings are subject to risk.

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