

**DEAR BARON EMERGING MARKETS FUND SHAREHOLDER:**  
**PERFORMANCE**

Baron Emerging Markets Fund (the "Fund") declined 4.98% (Institutional Shares) for the third quarter of 2018, while its principal benchmark index, the MSCI EM Index, retreated 1.09% for the quarter. The MSCI EM IMI Growth Index declined 5.37% for the quarter, reflecting the adverse performance of growth-oriented equities during the quarter. While emerging market ("EM") and international equities continue to underperform the major U.S. and global indexes in the quarter and year-to-date period, in our view the principal catalyst for such underperformance has shifted from expected dollar liquidity withdrawal to the departure of U.S. foreign and trade policy from market expectations and convention. In our view, this has caused risk premium to increase materially on international, and particularly, EM assets and currencies. While aggressive protectionism stands out as the primary driver of recent market turbulence, we also highlight the U.S.'s departure from convention on foreign policy matters, such as its orientation towards NATO allies and a major change in sanction strategy. Our conclusion is that in recent months it has become clear that President Trump's "America First" policy also suggests emerging markets last. In this context, while we certainly believe a legitimate agreement between the U.S. and China on trade or a change in U.S. Fed rhetoric would likely spark a reversal in EM relative and absolute performance, we also believe a more subtle catalyst could be a perceived peak in Trump's political currency, as any dilution to the more aggressive elements of his "America First" policy would trigger a mean reversion in the year-to-date divergence of performance between U.S. and EM equities. The EM correction, which we anticipated in January, is now well advanced, and we do not believe the U.S. markets or economy can remain insulated from the global liquidity and protectionist squeeze indefinitely. Contagion to the U.S. is likely in our view, and could set up a significant bottom in international and EM assets and currencies as these markets would likely begin to discount a change in the cadence of trade policy and/or Fed rhetoric. We remain generally enthusiastic regarding the longer-term prospects for EM equities based on the pillars of improved political direction, productivity enhancing reforms, and greater access by private sector entrepreneurs. Of course, we will be following upcoming elections in coming months and quarters for signs of confirmation. We remain prepared to take advantage of ongoing market volatility and remain optimistic that our differentiated discipline and process position us well over the long term.



**MICHAEL KASS**  
**PORTFOLIO MANAGER**

Retail Shares: BEXFX  
Institutional Shares: BEXIX  
R6 Shares: BEXUX

**Table I.**  
**Performance<sup>†</sup>**  
**Annualized for periods ended September 30, 2018**

	Baron Emerging Markets Fund Retail Shares <sup>1,2</sup>	Baron Emerging Markets Fund Institutional Shares <sup>1,2</sup>	MSCI EM Index <sup>1</sup>	MSCI EM IMI Growth Index <sup>1</sup>
Three Months <sup>3</sup>	(5.00)%	(4.98)%	(1.09)%	(5.37)%
Nine Months <sup>3</sup>	(13.31)%	(13.14)%	(7.68)%	(11.10)%
One Year	(8.03)%	(7.79)%	(0.81)%	(3.84)%
Three Years	9.26%	9.55%	12.36%	11.85%
Five Years	3.99%	4.26%	3.61%	4.59%
Since Inception (December 31, 2010)	4.00%	4.26%	1.26%	2.11%

Performance listed in the above table is net of annual operating expenses. Annual expense ratio for the Retail Shares and Institutional Shares as of December 31, 2017 was 1.36% and 1.10%, respectively. *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](http://www.BaronFunds.com) or call 1-800-99BARON.*

<sup>†</sup> The Fund's historical performance was impacted by gains from IPOs and/or secondary offerings, and 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.  
<sup>1</sup> The indexes are unmanaged. The MSCI EM (Emerging Markets) Index Net USD is designed to measure equity market performance of large and mid-cap securities across 23 Emerging Markets countries. The MSCI EM (Emerging Markets) IMI Growth Index Net USD is a free float-adjusted market capitalization index designed to measure equity market performance of large, mid and small-cap securities exhibiting overall growth characteristics across 23 Emerging Markets countries. The indexes and the Fund include reinvestment of dividends, net of withholding taxes, which positively impact the performance results.  
<sup>2</sup> The performance data does not reflect the deduction of taxes that a shareholder would pay on Fund distributions or redemption of Fund shares.  
<sup>3</sup> Not annualized.



# Baron Emerging Markets Fund

For the third quarter of 2018, we underperformed our benchmark MSCI EM Index, while modestly outperforming our all-cap EM growth proxy, the MSCI EM IMI Growth Index. Growth-related equities notably lagged the core EM Index during the quarter, in our view, largely a result of concerns emanating from the escalating U.S.-China trade friction and the perceived associated impact on earnings visibility. Although geopolitical and unconventional factors amplified the impact of what we expected to be a year of liquidity withdrawal and EM underperformance, we are still disappointed with our year-to-date absolute and relative performance. Growth-oriented and mid-/large-cap equities, where we are overweight relative to our benchmark and many peers, were hit particularly hard during the year-to-date period. However, we note that we trail the all-cap growth proxy by only a relatively modest amount.

From a sector perspective, adverse stock selection effect in the Financials sector had the largest negative impact on relative performance during the quarter. The overwhelming driver here was a significant decline in the investments comprising our India wealth management and housing finance themes. All our holdings here suffered double-digit percentage declines late in the quarter, triggered by the credit downgrade of a large government affiliated infrastructure lending entity known as IL&FS, subsequent to missed debt service payments. This unexpected development quickly led to a short-term liquidity crisis and a concern over the near-term outlook for credit growth and interest spreads, while previous high expectations exacerbated the market impact. We remain confident in the long-term appeal of our holdings, but took action during the quarter to reduce our overweight exposure. In addition, adverse stock selection in Health Care and lower exposure to the strong-performing Energy sector detracted from relative performance. Within Health Care, our China value-added theme-related holdings, **Sino Biopharmaceutical Ltd.**, **Yunnan Baiyao Group Co., Ltd.**, and **CSPC Pharmaceutical Group Limited** all suffered material declines and reversed year-to-date gains. While near-term earnings visibility has been recently questioned for all three companies, the Trump administration is directly targeting the China 2025 industrial policy, which has driven significant declines in all related equities in China since late spring. On the positive side during the quarter, stock selection effect in the Consumer Discretionary and Communication Services sectors contributed positively to relative performance, while from a country perspective, strong stock selection in South Africa and Malaysia and higher exposure to Mexico were additional bright spots.

**Table II.**  
Top contributors to performance for the quarter ended September 30, 2018

	Percent Impact
Taiwan Semiconductor Manufacturing Company Ltd.	0.30%
MyEG Services Berhad	0.25
Petróleo Brasileiro S.A. – Petrobras	0.24
Sinopharm Group Co. Ltd.	0.20
KIA Motors Corporation	0.19

Shares of leading semiconductor company **Taiwan Semiconductor Manufacturing Company Ltd.** climbed on resilient demand for its leading node applications driven by new consumer product cycles. Its long-term competitive positioning also strengthened as competitor GLOBALFOUNDRIES decided to exit the advanced nodes business, creating a more favorable market structure for incumbents such as Taiwan Semiconductor.

Shares of **MyEG Services Berhad** rose sharply during the quarter following news that the company won several new contracts to deliver low-cost, software-enabled reporting services to Malaysian government agencies. MyEG Services collects data and operates software systems allowing municipal offices to track immigration information, tax collection, and other vital information. While the company may find certain growth opportunities untenable under the new Malaysian regime, we believe it has monetization opportunities in its home market and in neighboring regions and remains undervalued.

**Petróleo Brasileiro S.A. – Petrobras** is one of the world's largest oil & gas companies focused on the development of oil fields off the coast of Brazil. Shares appreciated due to strong free cash flow and the relatively modest impact of diesel price caps on its refining segment. We remain invested given Petrobras' assets with low breakeven costs, an increase in production at pre-salt oil fields, the anticipated deleveraging of the balance sheet, and progress on the Transfer-of-Rights resolution with the Brazilian government.

Shares of **Sinopharm Group Co. Ltd.** rose in the quarter following news of an accretive acquisition we believe will help lower the company's borrowing costs. Sinopharm is China's largest pharmaceutical distributor, and has aggressively expanded its market share in recent years in an effort to eliminate inefficient middlemen from its supply chain. We continue to believe that Sinopharm will play an important role in assisting the government in lowering health care supply chain costs.

Shares of Korea-based automobile manufacturer **KIA Motors Corporation** contributed to performance. KIA is gaining market share in Korea from General Motors. KIA is also expected to deliver strong earnings growth in the U.S. and China after suffering temporary setbacks last year. Further, the company is a potential beneficiary of ongoing governmental reform, which is likely to be value accretive to shareholders. We remain investors due to KIA's strong brand recognition, global presence, quality products, and attractive valuation.

**Table III.**  
Top detractors from performance for the quarter ended September 30, 2018

	Percent Impact
Tencent Holdings, Ltd.	-0.67%
Sino Biopharmaceutical Ltd.	-0.52
Yunnan Baiyao Group Co., Ltd.	-0.41
CSPC Pharmaceutical Group Limited	-0.41
Alibaba Group Holding Limited	-0.40

**Tencent Holdings, Ltd.** operates China's most popular online gaming platform, as well as its leading social network and messaging service and its largest online media and entertainment business. Shares declined this quarter due to a change in the regulations governing video games that has effectively frozen new game approvals for the moment. We retain conviction, as we expect the freeze to be lifted and estimate that Tencent can grow each of its business segments for years to come given its scale, its track record of execution, and its unique online intellectual property and assets.

Shares of **Sino Biopharmaceutical Ltd.**, a leading Chinese pharmaceutical player focused on R&D, detracted from performance due to the launch of a pilot drug reimbursement program that, if implemented, could have a meaningful impact on profitability for certain medications. However, we believe Sino is benefiting from strong secular demand for health care services in China, driven by an aging population and growing incidence of chronic diseases. We retain conviction due to Sino's strong leadership position, robust drug pipeline, and extensive marketing network.

Shares of China-based pharmaceutical company **Yunnan Baiyao Group Co., Ltd.** detracted from performance as a slowdown in consumer spending hurt upgrades toward premium products. We believe the current subdued sentiment is temporary and that Yunnan Baiyao's core brand competitiveness remains solid as market share for key products continues to strengthen. Longer term, we believe Yunnan Baiyao will be a category winner in consumer segments such as toothpaste and shampoo.

Shares of **CSPC Pharmaceutical Group Limited**, a leading Chinese pharmaceutical player focused on R&D, detracted from performance due to the launch of a pilot drug reimbursement program that, if implemented, could have a meaningful impact on profitability for certain medications. However, we believe CSPC is benefiting from strong secular demand for health care services in China, driven by an aging population and growing incidence of chronic diseases. We retain conviction due to CSPC's strong leadership position, robust drug pipeline, and extensive marketing network.

**Alibaba Group Holding Limited** is China's largest e-commerce company, owning the country's two largest online shopping platforms in addition to 33% of Ant Financial. Shares detracted from performance due to fears over a trade war and the company's plan to continue investing in grocery and online food delivery, contributing to lower overall margins. We retain conviction, as we expect continued growth in all areas and a high reinvestment rate in newer market segments. We remain optimistic about Alibaba's long-term prospects.

## PORTFOLIO STRUCTURE

**Table IV.**  
Top 10 holdings as of September 30, 2018

	Percent of Net Assets
Tencent Holdings, Ltd.	3.7%
Alibaba Group Holding Limited	2.7
Samsung Electronics Co., Ltd.	2.5
Taiwan Semiconductor Manufacturing Company Ltd.	1.9
Sberbank of Russia PJSC	1.7
KIA Motors Corporation	1.7
Petróleo Brasileiro S.A. – Petrobras	1.6
China Mobile Ltd.	1.6
Fomento Económico Mexicano, S.A.B. de C.V.	1.5
KB Financial Group, Inc.	1.4

## EXPOSURE BY COUNTRY

**Table V.**  
Percentage of securities by country as of September 30, 2018

	Percent of Net Assets
China	25.9%
India	13.0
Korea	8.5
Brazil	7.7
Taiwan	7.2
Mexico	6.5
South Africa	4.8
Russia	2.8
Philippines	2.0
Argentina	1.9
Thailand	1.8
United Kingdom	1.4
Hong Kong	1.0
Malaysia	0.6
Indonesia	0.4
Panama	0.4
Nigeria	0.1

# Baron Emerging Markets Fund

*Exposure by Market Cap:* The Fund may invest in companies of any market capitalization, and we have generally been broadly diversified across large-, mid- and small-cap companies, as we believe developing world companies of all sizes often exhibit attractive growth potential. At the end of the third quarter of 2018, the Fund's median market cap was \$9.9 billion, and we were invested 69.2% in large- and giant-cap companies, 15.7% in mid-cap companies, and 1.1% in small- and micro-cap companies as defined by Morningstar, with the remainder in cash.

## RECENT ACTIVITY

During the quarter, we initiated several new investments, the most meaningful of which was **China Tower Corporation Limited**, which recently completed its initial public offering. China Tower is the dominant and near monopoly owner of wireless communications towers in China, formed in recent years when the three dominant Chinese telecom service providers spun off their wholly-owned tower assets. This restructuring was undertaken to achieve material scale and capital reduction benefits by sharing infrastructure and reducing overbuild, which we highlighted at the time as an example of our State-Owned Enterprise ("SOE") reform theme. We believe the company is quite early in the process of exploiting cost savings and capital efficiency benefits, while we envision several years of solid growth potential as China deploys 5G wireless equipment. In addition, now as an independent and public entity, we believe the company has a significant opportunity to leverage its unique and nationwide asset base to generate high-margin incremental revenue outside of its core tower-related business. Further, we suspect the company will be a beneficiary of recently announced targeted government stimulus undertaken to cushion the tightening impact of recent U.S. trade and foreign policy measures.

In addition, we initiated positions in: **CP All Plc** of Thailand, a high-quality convenience format retailer that we believe is positioned to leverage its extensive distribution into e-commerce fulfillment activities; **Sun Pharmaceuticals Industries Limited**, a leading India-based pharmaceutical and generics manufacturer that we believe is in the early stages of an extended earnings recovery; and **Zai Lab Limited**, an early leader in the nascent and developing Chinese biotech sector that is also a component of our China value-added theme.

During the quarter, we sold our position in **Maruti Suzuki India Ltd.**, recognizing significant gains, while also reducing several positions, particularly in China, as we moved to an underweight position given concerns that the U.S. protectionist threat would not be resolved in the short term. Collectively, the largest reductions were in our internet/technology, SOE bank, and A-share holdings related to our China value-added theme. We also reduced our significant positions in a range of financial investments, including **Housing Development Finance Corporation Limited** of India, **KB Financial Group, Inc.** of Korea, and **Sberbank of Russia PJSC**.

## OUTLOOK

In our second quarter letter, we suggested there was a rising risk of a larger correction in EM equities and currencies should, as we expected, trade friction continue to escalate through the midterm elections. The third quarter confirmed such concerns, as several EM markets exhibited higher volatility, while growth-related equities notably underperformed. In retrospect, we believe a key catalyst was the June transition from trade negotiation to trade provocation regarding bilateral discussions between the U.S. trade delegation and its Chinese counterpart. We further view this

event as confirmation of a broader exit by the Trump administration from its previous pattern of predictable transactional resolution. In other words, for the first year of Trump's presidency, he followed a pattern of establishing a provocative opening negotiating position, followed by a transactional and generally conventional compromise through which he could claim victory. Late this spring, the administration began to diverge from this pattern, as Trump increasingly de-emphasized the more traditional and conventional advisors among his inner circle, and began to increasingly "go with his gut" as well as favor more disruptive and unconventional positions in foreign policy and trade policy. We suggested in recent quarterly letters that we believed 2018 would be a year of global dollar liquidity withdrawal with associated higher volatility and likely EM and international equity underperformance, but the magnitude of short-term underperformance exceeded our expectations, largely due to the higher risk premium demanded by investors when the Trump administration departed from convention. In the near term, "America First" suggests EM last.

The key questions then for EM and international equity investors remain "What is the way forward?" and "What are the key catalysts we should look for as a signal that a relative and absolute bottom can be formed?" In our view, the way forward for EM remains capable political leadership, productivity enhancing reforms, and an ongoing shift in emphasis towards value-added, innovative and intellectual-capital based industries, largely led by enhanced access for private sector entrepreneurs. Much of this remains largely on track, though we must monitor upcoming elections in various jurisdictions for confirmation. In our view, the key market catalysts suggesting relief for EM equities would begin with the obvious: a credible truce or transactional agreement between the U.S. and China on trade. Next, in the absence of such an agreement, any contagion to the developed, and particularly, the U.S. markets, would significantly increase the likelihood that the Fed would begin to shift its rhetoric and narrow the expected magnitude and duration of its rate hike cycle; we would likely view this as the most significant potential catalyst given the scope of divergence in market performance year-to-date as well as the current positioning of institutional investors and speculators. Last, and a subtle catalyst, would be anything that dilutes President Trump's political currency, as we believe his policies are exacerbating the squeeze on EM economies and markets beyond what traditional economic and financial fundamentals would suggest. In our view, the period spanning the Supreme Court nomination process and the upcoming midterm elections could well mark "peak Trump" political currency; and should the House flip to the Democrats, we would view such an event as confirmation of a near-term peak in Trump's influence over Congress and policy. We believe such an outcome could spark a mean reversion in relative performance between EM and U.S. equities. As always, we remain confident in our unique forward-looking and bottom-up, fundamental approach, and remain attuned to developing themes and opportunities.

Thank you for investing in the Baron Emerging Markets Fund.

Sincerely,



Michael Kass  
Portfolio Manager

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*Investors should consider the investment objectives, risks, and charges and expenses of the investment carefully before investing. The prospectus and summary prospectus contains this and other information about the Funds. You may obtain them from its distributor, Baron Capital, Inc., by calling 1-800-99BARON or visiting [www.BaronFunds.com](http://www.BaronFunds.com). Please read them carefully before investing.*

**Risks:** In addition to the general stock market risk that securities may fluctuate in value, investments in developing countries may have increased risks due to a greater possibility of: settlement delays; currency and capital controls; interest rate sensitivity; corruption and crime; exchange rate volatility; and inflation or deflation. The Fund invests in companies of all sizes, including small and medium sized companies whose securities may be thinly traded and more difficult to sell during market downturns. 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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