Baron Emerging Markets Strategy

December 31, 2017

Dear Investor:

Performance

Baron Emerging Markets Strategy advanced 6.22% (net of fees) for the fourth quarter of 2017, and 40.88% for the full year, while its principal benchmark index, the MSCI EM Index, gained 7.44% for the fourth quarter and 37.28% for the calendar year. Emerging market equities led global markets throughout a strong year powered by healthy economic growth, strong earnings, and favorable policy support. In addition, elections and political risks were resolved favorably during the latter months of the year in countries such as India, Brazil, Chile, Argentina, and South Africa, helping fuel confidence and valuation support. Looking forward, we believe the recent outperformance by EM and other international equities may be in the early innings, as many countries are introducing productivity-enhancing reforms and political winds have shifted in a market-friendly direction. Further, we are intrigued by an explicit goal in China to gain market and profit share from Western multinationals in high value-added sectors, which we believe could broadly benefit EM corporate earnings. We are pleased with our year-to-date absolute and relative performance, particularly considering our below market beta, which tends to support our relative performance in more challenging market conditions. We remain optimistic that our differentiated discipline and process position us well over the long term to take advantage of substantial investment opportunities across our broad universe.

Table I.
Performance
Annualized for periods ended December 31, 2017

	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]	6.22%	6.47%	7.44%	8.17%
One Year	40.88%	42.25%	37.28%	44.70%
Three Years	9.41%	10.50%	9.10%	11.08%
Five Years	9.60%	10.54%	4.35%	6.49%
Since Inception (January 31, 2011)[3]	7.70%	8.38%	3.00%	4.61%

For the fourth quarter of 2017, while we underperformed the MSCI EM Index, we were comfortable with our performance in a strong market. For the full year, we notably outperformed in what proved an unusually strong year for equities worldwide. More significant, in our view, we have outperformed both the EM Index as well as the vast majority of our peers by a wide margin since the inception of the Strategy seven years ago. During the fourth quarter, the largest driver of adverse relative performance was stock selection effect in the Information Technology (IT) and Consumer Discretionary sectors. Notable corrections in China-based **Bitauto Holdings Limited**, **Baidu, Inc**., and **Sunny Optical Technology Group**, which had all experienced substantial appreciation earlier in the year, drove the poor performance in the IT sector. Similarly, within Consumer Discretionary, **Smiles Fidelidade S.A.** of Brazil and **TAL Education Group** of China also corrected after at least doubling since the beginning of 2017. On the positive side, stock selection supported relative performance in Health Care, driven by a product approval and regulatory reform benefiting **Sino Biopharmaceutical Ltd.** of China, and in Industrials, attributed to **Bidvest Group Ltd.** upon the favorable resolution of the ANC electoral process in

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, 2017, total Firm assets under management are approximately $25.3 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.

[1] 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.

[2] Not annualized.

[3] The Strategy has a different inception date than its underlying portfolio, which is December 30, 2010.

South Africa. For the full year, significant gains were broad based, with stock selection in Consumer Discretionary and IT contributing the most, while our modest cash position in a strong market was the only notable detractor from relative performance. From a country perspective, for the year, stock selection in China, where TAL Education, Sino Biopharmaceutical, Sunny Optical Technology, and **Hangzhou Hikvision Digital Technology Co., Ltd.** each gained over 100%, as well as stock selection in India, Brazil, and Russia drove strong relative performance.

Table II.
Top contributors to performance for the quarter ended December 31, 2017

	Percent Impact
Tencent Holdings, Ltd.	0.83%
Sino Biopharmaceutical Ltd.	0.83
FirstRand Limited	0.45
KB Financial Group Inc.	0.45
Bidvest Group Ltd.	0.39

Shares of **Tencent Holdings, Ltd.** increased on the back of strong fundamentals in its gaming and advertising businesses. The company, which operates China's leading social network and messaging platform (QQ and WeChat), largest online entertainment and media business, and the largest online PC and mobile gaming business, reaches almost a billion monthly users. We estimate Tencent will continue to grow all of its large business segments for years to come given its track record of execution, unique online intellectual property and assets, and scale.

Shares of **Sino Biopharmaceutical Ltd.** rose sharply on strong earnings growth fueled by the launch of key blockbuster drugs. As China's leading pharma player with a key focus on R&D, the company is well positioned to benefit from growing demand for health care services in the country. A fast-changing regulatory landscape will also favor established, innovative players such as Sino Bio, in our view. The company has a robust product pipeline that could potentially generate double-digit earnings growth over the next three-to-five years.

FirstRand Limited is a South Africa-based provider of banking and insurance services to retail and commercial clients. Shares rose on an improved top-down outlook after the country's ruling party elected Cyril Ramaphosa as its new president. We think Ramaphosa's anti-corruption campaign platform could potentially lead to a more disciplined fiscal policy, improved institutional strength, and better economic growth prospects. As the country's highest-quality bank, in our view, we think FirstRand could benefit from these potential changes.

KB Financial Group Inc. provides commercial and consumer financial services in South Korea. The stock rose in the fourth quarter after investor confidence in the country's economic growth rate and policy rate trajectory strengthened. In November, the Bank of Korea hiked rates for the first time since 2011. We believe the rate increase has positive implications for top-line growth at KB Financial and complements other strong bottom-up trends we see for the bank. During the quarter, the company also announced a sizeable share buyback program, which shows its flexibility in using excess capital.

Shares of **Bidvest Group Ltd.**, a leading South African conglomerate, rose during the fourth quarter. Despite a tough macro environment in South Africa, Bidvest reported steady earnings growth in the quarter. Along with other domestically focused businesses, it benefited from the election of a pro reform candidate as the ANC ruling party leader. The company, which operates in areas including financial services, automotive dealerships, electrical equipment, and freight services, maintained its stellar track record in creating shareholder value by investing in asset-light, high ROIC businesses.

Table III.
Top detractors from performance for the quarter ended December 31, 2017

	Percent Impact
Bitauto Holdings Limited	–0.29%
Ctrip.com International, Ltd.	–0.23
Sunny Optical Technology Group	–0.21
Eclat Textile Co., Ltd.	–0.21
TAL Education Group	–0.20

Bitauto Holdings Limited is one of two dedicated online auto financing platforms in China. Shares declined in the quarter following significant gains earlier in 2017 due to profit taking. We retain conviction in Bitauto because the company's core fundamentals remain intact. Online auto advertising and financing sectors remain poised for multiyear growth in China, and Bitauto remains a top player to benefit from that trend.

Ctrip.com International, Ltd. is the dominant online travel agent in China. Shares fell in the fourth quarter amid investor concerns about a new Chinese regulation on cross-selling travel methods. We retain conviction. Management believes Ctrip will adjust accordingly, and we think Ctrip's international air business, a rapidly growing segment with high margins, will offset the negative impact of the regulation. Ctrip is well positioned to capitalize on the growing dominance of Chinese travelers globally, and its 1 trillion RMB bookings target by 2020 is achievable, in our view.

Sunny Optical Technology Group is an integrated manufacturer of optical-related products in China. Its core business consists of handset camera modules and lenses, as well as vehicle lenses. After a significant run, shares retreated as a result of profit taking and market noises on the smartphone market. We maintain our long-term positive view on the stock as Sunny continues to gain market share in the camera lens business and is creating new growth drivers such as 3D sensing applications.

Eclat Textile Co., Ltd. is a Taiwanese supplier of high-tech nylon to the global sportswear industry. Shares fell during the fourth quarter because while the company is the best in its industry, it has been hurt by weak business trends among its customers. We retain conviction. In our view, Eclat possesses strong competitive advantages in fabric and garment technologies that allow it to operate at near-full capacity. With its strong pricing power, it enjoys solid revenue growth, high and stable margins, and high returns on capital.

TAL Education Group is a leading Chinese K-12 tutoring company, operating 575 learning centers in 36 cities across China. Shares declined in the fourth quarter due to market disappointment following a reduction in gross margins related to the rapid expansion phase TAL entered in 2017. We maintain conviction in TAL as a tutoring market leader with the opportunity to continue gaining market share for many years due to the strength of its brand and the vast opportunity ahead.

Portfolio Structure

Table IV.
Top 10 holdings as of December 31, 2017

	Percent of Net Assets
Tencent Holdings, Ltd.	4.2%
Alibaba Group Holding Limited	4.1
Baidu, Inc.	3.2
KB Financial Group Inc.	2.3
Samsung Electronics Co., Ltd.	2.1
Sino Biopharmaceutical Ltd.	1.9
Sberbank of Russia PJSC	1.8
Maruti Suzuki India Ltd.	1.8
Taiwan Semiconductor Manufacturing Company Ltd.	1.7
WH Group Limited	1.6

Exposure By Country

Table V.
Percentage of securities by country as of December 31, 2017

	Percent of Net Assets
China	31.5%
India	18.3
Korea	6.6
Brazil	6.0
Taiwan	5.2
South Africa	4.6
Mexico	4.2
Argentina	3.7
Russia	3.2
Philippines	2.5
Indonesia	1.9
Hong Kong	1.8
Panama	1.1
Singapore	1.1
Malaysia	1.0
United Kingdom	0.9
Chile	0.7
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 fourth quarter of 2017, the Strategy's median market cap was $11.8 billion, and we were invested approximately 76.8% in large- and giant-cap companies, 16.8% 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 initiated several new positions, including two new investments with China A share listings that square with our theme of domestic Chinese businesses targeting global multinationals' share of mainland profits in value-added industries. **Yunnan Baiyao Group Co., Ltd**. is a 100+ year old company focused on traditional Chinese medicine-based pharmaceutical and personal health products. The company holds the country's #2 market position in toothpaste behind Colgate, and has targeted brand extensions in shampoo and other personal care categories. We believe Yunnan is a likely beneficiary of state owned enterprise reform, as private shareholders gained majority control of the company in early 2017 with plans to aggressively target organic and M&A driven growth. In conjunction with the reform above, a recently instituted management incentive plan suggests to us improved corporate and capital efficiency with an emphasis on long-term shareholder value. **Kangde Xin Composite Material** is a leading research-driven, Chinese manufacturer of specialty films and materials, which has steadily been moving up the value-added curve to produce optical films used in LCD and OLED displays, energy efficient glass, and automotive and home appliance applications. We believe the company is currently the only vertically integrated manufacturer in China capable of competing head-to-head with global multinational leaders such as 3M, Eastman Chemical, and LG Corporation. We suspect further market share gains and product extensions, particularly in areas related to environmental protection, are forthcoming. The company was recently listed by Forbes as #47 on its list of the World's Most Innovative Companies. Further, Kandge Xin is a well-managed private sector company with an entrepreneurial culture, with the founding CEO and other employees owning a significant stake. Our third new investment in China during the quarter was **China Construction Bank Corporation ("CCB")**, our first investment in a Chinese state-owned bank, in consideration of our view that China is successfully managing a necessary transition in economic priorities while improving financial stability and credit quality. We believe the competitive environment in China is shifting in favor of the major banks, and that CCB is in a strong position, given its attractive, low-cost deposit base as liquidity to the non-bank financial sector wanes and yields on incremental loans gradually rise. During the quarter, we also made initial investments in **Tata Global Beverages Limited**, a high-quality consumer group in India, **Loma Negra Compañía Industrial Argentina Sociedad Anónima**, Argentina's leading cement producer, and **Petróleo Brasileiro S.A. – Petrobras**, the leading Brazilian oil & gas group, where we believe management and governance changes have driven solid progress on restructuring and deleveraging, and where we perceive an attractive foundation for future shareholder value creation.

During the year, we developed and invested in new themes related to broad reforms in Argentina, the wealth management sector in India, and in emerging leaders in innovative and intellectual capital-based companies in China. This last theme is focused on value-added industries such as biosciences, consumer products, automation, and artificial intelligence.

During the quarter, we exited several positions due to longer-term fundamental concerns or changes in management or corporate strategy. Such sales include **Catcher Technology Co., Ltd.** and **Novatek Microelectronics Corp**., both Taiwanese providers of smartphone, display and supply chain solutions, **Amara Raja Batteries Limited** of India, and **Steinhoff International Holdings N.V.**, a South Africa-based furniture manufacturer and retailer where we became concerned over an excess of acquisition-related activity. We also exited our position in **Grupo Financiero Banorte, S.A.B de C.V.** because we were uncomfortable with a related-party acquisition as well as upcoming election risk in Mexico.

OUTLOOK

In our recent quarterly letters, we suggested that EM economies and equities had entered a sweet spot and were likely to exhibit sustainable outperformance. In addition, last quarter, we highlighted the positive implications of stable real economic growth and improving credit quality in the Chinese banking system in the context of a tightening of credit to the housing market and the speculative financial economy in China. Given the ongoing strength of the global economy and a contained outlook for inflation, we concluded that the odds of a near-term overshoot to the upside in global (and particularly international and EM equities) were rising. As global growth demonstrated clear acceleration in the fourth quarter amid passage of stimulative tax legislation in the U.S., we believe this overshoot is now underway. While we have no prediction regarding when optimism will subside in the near term, on a forward looking basis, we believe the global markets are likely to experience increased volatility at some point in the year ahead, and we would not be surprised to see the first notable market correction in some time.

The principal reasons for the shift in our outlook since last quarter are the coordinated acceleration in global growth and rise in confidence, as well as a notable change in official policy orientation in China following the key Party Congress in November. While strong global growth is certainly a good thing, we believe the downside of elevated confidence is a likely rise in future inflation readings and risk of economic overheating; indeed, energy and commodity prices are already on the rise along with bond yields in several countries. Although equity markets are currently embracing the message, we believe it is likely a matter of time before tight labor conditions drive wage inflation, which we believe would elevate fears of more global tightening than the market is currently discounting. In our view, the balance of a strong economic environment alongside the rising risk of incremental liquidity tightening suggests higher volatility is coming, eventually resulting in a consolidation or broad trading range environment. Importantly, we feel such a consolidation would be a healthy development, curing excess optimism rather than foreshadowing a more concerning decline.

Regarding the policy shift in China, we were somewhat surprised by the abrupt and comprehensive nature of the communiqués. To summarize, our takeaway is that liquidity and credit to the property, non-bank financial, and asset management sectors will be further constrained. We also expect the relaxation of consumer credit availability to be partially reversed. It is clear China will prioritize a cleaner environment, as well as productivity enhancing and value-added sectors such as Health Care and IT. On balance, we believe economic and credit growth in 2018 is likely to slow on the margin, though financial risks will likely remain contained. To us, the key implication is that while China represented an upside surprise to global growth, corporate earnings, and equity performance in 2017, it may represent a modest drag on growth and earnings expectations in the year ahead. As active stock pickers, we remain focused on the longer-term beneficiaries of the many significant changes occurring in China, and would opportunistically view a correction driven by a pause in growth momentum.

While a market consolidation after the kind of equity appreciation experienced globally in 2017 would not be surprising, we continue to believe that EM outperformance is sustainable, particularly following any global correction. We remain encouraged by ongoing productivity-enhancing reforms in many EM countries, particularly in China and India, two large weights in the EM universe and our largest exposures by country. In addition to these factors, China's efforts to gain market share from Western multinationals in high value-added sectors, as well as the fact that most EM economies are less advanced cyclically than economies of more developed countries, suggest to us that EM equities may exceed our expectations when more challenging market conditions emerge.

In conclusion, while we remain in a sweet spot for EM economic growth and corporate earnings, the marked appreciation of the past year, high current optimism, and a likely moderation of abundant global liquidity support cause us to temper expectations for further substantial gains in the near term. However, the longer-term and more secular drivers remain encouraging, and we believe our unique, forward-looking, and bottom-up, process positions us well to continue to identify attractive EM investments as they arise.

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.

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.

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