Baron Emerging Markets Strategy

June 30, 2023

Dear Investor:

Performance

Baron Emerging Markets Strategy® gained 4.01% during the second quarter of 2023, while its primary benchmark, the MSCI EM Index, returned 0.90%. The MSCI EM IMI Growth Index gained 0.23% for the quarter. The Strategy outperformed both the primary benchmark and the emerging markets (EM) all-cap growth proxy in a period of relative macroeconomic and geopolitical calm but moderating global equity gains. The Strategy now stands ahead of both indexes midway through the year despite the fact that outside of the U.S., growth equities underperformed value, which is typically a headwind to our relative performance. The quarter began under the influence of fear that the strain on global banks and associated deposit flight would trigger a credit tightening and an abrupt economic slowdown, but such concerns tapered as the quarter progressed. On the contrary, for now, stubbornly strong wage, housing, and services inflation in the U.S. have rekindled expectations that the Fed will resume rate hikes imminently, which drove a significant increase in short- and long-term bond yields during the quarter. In a global context, U.S. technology and artificial intelligence (AI)-related shares stood out significantly. However, beyond this limited sphere, market breadth and momentum showed signs of deterioration, suggesting a potential signal that a consolidation or correction could be approaching. We remain encouraged over the longer term and maintain the premise that we are passing peak hawkishness and likely entering a period of EM equity outperformance.

Table I.
Performance for annualized periods ended June 30, 2023 (Figures in USD)[1]

	Baron Emerging Markets Strategy (net)[2]	Baron Emerging Markets Strategy (gross)[2]	MSCI EM Index[2]	MSCI EM IMI Growth Index[2]
Three Months[3]	4.01%	4.24%	0.90%	0.23%
Six Months[3]	6.84%	7.32%	4.89%	4.50%
One Year	2.98%	3.94%	1.75%	1.24%
Three Years	0.54%	1.49%	2.32%	0.17%
Five Years	0.53%	1.48%	0.93%	1.07%
Ten Years	3.90%	4.88%	2.95%	3.82%
Since Inception (January 31, 2011)[4]	3.69%	4.49%	1.47%	2.47%

Table II.
Calendar Year Performance 2018-2022 (Figures in USD)

	Baron Emerging Markets Strategy (net)[2]	Baron Emerging Markets Strategy (gross)[2]	MSCI EM Index[2]	MSCI EM IMI Growth Index[2]
2018	(18.40)%	(17.63)%	(14.57)%	(18.44)%
2019	19.05%	20.17%	18.42%	23.60%
2020	29.57%	30.78%	18.31%	30.75%
2021	(5.95)%	(5.05)%	(2.54)%	(5.50)%
2022	(25.77)%	(25.07)%	(20.09)%	(23.88)%

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 June 30, 2023, total Firm assets under management are approximately $41.8 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 our 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. GIPS® is a registered trademark owned by CFA Institute. CFA Institute does not endorse, promote or warrant the accuracy or quality of the report.

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.

1 With the exception of performance data, most of the data is based on a representative account. Such data may vary for each client in the Strategy due to asset size, market conditions, client guidelines, and diversity 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.

2 The **MSCI EM (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. Index performance is not Strategy performance; one cannot invest directly into an index.

3 Not annualized.

4 The Strategy has a different inception date than its representative account, which is 12/31/2010.

While China-related equities struggled during the quarter as the post-COVID recovery remained subdued, partially due to a second, albeit more moderate, COVID wave, we remain cautiously optimistic and continue to expect a consumption recovery to accelerate into the second half of 2023. Targeted policy easing measures continue to emerge alongside rising calls for more forceful stimulus, and we believe President Xi's new leadership team will ultimately achieve the recovery that they have prescribed. In the near term, we believe China offers attractive risk/reward potential with material upside should the economy either gain traction or provoke more substantial policy support. Indian equities returned to leadership, as valuations reset after two consecutive quarters of underperformance and the economic and earning expansion in the country continued on a healthy course. This reversal was a key driver of our second quarter outperformance, and we maintain conviction that India likely offers the most attractive long-term investment opportunity in the EM sector. Brazil also reversed first quarter underperformance logging significant gains, and we view the recent strength in both India and Brazil as a likely signal that several EM central banks are on the cusp of a rate cutting cycle – regardless of how the Fed progresses in the second half of 2023. This is unusual, and we believe can be attributed to the scale of U.S. COVID-related stimulus and resulting inflation, compared to a much more subdued and constrained response outside the U.S. This, along with several other catalysts detailed in the Outlook section of this letter, support our view that EM equities are poised to enter a period of much improved relative earnings and return potential. As always, we are confident that we have constructed a diversified portfolio of well-positioned and well-managed companies that are also benefiting from the tailwinds of long-term and attractive investment themes.

For the second quarter of 2023, we comfortably outperformed our primary benchmark, the MSCI EM Index, as well as our all-cap growth proxy. From a sector or theme perspective, solid stock selection in the Financials sector, most notably investments in our India wealth management/consumer finance theme (**Bajaj Finance Limited**, **Edelweiss Financial Services Limited**, **Max Financial Services Limited**, **Nippon Life India Asset Management Limited**, **Muthoot Finance Limited**, and **SBI Life Insurance Company Limited**) and fintech disruption theme (**XP Inc**. and **StoneCo Ltd.**), powered the vast majority of relative outperformance this quarter. In addition, favorable stock selection effect in the Industrials sector, driven by select holdings in our sustainability/ESG theme (**HD Korea Shipbuilding & Offshore Engineering Co., Ltd.** and **HD Hyundai Heavy Industries Co., Ltd.**), also bolstered relative results. Lastly, positive stock selection and our underweight positioning in the Materials sector also contributed to relative performance. Partially offsetting the above was adverse stock selection effect in the Information Technology sector, primarily attributable to our software-related investments in our China value-added theme (**Glodon Company Limited**, **Kingdee International Software Group Company Limited**, and **Venustech Group Inc.**). Poor allocation effect together with weak stock selection in the Energy sector also stood out as a detractor this quarter.

From a country perspective, favorable stock selection effect combined with our overweight positioning in India drove the majority of outperformance this quarter. Solid stock selection in Korea and Brazil were also key contributors to relative results. Partly offsetting the above was adverse stock selection effect in China, together with our exposure to Hong Kong. We are encouraged by the earnings-driven outperformance of our India holdings and remain excited about the long-term investment potential within the country. As expressed in previous letters, our optimism about India stems from the productivity enhancing economic reforms implemented by the Modi administration that are now supporting higher sustainable GDP growth while also accelerating the formalization and digitization of the economy. In our view, India is also a key beneficiary of the tectonic shifts in the geopolitical landscape that increasingly position the country as an attractive investment destination for global corporates looking to diversify their supply chains and manufacturing footprint outside of China. Despite the recent underperformance in China, primarily driven by near-term concerns about slowing economic activity, we are encouraged by easing regulatory pressures within the technology and property sectors and improving prospects of government sponsored stimulus to support economic growth and job creation. Many of our China investments, especially within the digitization theme and select positions in our China value-added and EM consumer themes continue to trade at deep discounts to fundamental intrinsic value, setting the stage for a favorable risk/return profile going forward.

Table III.
Top contributors to performance for the quarter ended June 30, 2023

	Percent Impact
HD Korea Shipbuilding & Offshore Engineering Co., Ltd.	0.81%
Taiwan Semiconductor Manufacturing Company Limited	0.59
Samsung Electronics Co., Ltd.	0.55
Bajaj Finance Limited	0.53
XP Inc.	0.52

HD Korea Shipbuilding & Offshore Engineering Co., Ltd. is a holding company for the largest shipbuilder in the world (based on order book size) and is the global leader in high-end vessels including liquified natural gas (LNG) powered ships. Shares increased as a result of solid performance in new orders at its subsidiary Hyundai Samho, already exceeding full fiscal year guidance. In addition, operating margin expectations have improved given the recent decline in steel prices combined with increases in new build prices. Korean shipbuilders have an oligopoly in LNG carrier shipbuilding, LNG dual-fueled and alternative zero-carbon fueled containerships and tankers. The tightening regulation on carbon emission, which will be fully adopted by the International Maritime Organization (IMO) by 2030, should drive higher demand for LNG dual-fueled ships as well as carbon-free ammonia-fueled ships. We expect a structural shortage of compliant ships to emerge as the IMO deadline nears, which should benefit Korea Shipbuilding given its leading position. We maintain our investment as a core holding within our sustainability/ESG theme.

Semiconductor giant **Taiwan Semiconductor Manufacturing Company Limited** contributed in the second 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, AI, automotive, 5G, and IoT, will allow the company to sustain strong earnings growth over the next several years.

Shares of South Korean conglomerate **Samsung Electronics Co., Ltd.** increased during the quarter due to an improving outlook for memory semiconductors in the second half of 2023, driven by DRAM and NAND inventory normalization and an increase in AI-related demand. We are confident Samsung will remain a global leader in semiconductors and 5G smartphones.

Table IV.
Top detractors from performance for the quarter ended June 30, 2023

	Percent Impact
Alibaba Group Holding Limited	–0.80%
Think & Learn Private Limited	–0.62
Glodon Company Limited	–0.56
Tencent Holdings Limited	–0.46%
Kingsoft Corporation Ltd.	–0.35

Alibaba Group Holding Limited is the largest retailer and e-commerce company in China. Alibaba operates shopping platforms Taobao and Tmall and owns 33% of Ant Group, which operates Alipay, China's largest third-party online payment provider. Shares of Alibaba were down this quarter, given uncertainty over the pace of China's post-COVID consumption recovery, and limited information around the company's announced plan to split into six units. We believe the restructuring plan has potential to unlock value, particularly in cloud, and the core e-commerce business' market share will stabilize. We retain conviction that Alibaba is well positioned to benefit from China's reopening and the growth in online commerce and cloud in China.

Think & Learn Private Limited, the parent entity of "Byju's – the Learning App," detracted during the quarter. Weak performance was driven by a marked slowdown in business momentum as COVID-related tailwinds that benefited online/digital education have begun to dissipate. In addition, Byju's announced that Deloitte had resigned as its auditor and will be replaced by BDO (another top five global audit firm). Three investor-appointed Board Directors also resigned during the quarter. These developments were deemed as material adverse events that required the fair market value of our holdings to be adjusted down accordingly. As India's largest education technology player, the company is well positioned, in our view, to benefit from structural growth in online education services in the country. While we are disappointed with recent developments, we continue to believe that Byju's remains a dominant franchise and can sustain low to mid-20s earnings growth in coming years.

Shares of **Glodon Company Limited**, a leading Chinese construction software provider, decreased during the quarter due to macroeconomic headwinds and relatively slow project starts for property and infrastructure. We retain conviction in Glodon, as we believe the company is uniquely positioned to benefit from increasing software penetration in the construction industry, which is the least digitized industry in China.

Portfolio Structure

Table V.
Top 10 holdings as of June 30, 2023

	Percent of Net Assets
Taiwan Semiconductor Manufacturing Company Limited	6.0%
Samsung Electronics Co., Ltd.	4.7
Tencent Holdings Limited	3.8
Alibaba Group Holding Limited	3.7
HD Korea Shipbuilding & Offshore Engineering Co., Ltd.	2.4
Bajaj Finance Limited	2.2
HDFC Bank Limited	2.2
Suzano S.A.	1.9
Delta Electronics, Inc.	1.9
PT Bank Rakyat Indonesia (Persero) Tbk	1.8

Table VI.
Percentage of securities by country as of June 30, 2023

	Percent of Net Assets
China	29.0%
India	25.3
Korea	11.4
Taiwan	7.9
Brazil	6.5
Hong Kong	2.8
Mexico	2.4
Indonesia	2.0
Philippines	1.9
South Africa	1.5
Peru	1.4
Poland	1.3
Japan	1.2
France	0.7
Italy	0.4
United Arab Emirates	0.3
Spain	0.2
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 second quarter of 2023, the Strategy's median market cap was $12.4 billion, and we were invested 49.4% in giant-cap companies, 35.7% in large-cap companies, 9.3% 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 second quarter, we added a few new investments to our existing themes, while also increasing exposure to various positions that we established in earlier periods. We continue our endeavor to add to our highest conviction ideas.

We were active in adding to our EM consumer theme by initiating a position in **Trent Limited**, a leading retailer in India that sells private label apparel, direct-to-consumer through its proprietary retail network. The company also has a joint venture with Spanish fast fashion group, Inditex, operating 20 Zara stores in India while incorporating key learnings into its own retail operations. In our view, Trent's competitive moat is its superior product quality, value-based pricing, and disciplined supply-chain management, which translates into strong brand equity and above industry same-store-sales growth. The company is rapidly scaling up its Zudio value fashion format, with the potential to triple store count to 1,000 in the next three to five years. In addition to the core apparel business, Trent also has a joint venture partnership with British retail chain Tesco to operate its 60-store Star Bazaar grocery chain. We expect the company to generate over 25% revenue growth in the near to medium term, driven by same-store-sales growth and outlet expansion. In addition, we believe operating leverage and growing franchisee mix will lead to better profitability and return on capital, driving more than 30% EBITDA CAGR over the next three to five years.

During the quarter, we also increased exposure to our digitization theme by initiating a position in **SK hynix Inc.**, a South Korean memory semiconductor company specializing in DRAM and NAND chips, which store data temporarily and permanently, respectively. SK hynix is the second-largest global memory vendor, behind Samsung Electronics. In our view, the memory industry has reached a cyclical bottom and is on the cusp of a multi-year growth phase, supported by inventory normalization and production cuts. Memory is a pillar of the data economy and enjoys structural demand growth as servers, smartphones, PCs, and other devices become ever more computationally intensive. We also believe SK hynix to be a key beneficiary of surging AI-driven demand for high-bandwidth memory (HBM), which uses advanced packaging to vertically stack DRAM chips, resulting in higher bandwidth, improved power efficiency, and a smaller form factor. The company has emerged as the industry leader in cutting edge HBM and is the sole supplier for NVIDIA's H100 AI chip, thanks to its superior durability and heat dissipation. We expect SK hynix to generate strong earnings growth over the next several years, with significant upside in incremental long-term memory demand from AI-related applications.

We also initiated an investment in **Max Healthcare Institute Limited**, the second largest hospital chain in India, with over 3,200 beds. Under the leadership of CEO and restructuring expert Abhay Soi, management has focused on cutting costs and improving return metrics at poorly managed hospitals. These efforts have helped Max Healthcare stand out among Indian hospital peers with best-in-class EBITDA margins, average revenue per occupied bed, and ROIC. In addition, we believe operating leverage, improving payor mix, medical tourism, an asset-light operation and management model, and optionality from tuck-in acquisitions could drive further earnings upside. We are excited about the multi-year growth opportunity that lies ahead for hospital services in India and believe Max Healthcare will be a key beneficiary of ongoing industry consolidation. We expect the company to more than double EBITDA in the next three to five years, while sustaining mid-teens revenue growth over the same time frame.

We added to several of our existing positions during the quarter, including **Tencent Holdings Limited**, **Alibaba Group Holding Limited**, **Kingdee International Software Group Company Limited**, **Wuliangye Yibin Co., Ltd.**, **Kanzhun Limited**, **Tata Consumer Products Limited**, **Baidu, Inc.**, and **LG Chem, Ltd.**

During the quarter, we exited several positions including **Glencore PLC**, **Ozon Holdings PLC**, **Norsk Hydro ASA**, **China Tourism Group Duty Free Corporation Limited**, **MediaTek Inc.**, **Yandex N.V.**, and **Meituan Inc.**

Outlook

In our first-quarter letter, we reiterated our view that markets were likely passing through peak hawkishness and saw the emergency liquidity injection related to the U.S. regional banking crisis as a bullish signal for global equities. However, we also pointed out the challenges posed by the anticipation of Fed rate cuts, higher earnings multiples, and a likely phase of earnings vulnerability, which could hinder further global equity gains. Despite the recent relative calm in macroeconomic and geopolitical volatility, we maintain our end-of-first-quarter outlook, noting that, aside from large-cap U.S. technology shares, equity appreciation has slowed or stalled in recent months. While global equities gained for a second quarter, buoyant U.S. employment has prevented the Fed from ruling out further rate hikes, and both market breadth and bond yields have risen.

In fact, the 10-year U.S. Treasury real yield is now revisiting levels that triggered the deposit flight and regional bank crisis in the first quarter. The prospect of rising real yields and a likely return to Fed rate hikes after a brief pause does not align with the rising multiples seen in U.S. and growth-related equities. Consequently, we believe tightening U.S. liquidity and higher bond yields could trigger a consolidation of recent gains, especially cooling the rally in technology and AI proxies if inflation measures fail to moderate in the near term. As we have stated before, we believe a correction in U.S. equities is likely necessary before global investors and allocators shift their focus to improving ex-U.S. relative earnings potential, sparking a sustainable relative outperformance cycle in EM equities.

In the realm of emerging markets (EM), China's post-COVID reopening recovery remained subdued, but there are positive aspects to consider, such as ongoing cost and capital discipline by private sector companies, which are encouraging signs for equity investors. We have suggested patience, particularly given that President Xi's new team signaled a desire for an economic rebound, and we continue to expect a consumption recovery to accelerate into the second half of 2023. Meanwhile, targeted policy easing measures continue to emerge alongside rising calls for more forceful support from policymakers. We note that several of our portfolio holdings are already showing solid fundamental performance in a challenging macro environment, and we remain cautiously optimistic against a backdrop of historic trough valuations, poor sentiment, and underweight positioning by global investors. We continue to believe that geopolitical concerns are priced into current valuations and that there is far too much to lose for China to initiate a move on Taiwan. We believe China likely represents the most attractive near-term risk/reward potential in the ex-U.S. sector. India equities returned to leadership, reversing first quarter underperformance while handily outperforming the MSCI EM Index during the quarter as the economic and earnings expansion there continues, and valuations had fully mean-reverted entering the quarter after two consecutive quarters of underperformance. This reversal was a key driver of our second quarter outperformance, and we remain optimistic regarding our various investments and overweight position, as we believe India offers the most attractive long-term investment opportunity in the emerging markets sector. Brazil also reversed first quarter underperformance with significant second quarter gains, and we view the recent strength in both India and Brazil as a manifestation of rising market confidence that several EM central banks are on the cusp of a rate cutting cycle – regardless of how the Fed progresses in the second half of 2023. This is unusual, and we believe can be attributed to the scale of U.S. COVID-related stimulus and resulting inflation, compared to a much more subdued and constrained response outside the U.S.

In summary, we remain of the view that after a long period of underperformance, EM equities are poised for a cycle of relative outperformance, principally driven by the following:

1. An eventual consensus recognition that a U.S. dollar bear market has begun. We believe the longer-term fundamentals for the dollar have been eroding for years, that we are well past peak dollar demand, and that the supply of U.S. Treasuries/dollars in circulation has made an important vector change higher as politicians have seized the levers of stimulus from central bankers (i.e., COVID and infrastructure stimulus). Once this view takes hold, the *tax* on holding non-U.S. assets will shift

to a tailwind to returns, sparking a reversal of capital/investment flows which we believe will be stimulative to consumption, investment, and earnings growth in ex-U.S. jurisdictions. We believe this reversal of capital and investment flows will spark a mean-reversion in EM equity valuations, which are currently at or near 30-year lows relative to U.S. equities.

2. The global capital investment cycle that is necessary to strategy de-globalization; security of energy, commodity, agriculture; and national security & defense is by definition a catalyst for outperformance of EM countries, whose economies and markets are simply more geared towards such a capital investment-driven environment. The past 20 years – post-Iron Curtain and China's ascension into the WTO – have been characterized by globalization and the reduction of capital deployed – much to the benefit of wealthy consumers in developed markets; this will now reverse and favor the owners of real assets and industrial pricing power, and there is simply more of that in the EM indexes.

3. India is the new China, and it will be the fastest growing major economy in the coming decade and beyond. Economic reforms, digitization, formalization, and rising credit penetration favor the most sophisticated, best-managed, public corporations such as those in which we have invested.

4. China's principal lever to drive necessary productivity gains is a major pivot towards self-sufficiency in the value-added industries that have been largely dominated by western multi-nationals over the past 20 years. The rise of local domestic champions in the auto/electric vehicle, automation/robotics, advanced manufacturing, pharmaceutical/biotechnology, software/AI/semiconductors, and consumer goods industries will move the dial on perceived relative earnings growth potential for Emerging Markets.

Sincerely,

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.