

## DEAR INVESTOR:

### PERFORMANCE

Baron Emerging Markets Strategy (the "Strategy") appreciated 0.86% (net of fees) for the first quarter of 2018, while its principal benchmark index, the MSCI EM Index, gained 1.42% for the quarter. Early in the quarter, emerging market equities continued the powerful advance of 2017, only to reverse and end the quarter with a marginal gain, as concerns regarding monetary and liquidity support, as well as the re-emergence of trade protectionism risk, deflated investor optimism. While we have noted the potential for a consolidation phase that could develop into a market correction, looking forward, we continue to believe EM and other international equities likely remain poised for a sustainable period of outperformance. We continue to believe that China's emphasis on gaining market and profit share from Western multinationals in high value-added sectors is well-placed, and presents attractive long-term investment opportunities. We believe we are positioned appropriately for a rise in market volatility and would look to capitalize on opportunities that typically arise in such an environment. We remain optimistic that our differentiated discipline and process position us well over the long term.

**Table I.**  
**Performance<sup>†</sup>**

Annualized for periods ended March 31, 2018

	Baron Emerging Markets Strategy (net) <sup>1</sup>	Baron Emerging Markets Strategy (gross) <sup>1</sup>	MSCI EM Index <sup>1</sup>	MSCI EM IMI Growth Index <sup>1</sup>
Three Months <sup>2</sup>	0.86%	1.09%	1.42%	1.20%
One Year	25.68%	26.89%	24.93%	30.11%
Three Years	9.83%	10.92%	8.81%	10.04%
Five Years	9.23%	10.22%	5.03%	6.78%
Since Inception (January 31, 2011) <sup>3</sup>	7.55%	8.24%	3.09%	4.62%

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 March 31, 2018, total Firm assets under management are approximately \$27.1 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 managed by BAMCO. 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-compliant presentation 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.

<sup>†</sup> The Strategy'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 MSCI EM (Emerging Markets) IMI indexes cited are unmanaged, free float adjusted market capitalization weighted indexes reflected in U.S. dollars. The MSCI EM (Emerging Markets) IMI Growth Index Net USD and the MSCI EM (Emerging Markets) IMI Index Net USD are designed to measure equity market performance of large-, mid- and small-cap securities in the emerging markets. The MSCI EM (Emerging Markets) IMI Growth Index Net USD screens for growth-style securities. The indexes and Baron Emerging Markets Strategy include reinvestment of dividends, net of foreign withholding taxes, which positively impact the performance results.

<sup>2</sup> Not annualized.

<sup>3</sup> The Strategy has a different inception date than its underlying portfolio, which is December 30, 2010.

For the first quarter of 2018, we modestly underperformed our benchmark MSCI EM Index; however, our relative performance improved as the market gave up its January gains, and we were comfortable with our absolute and relative performance. During the quarter, the largest driver of adverse relative performance was stock selection effect in the Financial sector, driven by our India wealth management theme. We believe stocks associated with this theme underperformed due to news of the initiation of a modest capital gains tax. Select bank holdings in Southeast Asia that we believe were particularly sensitive to the rise in global bond yields over the past several months also underperformed. From a country perspective, the overwhelming cause of adverse relative performance was India, where our multi-pronged reform and investment cycle themes were challenged in the short term by the surprise introduction of a modest capital gains tax, rising commodity prices and bond yields, and a case of bank fraud in the jewelry sector. We remain confident in the fundamental underpinnings of our India investments and general overweight position, and we believe the peak of underperformance for India equities is likely behind us.

Stock selection in the Information Technology sector had a positive effect, led by significant gains in **Kingdee International Software Group Co. Ltd.**, a Chinese software company transitioning to cloud-based services, **PagSeguro Digital Ltd.**, a Brazil-based payment services company, which completed its initial public offering during the quarter, and **MyEG Services Berhad**, a Malaysian payments and transaction services company. By country, stock selection effect in China was the principal driver of relative outperformance.

**Table II.**  
**Top contributors to performance for the quarter ended March 31, 2018**

	Percent Impact
Kingdee International Software Group Co. Ltd.	0.58%
PagSeguro Digital Ltd.	0.42
Petróleo Brasileiro S.A. – Petrobras	0.35
MyEG Services Berhad	0.33
Sunny Optical Technology Group	0.32



# Baron Emerging Markets Strategy

Shares of **Kingdee International Software Group Co. Ltd.**, an enterprise management software provider in China, rose during the quarter on solid cloud software sales. We believe Kingdee's cloud suite will provide significant value to customers seeking ways to counter rising labor costs in China and see cloud adoption in China rapidly rising from a low base. The Chinese government is emphasizing business productivity growth via software automation, and we believe the company is on track for expansion after a management transition, a repositioned sales channel, and the recent JD.com investment.

**PagSeguro Digital Ltd.** is a Brazilian payment processor and merchant acquirer. Shares rose during PagSeguro's first quarter as a publicly traded company on news that its business is growing at a rapid rate. We believe credit card and digital payment penetration is low among the Brazil population, and PagSeguro's digital wallet and physical device form an attractive platform that should allow small merchants to accept digital currency and grow over time, in our view.

Shares of **Petróleo Brasileiro S.A. – Petrobras**, the leader in offshore deep water oil production development in Brazil, appreciated in the first quarter due to lower perceived risk around Brazil's presidential elections and progress on a transfer-of-rights resolution with the Brazilian government that has implemented several market-oriented reforms in the oil & gas sector. We retain conviction due to the ramp-up in production at pre-salt oil fields. We also expect a deleveraging of the company's balance sheet through non-core asset divestments over the next several years.

Shares of **MyEG Services Berhad** rose in the quarter on a strong earnings report. MyEG is a software-enabled data services firm serving public entities in Malaysia. We believe MyEG has several exciting data service opportunities that could help the government lower its administrative costs and reduce bureaucracy. The company's new employer insurance and job-matching programs are designed to lower frictional costs, and its goods and services initiative helps improve tax compliance in Malaysia.

**Sunny Optical Technology Group** is an integrated manufacturer of optical-related products in China. Shares appreciated after the company's camera module and lens business exceeded market expectations, thanks to market share gains and margin expansion. New businesses, such as a 3D sensing module, provided additional upside to the company's growth trajectory. We continue to hold Sunny as one of our high conviction ideas.

**Table III.**  
Top detractors from performance for the quarter ended March 31, 2018

	Percent Impact
Tata Global Beverages Limited	-0.29%
Vakrangee Limited	-0.22
Motherson Sumi Systems Limited	-0.19
Edelweiss Financial Services Limited	-0.19
Max Financial Services Limited	-0.19

Shares of **Tata Global Beverages Limited**, the world's second largest tea company, declined due to profit-taking as earnings growth missed analyst consensus expectations. We retain conviction in Tata Global Beverages, as we believe new leadership at parent company Tata Sons will emphasize

efficiency and productivity and create significant shareholder value. We believe Tata Global Beverages is benefiting from a structural shift in consumer preference toward healthier beverages, especially in India. The company also operates the Starbucks franchise in India.

Shares of **Vakrangee Limited**, a digital and logistics services provider servicing rural India, declined sharply during the quarter following reports of improper trading activity in its shares and a lack of disclosure. While the company has denied any wrongdoing, we are evaluating the situation closely.

Shares of **Motherson Sumi Systems Limited**, a global auto parts supplier, fell in the quarter due to earnings results that missed analyst consensus and investor anticipation of a decline in original equipment manufacturer volumes. We think the company has a solid operational track record and a proven ability to make accretive acquisitions. The company is benefiting from industry consolidation across various geographies and is expanding its business in developing countries such as China and India.

Shares of **Edelweiss Financial Services Limited**, a leading non-bank financial company in India, declined in the quarter due to profit-taking and investor concerns about a new capital gains tax as well as rising bond yields that would lead to margin headwinds for the firm. The company is well-positioned, in our view, to benefit from growing demand for retail lending, distressed assets, and wealth management products and services, and has a prudent risk management process. We believe the company could generate a book value growth rate in the high teens over the next five years.

Shares of **Max Financial Services Limited**, India's leading life insurance company, declined in the quarter due to investor concerns about uncertainties related to Max Financial Services' collaboration with Axis Bank, a key distribution partner. Both parties are currently negotiating renewal terms. We remain invested as we think a commercial extension is highly likely and believe the company will benefit from strong consumer demand for term protection and financial savings products. We see secular growth opportunities in India's life insurance industry and expect mid-teens earnings growth over the next three-to-five years.

## PORTFOLIO STRUCTURE

**Table IV.**  
Top 10 holdings as of March 31, 2018

	Percent of Net Assets
Tencent Holdings, Ltd.	3.8%
Alibaba Group Holding Limited	3.7
Sberbank of Russia PJSC	2.5
Samsung Electronics Co., Ltd.	2.3
KB Financial Group, Inc.	2.1
China Construction Bank Corporation	2.0
Baidu, Inc.	1.8
Taiwan Semiconductor Manufacturing Company Ltd.	1.8
Housing Development Finance Corporation Limited	1.7
Sino Biopharmaceutical Ltd.	1.6

## EXPOSURE BY COUNTRY

**Table V.**  
Percentage of securities by country as of March 31, 2018

	Percent of Net Assets
China	31.8%
India	17.8
Brazil	7.1
Korea	6.6
Taiwan	5.6
South Africa	4.6
Mexico	4.1
Russia	4.0
Argentina	3.3
Philippines	1.9
Hong Kong	1.5
Malaysia	1.3
United Kingdom	0.9
Panama	0.9
Indonesia	0.9
Thailand	0.7
Nigeria	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 often exhibit attractive growth potential. At the end of the first quarter of 2018, the Strategy's median market cap was \$10.5 billion, and we were invested approximately 74.4% in large- and giant- cap companies, 17.2% in mid-cap companies and 1.5% in small- and micro-cap companies as defined by Morningstar, with the remainder in cash.

## RECENT ACTIVITY

During the quarter, we made several additions to existing themes and positions, notably in the China domestic value-added arena, where we initiated positions in **CSPC Pharmaceutical Group Limited**, our second bioscience and pharmaceutical investment, and **Han's Laser Technology Co. Ltd.**, a leading high-precision laser equipment company that we think is positioned to benefit from the rising penetration of industrial automation and electric vehicles. Also in this theme, we increased our investment in **Kandge Xin Composite Material**.

We also participated in the initial public offering of **PagSeguro Digital Ltd.**, a Brazilian payment services provider, which we believe has an attractive value and technology proposition, particularly for merchants who have not previously been able to offer credit or debit card-based payments. Further, we initiated positions in **KIA Motors Corporation**, which is a likely beneficiary of reform in Korea, aimed at improving corporate governance of the country's conglomerates, and **JSW STEEL Ltd.** of India, which we believe is positioned to be a consolidator of distressed assets and benefit from ongoing capacity reductions in China.

We would also like to emphasize two early-stage themes that took shape over the past quarter. In India, we have been following and researching the restructuring of Tata Sons, one of the oldest, largest, and most diversified industrial entities in the country. Over the past 15 years, the group implemented a global expansion strategy that yielded sub-par results, high leverage, and a deteriorating return on capital profile. We believe that

recent leadership changes at Tata Sons have the potential to yield significant value creation for shareholders in the group's publicly listed entities. Last year, the former CEO of Tata Consultancy Services was promoted to Chairman at Tata Sons, while a respected veteran investment banker assumed the role of CFO. The new leadership's top priority is to divest non-core and/or loss-making entities, reduce leverage, and focus on maximizing profit in its core India businesses. Organic growth, profitability, and return on capital will form the new basis for management accountability and incentive structures at the publicly traded subsidiary level. We now have positions in four Tata Sons companies. In addition to our positions in **Tata Global Beverages Limited** and **Tata Communications Limited**, this quarter we established new positions in **Tata Chemicals Limited** and **Titan Company Limited**. The latter is a high-quality jewelry and gold retailer that we believe could be a major beneficiary of industry disruption given the high-profile default of a competitor.

Comprising a second early-stage theme, we added another investment in the China state-owned enterprise bank sector, **Industrial and Commercial Bank of China Limited**, as we have gained conviction that recent improvements in asset growth, net interest margins, and credit quality are likely sustainable, leading to an acceleration in earnings growth for the first time in several years. We believe recent regulatory measures suggest that we have entered a period of market share gains for the traditional deposit-taking banks after several years of losses to non-bank financial players.

During the quarter, we sold our remaining investments in **Ctrip.com International, Ltd.**, **Banco Santander-Chile**, **LG Household & Health Care Ltd.**, **Sociedad Química y Minera de Chile SA** and **Multi Commodity Exchange of India Ltd.**, given concerns over deterioration in fundamentals or valuation. We also have modestly reduced our China technology holdings, which form the foundation of our internet and e-commerce theme, after a period of material gains by selling Ctrip, and reducing **Baidu, Inc.**, **Bitauto Holdings Limited**, **Alibaba Group Holding Limited**, and **Kingdee International Software Group Co. Ltd.**

## OUTLOOK

In our recent year-end letter, we suggested that the coalescence of improved global macroeconomic momentum, increased forward-looking confidence, and significant fiscal easing in the U.S. via tax cuts and deficit spending was reason to temper enthusiasm in the midst of what appeared an overshoot to the upside in global equities. While, at the time, we could not predict how far the equity uptrend might carry, we remarked that global markets were likely to experience increased volatility and a period of consolidation, if not perhaps a notable correction, as accelerating economic momentum and incremental fiscal easing would likely collide with the necessity for a greater-than-discounted withdrawal of liquidity.

Just after the ink had dried on our year-end letter, global equity markets began a marked correction, with a short-term spike in volatility measures driving spectacular moves in related ETF securities. At the time, many market commentators blamed the liquidation of certain ETF securities for the broader decline in equities. We believe the early-February decline likely foreshadows the consolidation phase we have expected, particularly given the high correlation of market positioning and trading-oriented strategies centered on expectations for a continued low-inflation and low-volatility environment. We don't conclude that this environment has ended; rather, for the first time since the 2008/2009 global financial crisis, we question its sustainability.



# Baron Emerging Markets Strategy

Our baseline expectation for 2018 has been that solid coincident economic and earnings momentum and rising inflation measures would necessitate incremental tightening and liquidity withdrawal by central bankers. Further, we have suggested that renewed policy tightening in China, alongside that already expected in the U.S., may represent a drag on economic growth and earnings expectations at some point this year. One quarter into the new year, we now update our baseline expectation. What has changed is two-fold: first, we have observed several signs that forward-looking, leading indicators of global economic activity may be peaking. A notable slowing of credit growth and trade flows in several countries, and a peak in developed world sovereign bond yields stand out. Second, Donald Trump has opened a Pandora's box with regard to protectionist measures, further illuminating the risk of slower growth and higher inflation. On February 5, 2018, Jerome Powell assumed the position of Federal Reserve Chairman. We believe this has particular significance, as a new Fed Chairman, under pressure to establish credibility, presents a greater risk of reacting to backward-looking data and perhaps tightening into a slowdown.

To us, all of the above supports our view that the record low volatility environment of recent years should not be expected to persist. However, a return to more normalized volatility is not necessarily a bad thing and

would likely present attractive opportunities. While we believe that the recent increase in the equity risk premium is largely appropriate, we are exiting a phase of uber-optimism and we do not currently foresee a scenario worse than a broad consolidation, perhaps ending with a correction should monetary tightening proceed too far. Taking a longer-term view, we remain encouraged by the ongoing foundation of productivity-enhancing reforms in many EM countries, as well as a favorable political shift in the direction of investment, business, and capital market-friendly policies. As always, we continue to believe our unique forward-looking and bottom-up, fundamental approach and process position us well to identify attractive investments as they arise.

Sincerely,



Michael Kass  
Portfolio Manager

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*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.*

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.