Baron Emerging Markets Strategy

BARON CAPITAL

December 31, 2022

Dear Investor:

Performance

Baron Emerging Markets Strategy gained 8.59% during the final quarter of 2022, while its principal benchmark index, the MSCI EM Index, returned 9.70%. The MSCI EM IMI Growth Index gained 9.28% for the quarter. In a year when growth stocks suffered under rising interest rates and deteriorating liquidity conditions, the Strategy declined 25.77%, the MSCI EM Index retreated 20.09%, and the MSCI EM IMI Growth Index lost 23.88%. The Strategy modestly underperformed both its principal benchmark index and the all-cap growth proxy during a strong fourth quarter for emerging market (EM) equities. In our previous letter, we surmised that we were likely passing through peak hawkishness; and as suggested, the fourth quarter featured a shift in sentiment regarding inflation expectations and anticipated central bank aggression, which was a primary catalyst for the global rally. Volatility remained elevated, as emerging equity markets, particularly those most sensitive to China, experienced a wave of selling early in the quarter over the country's unpopular adherence to the zero-COVID policy as well as unexpected changes to the Politburo standing committee, which abruptly reversed as the government's new leadership rolled out significant easing and stimulus measures and began to dismantle its zero-COVID measures. In our view, this vector change leaves China as the global jurisdiction with the highest likelihood of earnings expansion and outperformance relative to expectations as we enter 2023, while China's reopening would also marginally offset deteriorating global growth conditions. We believe that evolving macroeconomic conditions, relative valuations, and relative earnings prospects suggest that EM equities are likely positioned for a multi-year phase of outperformance. As always, we are confident that we have invested in many well-positioned and well-managed companies on a bottom-up basis that are poised to benefit from long-term and attractive investment themes.

Table I.
Performance†
Annualized for periods ended December 31, 2022

	Baron Emerging Markets Strategy (net)[1]	Baron Emerging Markets Strategy (gross)[1]	MSCI EM Index[1]	MSCI EM IMI Growth Index[1]
Three Months[2]	8.59%	8.85%	9.70%	9.28%
One Year	(25.77)%	(25.06)%	(20.09)%	(23.88)%
Three Years	(3.29)%	(2.37)%	(2.69)%	(2.02)%
Five Years	(2.55)%	(1.63)%	(1.40)%	(1.06)%
Ten Years	3.35%	4.28%	1.44%	2.65%
Since Inception[3] (January 31, 2011)	3.27%	4.06%	1.13%	2.20%

For 2022, we underperformed our primary benchmark, the MSCI EM Index, while more moderately trailing our all-cap EM growth proxy in a very difficult period for growth stocks worldwide. During the year, EM equities were marked with increased volatility, in our view primarily driven by challenges related to China's zero-COVID policy, economic and geopolitical uncertainties arising from Russia's invasion of Ukraine, and stubbornly high global inflation readings, which forced central bankers to tighten aggressively. From a sector or theme perspective, relative underperformance was largely a result of adverse stock selection in the Financials sector, primarily driven by a material correction in our fintech-related holdings

For strategy reporting purposes, the Firm is defined as all accounts managed by Baron Capital Management, Inc. ("BCM") and BAMCO, Inc. ("BAMCO"), registered investment advisers wholly owned by Baron Capital Group, Inc. As of December 31, 2022, total Firm assets under management are approximately $35.4 billion. Gross performance figures do not reflect the deduction of investment advisory fees and any other expenses incurred in the management of the investment advisory account. Actual client returns will be reduced by the advisory fees and any other expenses incurred in the management of the investment advisory account. A full description of investment advisory fees is supplied in the Firm's Form ADV Part 2A. Valuations and returns are computed and stated in U.S. dollars. Performance figures reflect the reinvestment of dividends and other earnings. The Strategy is currently composed of one mutual fund, a Collective Investment Trust, a multipartner SICAV fund, and a subadvised account managed by BAMCO; and a separately managed account and a private offshore fund managed by BCM. The Strategy invests mainly in non-U.S. companies of all sizes. The majority of investments are in companies domiciled in developing countries. The Strategy may invest up to 20% in companies in developed and frontier countries. BAMCO and BCM claim compliance with the Global Investment Performance Standards (GIPS®). To receive a complete list and description of the Firm's strategies or a GIPS Report please contact us at 1-800-99BARON.

Performance data quoted represents past performance. Current performance may be lower or higher than the performance data quoted. Past performance is no guarantee of future results.

† The Strategy's 10-year historical performance was impacted by gains from IPOs and there is no guarantee that these results can be repeated or that the Strategy's level of participation in IPOs will be the same in the future.

1 The **MSCI Emerging Markets Index** is designed to measure equity market performance of large and mid cap securities across 24 Emerging Markets countries. The **MSCI EM (Emerging Markets) IMI Growth Index** 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 24 Emerging Markets countries. MSCI is the source and owner of the trademarks, service marks and copyrights related to the MSCI Indexes. The indexes and the Strategy include reinvestment of dividends, net of foreign withholding taxes, which positively impact the performance results. The indexes are unmanaged. The index performance is not Strategy performance; one cannot invest directly into an index.

2 Not annualized.

3 The Strategy has a different inception date than its underlying portfolio, which is December 31, 2010.

(**Sberbank of Russia PJSC**, **Lufax Holding Ltd**, **TCS Group Holding PLC**, and **XP Inc.**). Poor stock selection effect in the Industrials sector due to investments in our China value-added (**Han's Laser Technology Industry Group Co., Ltd.** and **Zhejiang Dingli Machinery Co., Ltd.**) and sustainability/ESG (**China Conch Environment Protection Holdings Limited**, **Techtronic Industries Co. Ltd.**, and **Aeris Industria Comercio Equipamentos Geracao Energia SA**) themes also stood out as a key detractor during the period. Partially offsetting the above was favorable stock selection in the Materials sector, pertaining to select positions in our sustainability/ESG theme (**Glencore PLC** and **Suzano S.A.**), along with positive allocation effect in the Information Technology sector. In addition, our cash position in a weak market environment was also a positive contributor to relative performance during the year.

From a country perspective, for calendar year 2022, poor stock selection in China and Brazil drove the vast majority of relative underperformance. In our view, the weakness in China was primarily driven by near-term earnings disruption pertaining to the country's zero-COVID policy. As illuminated elsewhere in this letter, we expect our China investments to stage a solid recovery in the year ahead as the worst of COVID-related disruption is now likely behind us and a new easing and stimulus cycle has taken shape. In our view, despite a late-year rally, current market prices remain well below fundamental intrinsic value for many of our investments. Partly offsetting the above was positive allocation and stock selection effect in Korea. Our active exposure to the U.K., led by our single investment in Glencore PLC as part of our sustainability/ESG theme, along with positive allocation effect in Taiwan, also contributed positively to relative performance during the year.

For the fourth quarter, we modestly underperformed our principal MSCI EM Index, as well as the EM all-cap growth proxy. Our large overweight positioning together with adverse stock selection in India was the key detractor to relative performance during the quarter. We are not surprised by a retracement of prior period gains in our India holdings and remain enthusiastic long term, as landmark economic reforms implemented by the Modi administration are now supporting higher sustainable GDP growth while also accelerating formalization and digitization of the economy. Our cash position in a market rally combined with weak stock selection and allocation effect in Korea also contributed to the relative shortfall during the quarter. From a sector or theme perspective, poor stock selection effect in Financials (**Bajaj Finance Limited**, **Max Financial Services Limited**, **SBI Life Insurance Company Limited**, **JM Financial Limited**, and **Nippon Life India Asset Management Limited**) and Health Care (**Hapvida Participacoes e Investimentos S.A.**, **Zai Lab Limited**, and **Divi's Laboratories Limited**) were a drag on relative results. We are encouraged by our recent performance and expect to recoup prior period losses for many of our investments, particularly within our digitization, sustainability/ESG, and China value-added themes.

Table II.
Top contributors to performance for the quarter ended December 31, 2022

	Percent Impact
Samsung Electronics Co., Ltd.	0.71%
Taiwan Semiconductor Manufacturing Company Limited	0.49
Tencent Holdings Limited	0.45
Tenaris S.A.	0.44
Kingdee International Software Group Company Limited	0.41

Shares of South Korean conglomerate **Samsung Electronics Co., Ltd.** increased during the quarter due to investor expectations of a stabilization in DRAM and NAND prices heading into 2023. We are confident Samsung will remain a global leader in memory, smartphones, and foundry services and a major beneficiary of long-term semiconductor demand growth.

Semiconductor giant **Taiwan Semiconductor Manufacturing Company Limited** contributed in the fourth quarter due to easing geopolitical concerns and expectations for end-demand recovery later in 2023. We retain conviction that Taiwan Semi's technological leadership, pricing power, and exposure to secular growth markets, including high-performance computing, automotive, 5G, and IoT, will allow the company to sustain strong earnings growth over the next several years.

Tencent Holdings Limited operates the leading social network and messaging platforms (QQ, WeChat), the largest online entertainment and media business, and the largest online gaming business in China. Shares of Tencent were up this quarter, given improving macroeconomic conditions, the end of China's zero-COVID policy, and slowing regulatory activity in China. We retain conviction that Tencent can sustain durable growth given its track record of execution, scale, and unique and diversified online assets.

Tenaris S.A. manufactures seamless steel pipe products with large operations in the U.S., Latin America, and the Middle East. Most of its products are oil country tubular goods (OCTG) supplied for the energy industry. Shares increased on an earnings beat generated by higher margins as a result of shortages of OCTG pipe. As one of the lowest-cost OCTG producers, we think Tenaris will be a major beneficiary of the increase in U.S. drilling capital expenditures needed to increase domestic energy security and reduce global reliance on Russian oil and gas.

Kingdee International Software Group Company Limited, a leading Chinese enterprise resource planning (ERP) software company, contributed in the fourth quarter on an improving macroeconomic growth outlook and expectations for increased enterprise software spending. We believe Kingdee will be a key beneficiary of Chinese enterprises' digital transformation and software localization. We expect Kingdee to take market share from foreign ERP providers while transitioning to a subscription, cloud-based model, leading to increased recurring revenue and earnings visibility.

Table III.
Top detractors from performance for the quarter ended December 31, 2022

	Percent Impact
Bajaj Finance Limited	–0.33%
Baidu, Inc.	–0.22
Hapvida Participacoes e Investimentos S.A.	–0.21
Max Financial Services Limited	–0.16
China Conch Environment Protection Holdings Limited	–0.13

Bajaj Finance Limited, a leading non-bank financial company in India, detracted from performance largely as a result of anticipated weakness in near-term earnings growth owing to a broad slowdown in consumer discretionary spending. We retain conviction in Bajaj due to its best-in-class management team, robust long-term growth outlook, and conservative risk management frameworks. We think the company is well positioned to benefit from growing demand for consumer financial services such as mortgages, personal and credit card loans, among other related products.

Shares of **Baidu, Inc.**, a leading Chinese artificial intelligence company, fell in the fourth quarter due to geopolitical uncertainties and COVID-related lockdowns. We retain conviction that Baidu will deliver strong earnings growth over the next several years, driven by the secular growth in digital advertising, market share gains in cloud computing, continued progress in autonomous vehicle development, and improving operational efficiency.

Hapvida Participacoes e Investimentos S.A. is Brazil's largest vertically integrated HMO. Disappointing performance can be attributed to earnings weakness due to COVID-related headwinds and anemic growth in new member lives. We retain conviction given the company is benefiting from rising penetration of health care services in the country, and we believe it will gain market share by offering cost-effective plans nationwide. We expect earnings to sustain mid-teens growth over the next three to five years.

Shares of **Max Financial Services Limited** declined in the quarter as a result of near-term earnings weakness due to slowing premium growth delivered by its largest distribution partner, Axis Bank. We retain conviction. As India's leading life insurance player, the company is benefiting from strong consumer demand for term protection and financial savings products. We expect mid-teens premium growth over the next three to five years.

China Conch Environment Protection Holdings Limited is an emerging leader in hazardous/solid waste treatment through cement co-processing projects in China that recently spun off from China Conch Venture Holdings. Shares fell due to a decline in margins and investor concerns about weaker demand. We remain shareholders. The cement co-processing business enjoys high levels of support by the Chinese government. Co-processing has 40%-plus margins underpinned by low costs and strong pricing power relative to other methods that are two to three times more expensive and more capital intensive.

Portfolio Structure[1]

Table IV.
Top 10 holdings as of December 31, 2022

	Percent of Net Assets
Taiwan Semiconductor Manufacturing Company Limited	4.9%
Samsung Electronics Co., Ltd.	3.6
Alibaba Group Holding Limited	3.1
Tencent Holdings Limited	2.7
Reliance Industries Limited	2.7
Bajaj Finance Limited	2.6
Suzano S.A.	2.0
Bharti Airtel Limited	1.8
Korea Shipbuilding & Offshore Engineering Co., Ltd.	1.7
PT Bank Rakyat Indonesia (Persero) Tbk	1.6

Exposure By Country

Table V.
Percentage of securities by country as of December 31, 2022

	Percent of Net Assets
China	31.7%
India	25.7
Korea	7.8
Taiwan	7.0
Brazil	5.7
Hong Kong	3.8
Indonesia	2.6
Mexico	2.3
Philippines	1.8
South Africa	1.5
United Kingdom	1.4
Italy	1.3
Peru	1.3
Poland	1.2
Japan	1.1
Norway	0.5
United Arab Emirates	0.3
Spain	0.1
United States	0.1
Russia	0.0*

* The Strategy's exposure to Russia was less than 0.1%.

Exposure by Market Cap: The Strategy 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 fourth quarter of 2022, the Strategy's median market cap was $10.3 billion, and we were invested 50.5% in giant-cap companies, 36.1% in large-cap companies, 8.8% in mid-cap companies, and 1.7% in small- and micro-cap companies, as defined by Morningstar, with the remainder in cash.

Recent Activity

During the fourth quarter, we added two new investments to existing themes while also increasing exposure to several positions that were established in earlier periods. We continue our endeavor to add to our highest-conviction ideas.

We added to our sustainability/ESG theme by initiating a position in **Norsk Hydro ASA**, a global producer of aluminum and other related products. The company is vertically integrated with operations across all major aspects of the aluminum value chain, from bauxite and alumina mining to smelting and production. Norsk Hydro is strategically positioned as an upstream producer of aluminum with a very low carbon footprint due to its captive hydro-electricity generation. This, in our view, is a growing competitive

[1] Top 10 holdings, exposures by country and market cap, portfolio characteristics, and recent activity are based on a representative account. Such data may vary for each client in the Strategy due to asset size, market conditions, client guidelines, and diversify of portfolio holdings. The representative account is the account in the Strategy that we believe most closely reflects the current portfolio management style for the Strategy. Representative account data is supplemental information.

advantage as we expect prices of carbon emissions to rise over time as global economies strive to achieve their carbon net-zero targets. We are optimistic regarding aluminum prices and expect a multi-year supply deficit driven by capacity constraints arising from decarbonization commitments in China and elsewhere. In addition, we expect structural demand growth from electric and lighter weight vehicles.

During the quarter, we also increased exposure to our digitization theme by initiating an investment in **MediaTek Inc.**, a Taiwanese fabless semiconductor company that is the largest global volume supplier of smartphone application processors. In our view, MediaTek will be a key beneficiary of a cyclical recovery in Android smartphone demand, driven by the reopening of China's consumer economy and industry-wide inventory restocking. We have followed the company for many years, and opportunistically invested as sentiment turned against the semiconductor industry, with MediaTek offering growth potential and a double-digit current dividend yield. Longer term, we expect MediaTek to benefit from secular growth in 5G smartphone adoption, driving a higher average selling price for its application processors, while leveraging its strong technological capabilities to gain market share in the premium smartphone segment. We also believe that the company's competitively advantaged non-smartphone product portfolio, including Wi-Fi chips, PC modems, and power management ICs, has structural upside from long-term semiconductor content growth.

Finally, we added to several of our existing positions during the quarter, most notably **Jiangsu Hengli Hydraulic Co., Ltd.**, **HDFC Bank Limited**, **Glodon Company Limited**, **JD.com, Inc.**, **Delta Electronics, Inc.**, **B3 S.A. – Brasil, Bolsa, Balcao**, and **Shenzhen Mindray Bio-Medical Electronics Co., Ltd.** During the quarter, we also exited our position in **Kweichow Moutai Co., Ltd.**, owner of China's most valuable domestic spirits brand, given concerns that rolling COVID-related lockdowns and a slowdown in China's property sector may reduce high-end consumption.

Outlook

In our third quarter letter, we suggested that Fed hawkishness was likely reaching a zone of practical constraint, as, in our view, investors believed that the Fed's impatience with backward-looking and elevated inflation readings would manifest as a policy error and/or trigger financial instability. We suggested that a peak in the U.S. dollar, real interest rates, and sovereign bond yields would likely signal the passing of peak hawkishness and result in moderating equity risk premia and a trough in earnings multiples. We believe the fourth quarter of 2022 has likely confirmed the prediction above, and as we stated in our last letter, these conditions suggest to us that we are entering a sustainable period of EM equity outperformance. While a global earnings contraction remains a possibility, we believe the combination of macroeconomic conditions, relative valuation, and relative earnings prospects warrant that forward-looking investors should begin to rebalance portfolios. In our view, now is the time to take a contrarian view of ex-U.S. investments.

While the fourth quarter concluded with solid global equity returns, the quarter was nonetheless characterized by high volatility, particularly in EM. Early in the quarter, disappointment with China's adherence to its zero-COVID policy, as well as unexpected changes to the Politburo standing committee, triggered a second capitulation in equities, only to be fully reversed when authorities abruptly unveiled aggressive easing and stimulus measures and signaled the dismantling of zero-COVID. We believe this market capitulation quite likely represents a very important bottom in China and related equities, and, in our view, further confirms the likelihood that EM equities are positioned for improvement in relative performance. From the end of October to year end, EM equities outperformed the S&P 500 Index by approximately 13%, and this outperformance has continued into the new year. In the near term, we believe China is the global jurisdiction with the greatest likelihood of earnings recovery and outperformance, triggered by the previously mentioned post-COVID economic reopening and coincident large-scale easing and stimulus measures. In contrast, while the U.S./global economy is likely moving past peak hawkishness, we expect an extended period of slowing economic growth and earnings vulnerability while awaiting the next Fed easing cycle. In other words, while the global markets are likely reaching a trough in earnings *multiples,* we are now entering an undefined period of uncertainty for U.S./global *earnings* power, and the unresolved question will shift to whether the Fed will wait too long to pivot to an easing bias.

Notwithstanding the recent outperformance noted above, we enter 2023 with U.S. equities trading at a near record high relative to EM equities and face an elevated risk of earnings disappointment, while EM equities in aggregate are trading near a 25-year low relative to U.S. equities and, in our view, stand poised for an improving relative economic and earnings outlook. Over the intermediate and longer term, while a mean reversion in relative valuation is enough to suggest material outperformance, it is a marked improvement in relative earnings expectations that will trigger sustained and unexpected outperformance. As we have outlined in previous communications, we believe the principal catalysts for improving EM relative earnings expectations will be the global capital investment cycle, which is required to fund deglobalization, supply-chain diversification, sustainability, and energy, commodity, and agricultural security; India's productivity initiatives reaching escape velocity and driving a virtuous investment cycle; and China's pivot to value-added economic activity. Further, we believe we are at or near a final top in the 14-year, extended U.S. dollar bull market and expect that a subsequent period of stronger EM currencies and stable or moderating bond yields will prove stimulative to consumption, investment and corporate earnings in these jurisdictions. In short, we reiterate that we believe now is a time to take a contrarian view of the EM equity asset class.

Sincerely,

Michael K

Michael Kass
Portfolio Manager

The performance of accounts in the Strategy may be materially different at any given time. Differences that may affect investment performance include cash flows, inception dates, and historical prices. Positions may not be the same or may be traded at different times. In addition, accounts in the Strategy may be pursuing similar investment strategies, but may have different investment restrictions.

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 Strategy 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 Strategy 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 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.