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Michael Kass: What's changed and what hasn't for emerging market and international equities

This is an edited version of an April 26, 2022, Q&A with Michael Kass, portfolio manager of Baron Emerging Markets Fund, Baron International Growth Fund, and Baron New Asia Fund; and Anuj Aggarwal, portfolio manager of Baron New Asia Fund; with additional commentary from members of the EM/International research team. To access the recording, please visit our website.

Executive Summary

- EU Mutualization, Defense Spending, and Supply Chain Diversification form a new investment theme we call Global Security. We anticipate a redirection of capital flows into these areas, where previously there has been no substantial spending in the last 10 to 20 years.
- India, in our view, is the most attractive Emerging Markets (EM) destination for long-term investment. We believe India is likely to become the greatest net beneficiary of the new geopolitical environment.
- We see substantial upside and recovery potential in China, particularly for value-add positions such as those in our portfolio which have been hit the hardest.
- During the first quarter, we aggressively began paring back our Russia exposure and have now written down our exposure to essentially zero.
- China's COVID-related challenges and the cumulative impact of financial tightening are beginning to impact growth expectations. We're seeing some demand erosion in commodity and energy prices. We think we may be nearing a bottoming of multiples on growth stocks.

Q&A with Michael Kass, Anuj Aggarwal, and the EM/International Team

To start, please give us a quick recap on first quarter performance.

Michael Kass It has been a very challenging period, particularly for active growth-oriented investors.

For the EM Fund, Russia going to zero was a key detractor, but China had a larger impact on our relative performance as a result of the higher risk premium in the wake of Russia's invasion of Ukraine and the Omicron outbreak in China. We see some adverse impact from long-duration holdings in India and Brazil. Our zero weighting in energy-heavy Saudi Arabia detracted from relative performance. We had positive absolute returns from our Sustainability theme, largely from specialty materials companies that serve the electronic vehicle battery and electrification markets. We also had strength in select Consumer investments.

For the International Growth Fund, the key drivers of underperformance were Digitization holdings. Russian Fintech investments had a negative impact. Select EU Mutualization investments were down on concerns around the growth impact and possible financial contagion related to the crisis in Ukraine.

How do you view the short- and long-term implications for investors of Russia's invasion of Ukraine?

Michael Kass The invasion was unexpected in scope, as was the Western/NATO reaction. In the immediate aftermath of Russia's invasion, geopolitical concerns have subjugated economic and financial interests. We haven't seen this happen in many years.

Do you see any opportunities emerging amid all the volatility and uncertainty?

Michael Kass While we can't predict how the war is going to play out, we can draw some likely longer-term conclusions.

1. Russia is now much more vulnerable and isolated than before February 24th. Unfortunately, it would appear the Russian population is likely to bear the brunt of the economic pain.
2. European defense and security spending will need to rise materially. We also expect EU Mutualization will advance to a new level given shared concerns across Europe.
3. European countries will need to secure localization of supply in key energy, commodity, agricultural, and other markets. This, along with Defense Spending and Supply Chain Diversification, forms a new investment theme we call Global Security. We anticipate a redirection of capital flows to these areas, where there has been no substantial spending in the last 10 to 20 years.
4. India is the most attractive EM destination for long-term investment and is a large overweight position across our strategies. We believe India is likely to become the greatest beneficiary of the new geopolitical environment. It's the largest developing world democracy. It's an ally of the U.S. and NATO members, particularly in Asia. It is highly attractive to multinational manufacturers as a source of supply chain diversification.

What are your thoughts about China's recent COVID-related challenges?

Michael Kass We think the weakness in China equities, particularly the ADR listings where we have material exposure, is due to China's reaction to the current breakout. Its 2020-style, zero-tolerance lockdowns is impacting near-term economic activity, earnings expectations, and investor sentiment.

China equities, especially growth equities, are down 30% to 50% year-to-date, and considerably more since last year's peak. This is not the start of a correction; it's more the capitulation phase. Local Chinese and Hong Kong investors tend to be more focused on short-term trading. We think the markets are too focused on the near-term COVID earnings disruption rather than the long-term earning power of quality franchises. We believe long-term earnings will remain intact for a vast majority of companies in China.

What was your Russian weighting, and is it a complete write off?

Michael Kass Entering the year we had an overweight position, about 6% of the portfolio. During the first quarter we aggressively began paring that back. We had just over 400 basis points of exposure heading into February 24. We have written down our exposure to essentially zero. I think most active managers have written down the carrying value of those positions to zero or near zero.

Have you made any significant changes to the principal themes or weightings in your portfolios?

Michael Kass: For Baron Emerging Markets Fund**,** with the exception of the new Global Security theme, there were no major changes. Because of relative price performance, Sustainability investments became a larger portion of the portfolio. Classic growth stocks were down during the quarter. We added on the margin to our Digitization theme, largely in China. That remains our largest theme weighting, and ended the quarter at just over 27%. The other large theme weightings are EM Consumer at 16%, Sustainability at 14%, India Wealth Management at just over 10%, and Consumer Finance at just under 10%. On a country basis, we reduced Russian exposure and redeployed into Brazil. Early in the quarter we reduced our India weight, which was a big outperformer in 2021, and reallocated to China, which underperformed last year given its aggressive tightening campaign.

For Baron International Growth Fund, other than the Global Security theme, the most significant change was our addition of seven new holdings to the Sustainability theme, which now represents about 16% of assets. We reduced our weighting in the China Value-Added theme. The largest thematic exposure remains Digitization at just under 20% of assets, followed by Sustainability, Biotech, and Diagnostics, all at just above 7%. The Luxury and Global Security themes are about 4.5%.

Let's get updates and theme details from the analyst team.

India

Anuj Aggarwal India has been a large focus in our EM strategy for the past few years, and accounts for about 23% of the portfolio as of March 31. It was one of the top-performing markets in the world last year and remains relatively resilient. Thanks to economic reforms and increasing consumption driven by a growing middle class with rising disposable incomes, we see India entering a virtuous investment cycle. We believe GDP growth can sustain levels of 6% or more over the next seven to ten years.

India's Digital ecosystem is 10 to 15 years behind China, which implies a long runway for growth. We've identified dominant players in industry verticals such as **Bajaj Finance Limited**, the country's largest tech platform with more than 90% market share. **Bundl Technologies Private Limited** is the parent entity of Swiggy, the dominant food delivery and logistics platform. **Reliance Industries Limited**, one of the largest positions in the EM strategy, is becoming India's largest digital services platform by providing value-added services to more than 400 million mobile subscribers. The company has disrupted the telecommunications industry by providing unlimited data access for $2 a month. We've doubled our money since investing three years ago and believe it can double again over the next five years.

Another theme is Indian Consumer Finance. We see a huge opportunity for private sector banks and financial institutions to grow credit. Our Financialization of Household Savings theme targets the pivot from gold, real estate, and deposits into financial products like mutual funds, life insurance, and equities. We're invested in companies such as **SBI Life Insurance Company Limited**, **Max Financial Services Limited**, and **Nippon Life India Asset Management Limited**.

Sustainability

Chingiz Gadimov In our last update, I highlighted two names in the battery metal space: **Glencore PLC** and **AMG Advanced Metallurgical Group**. Both were top contributors for both Funds in the quarter.

We added three investments in Europe that we think will benefit from the shift from Russian natural gas. Our thesis is that the invasion of Ukraine will accelerate plans by many nations, particularly in Europe, to deploy renewables as part of their energy security agenda.

Aker Carbon Capture AS is a European market leader with products that allow the capture of CO^2 emissions from industrial sites. Aker's patented solvents are among the most environmentally safe products on the market, a key competitive advantage.

Ceres Power Holdings plc is a fuel cell technology company. Hydrogen fuel cells help reduce emissions in hard-to-decarbonize sectors and the power sector. Ceres has a proprietary solid oxide fuel technology and partnerships with leading OEMs in Germany, China, and Korea. We like the company's asset-light business model of licensing its technology to partner OEMs, which generates revenue through high-margin royalties and licensing fees.

Meyer Burger Technology Ltd is a Swiss supplier of solar modules. Its next-generation models are more efficient than competitors, allowing for premium pricing and high EBITDA margins. It also aligns with our Supply Chain Optimization and Energy Security themes since its plants are in Germany and the U.S., helping customers reduce reliance on China, which currently supplies 80% of global solar modules.

International Defense / Financials

Jose Barria I want to highlight two investments we initiated over the last six months.

The first is **Korea Aerospace Industries, LTD**, South Korea's leading aviation technology company. It's part of our Global Security theme. It manufactures military aircraft and provides lifetime support for its products. Its businesses include supplying aircraft to the South Korean government, exporting aircraft to other countries, and manufacturing commercial aircraft parts. We think this company is poised to benefit from a recovery in civilian aircraft demand and an increase in international defense budgets.

The second is **PT Bank Rakyat Indonesia,** one of Indonesia's largest banks focused on lending in the microfinance and the SME segments. We like two things about this company. First, Indonesia underwent a severe economic shock from COVID, and its recovery has trailed other markets. During this time, Bank Rakyat built large reserves against potential losses and slowed its new loans originations. It now finds itself with a strong, high-quality balance sheet, which we believe will translate into lower provision expenses. Second, we believe the country is set to enter a new credit cycle with accelerating loan demand. The macro situation has improved in recent months due to rising prices of its main commodity exports. Bank Rakyat has also improved its cost ratio through investments in technology and synergies from the recent acquisition of two smaller banks. We think this bank has reached an inflection point in its earnings trajectory and will likely see an upswing in earnings and profitability.

Consumer

Eric Guzman A key theme over the next year or two will be the impact of inflation on consumption and corresponding shifts in wallet share. A new position for Baron International Growth Fund is Polish food retailer **Dino Polska S.A.** We have been following Dino and talking to management for over two years to build conviction around long-term growth potential and profit drivers. During the quarter, Polish equities sold off on Russia's invasion of Ukraine and inflation across Europe. Dino was caught in that sell-off and we took advantage to initiate a position.

We think grocers are in a better position than other retailers in an environment where consumer discretionary spending is pinched by inflation. Dino has historically generated double-digit same-store sales, 20%+ unit growth, and high returns on capital. That's incredibly unusual for a grocer. We think its current market share of around 4% and 1,800 stores can more than triple at high margins and returns. Here are five key points why:

1. Poland has a much more diversified base of small food producers than other countries, allowing Dino to procure from a fragmented base of local brands rather than large food conglomerates. This creates bargaining power other leading grocers don't have.
2. Dino is vertically integrated. For example, it does its own processing of meat, a core category in the Polish diet and roughly 15% of revenue.
3. Dino builds its own stores so it does not pay 3% of sales on rent as competitors do. The relative cost advantage widens with inflation, which inevitably works its way into competitors' rental expense.
4. Poles are still at an income growth stage where the marginal propensity to consume on staples is higher than most European countries, so wage inflation translates to higher same-store sales.
5. We like the founder, who still owns 51% of the shares and is active in the business. He constantly visits stores and scrutinizes expenses and drives the company's culture.

China Digitization

Eitan Chemerinski In China, we are looking to leverage market volatility to invest in companies with strong competitive advantages and compelling long-term growth opportunities at attractive valuations.

As part of our Digitization theme, we initiated an investment in **Baidu, Inc.**, a leading artificial intelligence company with three main business lines: mobile, cloud, and autonomous driving. Baidu is best known for its mobile ecosystem, which includes China's dominant search engine with more than 620 million monthly active users. This ecosystem should benefit from the double-digit secular growth of China's digital advertising industry as well as new anti-monopoly regulations that require the opening of content across Chinese Internet platforms. We believe these regulations will allow Baidu to expand its search results, improve user engagement, and drive faster advertising revenue growth.

Baidu's cloud business is one of the largest and fastest-growing in China. It's differentiated by an AI solution and focus on higher value SaaS offerings. We expect Baidu cloud can grow 45% over the next few years as it takes share from larger incumbents.

Baidu is also developing autonomous driving technologies. Over the next five to ten years, we could start to see the large-scale commercialization of autonomous robo-taxis in China. We believe Baidu can be a leader in this potentially massive market, since it's already licensing its lower-level driver assistant technology to leading Chinese auto manufacturers, with an order backlog of more than $1 billion.

How and when do you see growth stocks coming back into favor?

Michael Kass We need to see inflation expectations come down. I'm not talking about observed current inflation, which is always a lagging indicator. The leading indicator of forward inflation expectations is when financial tightening begins to impair future growth expectations – when you see demand erode to the point that key inflation drivers begin to moderate. Bond yields rising and credit spreads widening provide more financial tightening than the Fed does directly. The market is a more overwhelming and taming force to inflation and growth.

I would say the impact of China's COVID challenges and the cumulative impact of the financial tightening is beginning to impact growth expectations. Some are now talking about the likelihood of recession, and we're seeing some demand erosion in commodity and energy prices. That suggests we may be nearing a bottoming of multiples on growth stocks. It remains to be seen whether enough financial tightening is priced into markets. Once that starts to run its course, the Fed will likely begin to throttle back and begin to express that it's unlikely to continue hiking rates. If the market has priced in five, six or seven interest rate hikes, I think we'll see growth stocks begin to recover.

I think most speculative, long-duration growth stocks lacking current earnings peaked around February of 2021. That puts us well into a year of compression on those multiples and those stocks. Within emerging markets, we saw material Central Bank hiking and financial tightening last year, in China and Brazil particularly, so emerging markets are well ahead of the Fed in that regard.

Investors should consider the investment objectives, risks, and charges and expenses of the investment carefully before investing. The prospectus and summary prospectuses contain this and other information about the Funds. You may obtain them from the Funds' distributor, Baron Capital, Inc., by calling 1-800-99BARON or visiting www.BaronFunds.com. Please read them carefully before investing.

Baron International Growth Fund's annualized returns for the Institutional Shares as of March 31, 2022: 1-year, -8.35%; 5-years, 10.23%; 10-years, 8.42%; Since Inception (12/31/2008), 10.91%. Annual expense ratio for the Institutional Shares as of December 31, 2021, was 0.96%, but the net annual expense ratio was 0.95% (net of the Adviser's fee waivers). **MSCI ACWI ex USA Index** annualized returns for the as of March 31, 2022: 1-year, -1.48%; 5-years, 6.76%; 10-years, 5.55%; since fund inception, 7.45%. **MSCI**

ACWI ex USA IMI Growth Index annualized returns for the as of March 31, 2022: 1-year, -5.75%; 5-years, 8.67%; 10-years, 6.84%; since fund inception, 8.71%.

Baron Emerging Market Fund's annualized returns for the Institutional Shares as of March 31, 2022: 1-year, -19.20%; 5-years, 4.68%; 10-years, 5.31%; Since Inception (12/31/2010), 4.30%. Annual expense ratio for the Institutional Shares as of December 31, 2021, was 1.08%. **MSCI EM Index** annualized returns for the as of March 31, 2022: 1-year, -11.37%; 5-years, 5.98%; 10-years, 3.36%; since fund inception, 2.32%. **MSCI EM IMI Growth Index** annualized returns for the as of March 31, 2022: 1-year, -15.90%; 5-years, 7.62%; 10-years, 5.00%; since fund inception, 3.57%.

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 expiring on August 29, 2032, unless renewed for another 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 or call 1-800-99BARON.

Baron International Growth Fund: Performance for the Institutional Shares prior to 5/29/2009 is based on the performance of the Retail Shares, which have a distribution fee. The Institutional Shares do not have a distribution fee. If the annual returns for the Institutional Shares prior to 5/29/2009 did not reflect this fee, the returns would be higher.

Baron International Growth Fund's 4Q 2021 historical performance was impacted by gains from IPOs and there is no guarantee that these results can be repeated or that the Fund's level of participation in IPOs will be the same in the future.

Risks: Non-U.S. investments may involve additional risks to those inherent in U.S. investments, including exchange-rate fluctuations, political or economic instability, the imposition of exchange controls, expropriation, limited disclosure and illiquid markets. This may result in greater share price volatility. 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. Securities of small and medium-sized companies may be thinly traded and more difficult to sell.

The discussion of market trends is not intended as advice to any person regarding the advisability of investing in any particular security. The views expressed in this document reflect those of the respective writer. Some of our comments are based on management expectations and are considered "forward-looking statements." Actual future results, however, may prove to be different from our expectations. Our views are a reflection of our best judgment at the time and are subject to change at any time based on market and other conditions and Baron has no obligation to update them.

Portfolio holdings as a percentage of net assets as of March 31, 2022, for securities mentioned are as follows: AMG Advanced Metallurgical Group N.V. – Baron International Growth Fund (2.1%); **Glencore PLC** – Baron International Growth Fund (2.1%); Baron Emerging Markets Fund (3.1%); **Bajaj Finance Limited** – Baron International Growth Fund (1.1%); Baron Emerging Markets Fund (2.1%); **Bundl Technologies Private Limited** – Baron Emerging Markets Fund (0.9%); **SBI Life Insurance Company Limited** – Baron Emerging Markets Fund (1.1%); **Aker Carbon Capture AS** – Baron International Growth Fund (0.8%); **Ceres Power Holdings plc** – Baron International Growth Fund (0.6%); **Reliance Industries Limited** – Baron International Growth Fund (1.4%), Baron Emerging Markets Fund (2.5%); **Meyer Burger Technology Ltd** – Baron International Growth Fund (0.7%); **Max Financial Services Ltd.** – Baron International Growth Fund (0.5%), Baron Emerging Markets Fund (1.0%); **Nippon Life India Asset Management Limited** – Baron International Growth Fund (0.5%), Baron Emerging Markets Fund (0.8%);

Korea Aerospace Industries, LTD, – Baron Emerging Markets Fund (0.6%); **PT Bank Rakyat Indonesia** – Baron Emerging Markets Fund (1.4%); **Dino Polska S.A.** – Baron International Growth Fund (0.6%).

Top 10 holdings as of March 31, 2022

Baron International Growth Fund

Holding	% Assets
AstraZeneca PLC	2.1
Glencore PLC	2.1
AMG Advanced Metallurgical Group N.V.	2.1
Linde plc	2.0
Befesa S.A.	2.0
Arch Capital Group Ltd.	1.9
Nestle S.A.	1.8
Pernod Ricard SA	1.7
eDream IDIGEO SA	1.7
Keyence Corporation	1.6
Total	19.0

Baron Emerging Markets Fund

Holding	% Assets
Taiwan Semiconductor Manufacturing Company Ltd.	5.2
Samsung Electronics Holdings Limited	3.7
Tencent Holdings Limited	3.2
Glencore PLC Bajaj Finance Limited	3.1
Alibaba Group Holdings Limited	2.7
Reliance Industries Limited	2.5
Bajaj Finance Limited	2.2
Suzano S.A.	1.9
Wal-Mart de México,	1.8
Korea Shipbuilding & Offshore Engineering Co., Ltd	1.8
Total	28.4

Portfolio holdings are subject to change. Current and future portfolio holdings are subject to risk.

Non-mutual fund products are available to institutional investors only.

For the period ended 3/31/2022, the Baron International Growth Fund received a 4-Star Overall Morningstar Rating™, 3-Star 3-Year Rating, 4-Star 5-Year Rating, and 4-Star 10-Year Rating. The Morningstar Ratings are based on the Morningstar Risk-Adjusted Return measures of 389, 389, 339, and 224 funds in the category, respectively. This Morningstar Rating is for the Institutional share class only; other classes may have different performance characteristics.

For the period ended 3/31/2022, the Baron Emerging Markets Fund received a 4-Star Overall Morningstar Rating™, 2-Star 3-Year Rating, 2-Star 5-Year Rating, and 5-Star 10-Year Rating. The Morningstar Ratings are based on the Morningstar Risk-Adjusted Return measures of 730, 730, 625, and 352 funds in the category, respectively. This Morningstar Rating is for the Institutional share class only; other classes may have different performance characteristics.

The **Morningstar Rating™** for funds, or "star rating", is calculated for managed products (including mutual funds, variable annuity and variable life subaccounts, exchange-traded funds, closed-end funds, and separate accounts) with at least a three-year history. Exchange-traded funds and open-ended mutual funds are considered a single population for comparative purposes. It is calculated based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a managed product's monthly excess performance, placing more emphasis on downward variations and rewarding consistent performance. The Morningstar Rating does not include any adjustment for sales loads. The top 10% of products in each product category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars, and the bottom 10% receive 1 star. The Overall Morningstar Rating for a managed product is derived from a weighted average of the performance figures associated with its three-, five-, and 10-year (if applicable) Morningstar Rating metrics. The weights are: 100% three-year rating for 36-59 months of total returns, 60% five-year rating/40% three-year rating for 60-119 months of total returns, and 50% 10-year rating/30% five-year rating/20% three-year rating for 120 or more months of total returns. While the 10-year overall star rating formula seems to give the most weight to the 10-year period, the most recent three-year period actually has the greatest impact because it is included in all three rating periods.

The **MSCI Emerging Markets Index** is an unmanaged float-adjusted market capitalization index designed to measure equity market performance of large and mid cap securities in the emerging markets. 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 27 Emerging Markets countries. The **MSCI ACWI ex USA Index Net USD** measures the equity market performance of large and mid cap securities across developed and emerging markets, excluding the U.S. The **MSCI ACWI ex USA IMI Growth Index Net USD** measures the performance of large, mid and small cap growth securities across developed and emerging markets, excluding the U.S. MSCI is the source and owner of the trademarks, service marks and copyrights related to the MSCI Indexes. The indexes and the Fund include reinvestment of dividends, net of foreign withholding taxes, which positively impact the performance results. The indexes are unmanaged. Index performance is not Fund performance; one cannot invest directly into an index.

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