

## DEAR BARON EMERGING MARKETS FUND SHAREHOLDER:

## PERFORMANCE

Baron Emerging Markets Fund (the "Fund") appreciated 11.95% (Institutional Shares) for the first quarter of 2019, while its principal benchmark index, the MSCI EM Index, gained 9.93% for the quarter and the MSCI EM IMI Growth Index appreciated 11.50%. In the first quarter, while exhibiting a strong rebound from the prior quarter's weakness, emerging market ("EM") equities underperformed U.S. and global indexes, in our view a period of mean reversion after material outperformance in the prior three months. As we anticipated in our year end 2018 letter, the current year has begun with an impressive rally in global equities, as geopolitical and monetary policy risks have receded. Notably, the U.S. administration has declared that it is seeking compromise in its trade dispute with China, and Fed Chairman Powell has reversed previous comments, clearly articulating a shift from a tightening bias to neutral. We are pleased to see the risk premium on equities normalize; however, given an ongoing global economic slowdown, material absolute gains in EM equities from here may be on hold until the Fed shifts its posture to easing. Given that we believe the epicenter of the slowdown may well be shifting to the U.S., we reiterate that we believe EM and international equities are likely bottoming on a relative return basis, and we see a mean reverting phase of outperformance in coming years as likely. Regardless, we are confident that we have invested in many well-positioned and well-managed companies on a bottom-up basis, with the potential for attractive returns over the long term.

**Table I.**  
**Performance**  
**Annualized for periods ended March 31, 2019**

	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>	11.81%	11.95%	9.93%	11.50%
One Year	(9.78)%	(9.51)%	(7.41)%	(10.14)%
Three Years	9.53%	9.82%	10.68%	10.59%
Five Years	3.65%	3.91%	3.68%	4.37%
Since Inception (December 31, 2010)	4.36%	4.62%	1.39%	2.26%

For the first quarter of 2019, we outperformed both our primary benchmark, the MSCI EM Index, as well as our all-cap EM growth proxy. While encouraged by our recent quarterly results, we were more pleased that we



MICHAEL KASS

PORTFOLIO MANAGER

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

have outperformed in consecutive quarters, each marked by near opposite market conditions, suggesting we have returned to solid alpha capture. While we believe near-term earnings performance may be subpar across pockets of our portfolio, we also believe the equity markets are looking through the dip and correctly anticipating an earnings recovery later in the year, particularly in China and related markets. If, as we suspect, we are exiting the period of excess dollar liquidity withdrawal that characterized the past year, then EM equities have likely bottomed on a relative basis after a multi-year downturn.

During the quarter, our positive relative performance was led by stock selection effect in the Information Technology ("IT"), Health Care, and Consumer Staples sectors. Within IT, our disruptive Brazilian payment platform investments, **PagSeguro Digital Ltd.**, which rose just under 60%, and **StoneCo Ltd.**, which rallied over 120% during the quarter, both recovered from previous weakness as earnings results suggested that aggressive measures by legacy competitors were not noticeably impacting growth and earnings momentum. Also within this sector, **Hangzhou Hikvision Digital Technology Co., Ltd.**, **Delta Electronics, Inc.**, and **Lenovo Group Limited**, all appreciated meaningfully, in our view, as a result of the perception of changing trade relations between China and the U.S.

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, 2018 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 Adviser reimburses certain Baron Fund expenses pursuant to a contract with an 11-year term 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](http://www.BaronFunds.com) or call 1-800-99BARON.*

<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

Within Health Care, **Zai Lab Limited**, **Sino Biopharmaceutical Ltd.**, and **Yunnan Baiyao Group Co., Ltd.**, all part of our China value-added theme, drove performance. Finally, **WH Group Limited**, a China-based protein processor which recovered strongly on the perceived end of disruptive tariffs, drove performance in the Consumer Staples sector.

Offsetting a portion of the above, adverse stock selection in the Materials sector was driven by **Tata Chemicals Limited** of India and **Kangde Xin Composite Material**, a Chinese specialty materials manufacturer which disclosed a material lapse in corporate governance early in the year. In addition, poor stock selection effect in the Financials sector was driven by our investment in Korean bank **KB Financial Group, Inc.**, as well as our broad and thematic exposure to Indian financials, which suffered lingering effects from last year's liquidity crunch. Finally, our cash position in a strong market also detracted from relative performance during the quarter.

From a country perspective, as already referenced above, strong relative performance was driven by investments in Brazil, with **Petroleo Brasileiro S.A. Petrobras** also contributing, and China, partially offset by underperformance in India.

**Table II.**

**Top contributors to performance for the quarter ended March 31, 2019**

	Percent Impact
Alibaba Group Holding Limited	1.03%
PagSeguro Digital Ltd.	0.64
WH Group Limited	0.53
China Tower Corporation Limited	0.52
Petroleo Brasileiro S.A. Petrobras	0.50

**Alibaba Group Holding Limited**, the largest retailer and e-commerce company in China, owns and operates shopping platforms Taobao and Tmall. Alibaba also owns 33% of Ant Financial, which owns Alipay, the largest third-party online payment provider in China. Shares appreciated in the first quarter due to solid business results and positive commentary surrounding Chinese consumption trends. We believe Alibaba's core business remains extremely profitable and continues to grow rapidly, with tailwinds to the company driven by strong mobile and advertising growth.

Shares of **PagSeguro Digital Ltd.**, a payment processor and merchant acquirer, rose in the quarter due to improving sentiment in Brazil and the muted impact of competitive offerings among the company's micro-merchant customer base. We retain conviction, as we believe PagSeguro will continue to build out a product ecosystem allowing the company to offer digital banking products to its customers.

Shares of China-based **WH Group Limited**, the world's largest pork processor and producer, appreciated due to the increased likelihood of a global trade resolution, which would almost certainly benefit WH's U.S. export business. Additionally, a rising supply shortage in China caused by African Swine Fever helped improve market sentiment on the company. We think WH offers balanced growth potential, continues to trade at an attractive valuation, and we retain conviction in the stock.

**China Tower Corporation Limited** is the largest wireless tower company in the world. Shares increased in the quarter following solid operating results and additional plans for Chinese carriers to begin testing 5G networks. We believe China Tower will be a key beneficiary of Chinese 5G network build-out, as new equipment will mostly likely be added to its existing asset base, allowing the company's returns on capital to increase over time.

**Petroleo Brasileiro S.A. Petrobras** is one of the largest integrated oil & gas companies in the world. Shares appreciated due to financial results that beat Street expectations as well as progress on deleveraging. Petrobras has been the global leader in offshore deepwater oil production development, and the company has assets with some of the lowest breakeven costs in the industry. We continue to like the shares due to ramp-up in production at pre-salt oil fields, material improvement in free cash flow, and an expected deleveraging of the balance sheet with non-core asset divestments.

**Table III.**

**Top detractors from performance for the quarter ended March 31, 2019**

	Percent Impact
Exide Industries Ltd.	-0.21%
KB Financial Group, Inc.	-0.15
Tata Chemicals Limited	-0.14
Pepkor Holdings Limited	-0.09
Kangde Xin Composite Material	-0.09

**Exide Industries Ltd.** sells new and replacement batteries to vehicle owners across India. Shares fell as local currency weakness led to margin pressure on quarterly earnings. We continue to believe Exide's dominant distribution network will allow it to gain share in a highly fragmented sector, which, along with a cost containment program and value from an insurance subsidiary, should create value for long-term shareholders, in our view.

**KB Financial Group, Inc.** is a leading financial services group in South Korea. Shares declined during the quarter due to a weakening macroeconomic environment that tempered investor expectations for loan growth, net interest margins, and loan loss provisions. The financial industry in South Korea is facing regulatory pressures to curb consumer loan growth and cut fees, but we remain optimistic about KB's growth opportunity given stable margins, efforts to rationalize costs, and earnings contributions from non-banking subsidiaries.

Shares of **Tata Chemicals Limited** declined in the first quarter due to earnings growth that fell short of investor expectations. As the world's leading producer of soda ash, the company is benefiting from growing demand for real estate, cars, and detergents, as well as other products requiring soda ash as a raw material. Tata has a formidable branded salt business in India, and is venturing into other related consumer products. We retain conviction due to growth opportunities in the branded salt/consumer business, along with a more focused strategic restructuring still in the early innings.

Shares of **Pepkor Holdings Limited**, a leading South African apparel retailer, declined in the first quarter, driven by anemic earnings growth across the retail universe, where consumer spend remains weak. We retain conviction due to Pepkor's economies of scale and its ability to provide quality apparel at industry-low prices. We expect sustained low-teens earnings growth over the next three to five years, driven by market share gains and a recovery in consumer spend. We believe Pepkor is well positioned to gain share should the domestic macro environment remain weaker than we expect.

Shares of **Kangde Xin Composite Material** declined during the quarter due to the impact of continued macro weakness on the company's core optical films business. Negative market sentiment and rumors surrounding Kangde's liquidity situation also weighed on the stock. We exited our position due to rising uncertainty regarding the company's ability to manage its pledged share issue. We remain positive on Kangde's long-term strategic significance and growth roadmap, and we may revisit the opportunity in the future.

## PORTFOLIO STRUCTURE

Table IV.  
Top 10 holdings as of March 31, 2019

	Percent of Net Assets
Alibaba Group Holding Limited	3.8%
Tencent Holdings Limited	3.7
Petroleo Brasileiro S.A. Petrobras	2.0
Samsung Electronics Co., Ltd.	1.8
China Mobile Ltd.	1.8
China Tower Corporation Limited	1.7
Taiwan Semiconductor Manufacturing Company Ltd.	1.7
Sberbank of Russia PJSC	1.6
PagSeguro Digital Ltd.	1.6
B3 S.A. – Brasil, Bolsa, Balcao	1.5

## EXPOSURE BY COUNTRY

Table V.  
Percentage of securities by country as of March 31, 2019

	Percent of Net Assets
China	32.6%
India	15.6
Brazil	10.0
Taiwan	7.6
South Africa	5.3
Korea	4.7
Mexico	3.4
Philippines	2.5
Russia	2.2
Argentina	2.1
Thailand	2.0
United Kingdom	1.3
Hong Kong	1.0
Finland	0.9
Panama	0.5
Hungary	0.5
Malaysia	0.4
Indonesia	0.3
Nigeria	0.1

*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 can exhibit attractive growth potential. At the end of the first quarter of 2019, the Fund's median market cap was \$10.7 billion, and we were invested 75.0% in large- and giant-cap companies, 16.7% in mid-cap companies, and 1.3% in small- and micro-cap companies as defined by Morningstar, with the remainder in cash.

## RECENT ACTIVITY

During the quarter, we initiated several positions, most representing additions to existing themes such as our China value-added, India financialization, and EM consumption themes. Given our rising confidence in

incremental targeted stimulus measures and improved trade relations between the U.S. and China, we initiated positions in **Guangzhou Automobile Group Company Limited** and **Ping An Insurance (Group) Company of China, Ltd.**, both leaders in their respective industries. Guangzhou Auto manufactures and represents the Toyota and Honda brands in China, is in our opinion the best managed auto OEM in China, and we believe given its prudent inventory management during the recent industry downturn as well as its upcoming capacity expansion and new model launch schedule, is well positioned to achieve a solid earnings expansion as government stimulus targeting consumers kicks in. Ping An, China's leading diversified insurance and financial franchise and a company we have long admired, has been leveraging its strengths to build a leading internet-based, diversified fintech platform; this transition should lead to a stable, fee-based income stream with many years of profitable growth ahead. Further, in returning our China investments to a near market weight position, we initiated investments in **Lenovo Group Limited**, a likely beneficiary of data center, cloud, and 5G investments; and **GDS Holdings Limited**, a leading data center operator; while adding to several existing holdings, including **Tencent Holdings Limited**, **Alibaba Group Holding Limited**, **Hua Hong Semiconductor Limited**, **Kunlun Energy Company Limited**, and **China Mobile Ltd.** In India, we viewed the timely and efficient response to the Pakistan border skirmish as a likely catalyst to secure a manageable majority in the upcoming general elections for Modi and his political alliance. This, together with encouraging signs that the worst of India's liquidity challenges have passed, offered us the opportunity to increase our holdings in what we view as market share gainers that will benefit longer term from the consolidation now occurring in India's financial and property sectors. During the quarter, we established a position in **RBL Bank Limited**, a fast-growing private sector bank, in our view, with a capable management team, while also adding to existing positions in **HDFC Bank Limited**, **Piramal Enterprises Limited**, and **Bajaj Finance Limited**. Also in India, we initiated a position in **Reliance Industries Limited**, which is engaged in what we see as an exciting transformation, leveraging and investing its considerable cash flow from oil refining into a disruptive position in data communications, modern retail, e-commerce, and digital media & entertainment. Given recent government and regulatory rulings that we believe favor domestic internet companies, we believe Reliance will emerge as the most likely "Amazon of India" in coming years.

During the quarter, we also exited certain investments, most notably **America Movil, S.A.B. de C.V.** of Mexico, as we no longer believe the AMLO administration will pursue policies that favor profitable geographic expansion for Mexico's leading telecom and data service provider. We took a substantial profit on our investment in **Pinduoduo Inc.**, the fast-growing Chinese social e-commerce player, as recent results and an unexpected follow-on equity offering caused us to question earnings quality. Also in China, we sold: **Kangde Xin Composite Material** after a material governance weakness came to light early in the new year; **CSPC Pharmaceutical Group Limited**, based on uncertainty regarding future pricing power as China continues to pursue national drug reimbursement through regional tenders; and **Baidu, Inc.** on concerns regarding the longer-term visibility for earnings growth. In addition, we reduced our position in **China Tower Corporation Limited** after achieving material gains in recent months, while also reducing our positions in **Samsung Electronics Co., Ltd.** and **Taiwan Semiconductor Manufacturing Company Ltd.**, as we are more skeptical than consensus regarding a strong second half earnings recovery for semiconductor demand and pricing.

# Baron Emerging Markets Fund

## OUTLOOK

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Our year-end 2018 letter proved prescient as we posited, “[L]ooking ahead, in the near term, we believe a rally in global equities is more likely than a further decline, as markets begin to anticipate a de-escalation of protectionist measures and improving global trading conditions, as well as a more flexible Fed mandate.” Further, “[S]hould the outlook for foreign and trade policy reduce pressure on China, and Fed policy shift to a marginally more accommodative stance, we believe many of our existing investments offer material upside from current levels.” During this year’s first quarter, many of the most impaired equities and currencies of the prior six months staged impressive recoveries as the above catalysts materialized much as we had anticipated—though most remain well below their highs from the prior year. We view the recent reversal in performance of global equities as largely justified, as policy and economic tail risks have de-escalated, and China has incrementally introduced targeted stimulus measures and broad reforms.

While we are certainly encouraged with the turn of events, as we look forward from here, we question whether global economic conditions will underwrite further gains for global equities in the near term. While we are increasingly confident that we are at or near an important inflection point in market leadership, where EM and international equities and currencies can begin a period of sustained outperformance, we are less confident in the near-term outlook for the U.S. economy, corporate earnings, and equities. While global equities have repriced to reflect declining policy tail risks and now discount forward Fed rate cuts, we suspect that the Fed’s shift to neutral also suggests rising risks to the U.S. economy, and corporate earnings in particular, and we believe capital markets may need to retest lower levels in order to coax the Fed into full-scale easing mode. In our view, China’s increasingly aggressive response to weak domestic conditions suggests a bottom and enhanced forward-looking earnings, while we suspect U.S. corporate earnings expectations are peaking. The U.S. equity market has

vastly outperformed its international peers as the U.S. is driven by domestic consumption and has benefited from fiscal stimulus and tax-incented investment, and we believe we are likely entering a period where the waning of such effects will lead to a mean reversion in equity performance.

Regarding the EM outlook in particular, we remain enthusiastic towards and overweight Brazil, anticipating a cyclical recovery and longer-term structural reforms, however we do anticipate some volatility in the coming months as the social security reform proceeds through the legislative process. We also believe China can continue to surprise to the upside this year, as we expect the earnings outlook to improve and U.S. trade aggression to remain suppressed, as the U.S. economy slows and the President shifts focus to the next general election. Finally, we recently increased our overweight position in India, where the recent military provocation with Pakistan has raised political support for Modi and the NDA alliance, suggesting a greater likelihood of both a Modi victory in the May election and a legislative majority sufficient to continue an aggressive reform agenda. In short, while we would not be surprised by, and perhaps expect, some near-term retracement of recent gains, we also believe we are exiting a long period of EM equity underperformance and believe we own a portfolio of quality growth companies poised to deliver returns in the coming years.

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.

Alpha measures the difference between a fund’s actual returns and its expected performance, given its level of risk as measured by beta. Alpha Capture is the name given to the method by which funds extract value by tracking and measuring their performance both in absolute terms and relative to their peers.

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 manager 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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