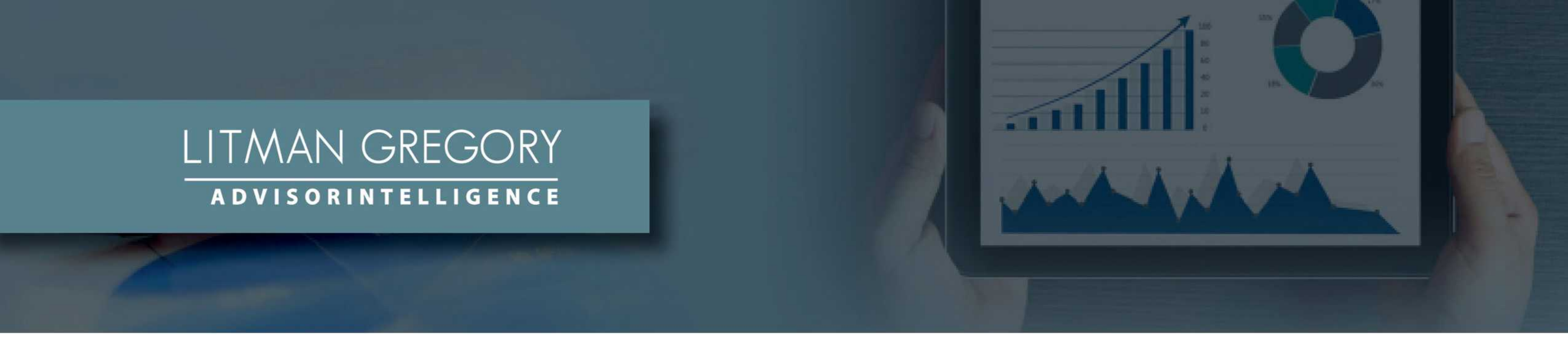

Baron's Michael Kass: Recent Challenges in China and India

December 2018

We recently had a conversation with Michael Kass, portfolio manager of Baron Emerging Markets (BEXIX, BEXFX) and Baron International Growth (BINIX, BIGFX). Foreign equity markets have had a challenging 2018, and we thought it would be useful to share Kass's perspectives on the markets and the portfolios he manages.

Kass believes emerging-market (EM) performance has largely been driven by the impact of unconventional U.S. policies, particularly regarding trade. Kass says uncertainties around shifting geopolitical relationships are significant and have led to a higher risk premium being applied to EM stocks.

A Downdraft in China Stocks

Kass says many of the Chinese names he owns were down significantly from their January 2018 peak, due in large part to trade tensions with the United States. He expects China won't bear the burden alone, and that the United States will also face adverse consequences from a trade war. If relations continue to deteriorate and a cold trade war scenario plays out between the two countries, economic consequences could include slower growth and higher inflation. In addition, the state could increasingly intervene in economic activity and crowd out private-sector activity. For investors, the result would be lower returns on capital and lower multiples. Kass says, "We're in the very early innings, and it's way too early to conclude anything."

Some of the stocks that have been negatively impacted this year make up Kass's "China value added" theme. This theme is based on the potential for mainland Chinese companies to take market share from foreign-domiciled multinational companies. "Made in China 2025" is a government-directed strategic initiative to move China's manufacturing capabilities up the value chain. Kass and his team have identified Chinese companies that potentially stand to benefit from capturing a higher share of profits at the expense of multinational competitors. Some of these names include Kangde Xin Composite Material Group and Yunnan Baiyao Group, which were each down about 30% between the end of the first quarter of the year and mid-November. Currently, this theme has a roughly 7% allocation in the EM strategy. The team mitigated some poor performance by reducing exposure across the full Chinese portfolio by around five percentage points in June as the markets were rallying on hopes that trade negotiations would resolve tensions. Kass says, "We had high conviction there was very low probability that the U.S. wanted any kind of an agreement [before] the midterm [elections]." Since that time, the market's consensus view has more or less aligned with Kass's, and risk premiums have blown out. As a result, the team has more recently been adding to names where the market has repriced the risk premium to levels deemed too high.

Positive Reform Outlook in India Despite Recent Setback

The funds' Indian financial holdings were also challenged in the second half of the year, but for different reasons. Kass believes the overall reform story in India is very attractive due to it being the EM country with the highest participation by private-sector entrepreneurs (entrepreneurial management is an important consideration for Kass). The election of prime minister Narendra Modi brought about demonetization and tax-reform policies with the hope of encouraging greater use of financial assets by the general population. Demonetization "flooded the system with deposits" at financial institutions and allowed India to achieve high credit growth. Earlier this year, however, a government-affiliated infrastructure lending entity called IL&FS (not owned in either portfolio) missed interest and principal payments on outstanding debt—an event that led to a shorter-term liquidity crisis in India.

Indian financials stocks, including those owned by the team, fell sharply in the aftermath as funding costs rose and credit growth—which had been running between 20% and 30% in India—fell to between 10% and 15%. As a result, earnings prospects for this sector diminished. Portfolio holdings Edelweiss Financial Services and JM Financial, two of the three biggest players in the Indian asset management industry, saw their stock prices fall by around 36% and 25%, respectively, in the third quarter of 2018. The portfolio's India exposure fell from around 17% to around 12% at the trough of the crisis. About half that change was due to actively trimming out of names right after the IL&FS default to try to limit exposure to the negative fallout. Both financial and non-financial Indian names were trimmed (non-financial names like Maruti Suzuki were trimmed because of the second-order effect from a worse credit environment resulting in a slower growth rate for credit-dependent companies).

Kass says, "The ease of credit conditions became too easy for a period of time," which he believes induced the liquidity crisis. But he maintains long-term conviction in the companies he owns, and despite their slightly diminished earnings prospects he says, "We think the best and highest-quality companies with the greatest capital and credit controls are going to be gaining market share. We think that would apply to the companies we own."

Litman Gregory Opinion

Our conversations with Kass throughout the many years we have known him have continuously reaffirmed our confidence in his execution of his investment discipline, including factors we believe will allow him to beat his average peer and benchmarks. Kass believes the best way to compound wealth is to invest in businesses with long-term competitive advantages and substantial open-ended, long-term growth potential. Importantly, these businesses need to be run by entrepreneurs with the strategic vision and financial sophistication to sustain an above-average return on capital, and who have also instituted shareholder-friendly corporate governance. When he doesn't see these characteristics, he will not invest.

These funds haven't been able to avoid the difficulties that have troubled international and emerging markets during 2018. But longer-term results remain significantly better than the benchmarks. The performance of both funds since their respective inception dates has been strong. Baron International Growth has gained 10.34% annualized (since its 12/31/2008 inception date through 11/30/2018), compared to the 7.13% gain of the MSCI ACWI ex USA Index over the same time period. Baron Emerging Markets has gained 3.75% annualized (since its 12/31/2010 inception), beating the 0.58% annualized return of the MSCI Emerging Markets Index over the same period.

We believe Baron Emerging Markets and Baron International Growth will beat their benchmarks over the long term. Our confidence stems from Baron Capital's disciplined long-term approach to growth investing and portfolio manager Kass's superior understanding of long-term themes and business models, including a prudent macro-risk overlay, which we believe is especially important to have in emerging markets. We continue to recommend both Baron Emerging Markets and Baron International Growth.

—Alistair Savides, CFA, and Rajat Jain, CFA

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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 Emerging Markets Fund's annualized returns for the Institutional Shares as of December 31, 2018: 1-year, -18.49%; 5-years, 1.96%; Since Inception (12/31/2010), 3.30%. Annual expense ratio for the Institutional Shares as of December 31, 2017 was 1.10%.

Baron International Growth Fund's annualized returns for the Institutional Shares as of December 31, 2018: 1-year, -17.68%; 5-years, 2.63%; Since Inception (12/31/2008), 9.52%. Annual expense ratio for the Institutional Shares as of December 31, 2017 was 1.13%, but the net annual expense ratio was 0.95% (restated to reflect management fee reduction from 1.00% to 0.88% and current expense waivers).

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 has reimbursed certain Baron Fund expenses (by contract as long as BAMCO, Inc. is the adviser to the Fund) 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.

The International Growth Fund'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.

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. 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 Funds invest 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 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 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 are subject to change. Current and future portfolio holdings are subject to risk.

Baron Emerging Markets Fund holdings as a percentage of net assets as of December 31, 2018 for securities mentioned are as follows: **Yunnan Baiyao Group Co., Ltd.** – 0.9%; **Kangde Xin Composite Material** – 0.6%; **JM Financial Limited** – 0.6%; **Edelweiss Financial Services Limited** – 0.3%.

Baron International Growth Fund holdings as a percentage of net assets as of December 31, 2018 for securities mentioned are as follows: **JM Financial Limited** – 0.6%; **Kangde Xin Composite Material** – 0.3%.

For information pertaining to iShares, please refer to that firm's website.

MSCI ACWI ex USA Growth Index captures large and mid-cap securities exhibiting overall growth style characteristics across 22 Developed Markets countries and 24 Emerging Markets countries. The growth investment style characteristics for index construction are defined using five variables: long-term forward EPS growth rate, short-term forward EPS growth rate, current internal growth rate and long-term historical EPS growth trend and long-term historical sales per share growth trend. **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 index performance is not fund performance; one cannot invest directly into an index.

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Baron Emerging Markets Fund Top 10 Holdings as of December 31, 2018

Holding	% Holding
Tencent Holdings Limited	3.3
Alibaba Group Holding Limited	2.4
Taiwan Semiconductor Manufacturing Company Ltd.	2.4
China Tower Corporation Limited	2.3
Samsung Electronics Co., Ltd.	2.3
Petróleo Brasileiro S.A. – Petrobras	2.1
China Mobile Ltd.	1.7
KIA Motors Corporation	1.7
Rumo S.A.	1.7
WH Group Limited	1.6
Total	21.5

Baron International Growth Fund Top 10 Holdings as of December 31, 2018

Holding	% Holding
AstraZeneca PLC	2.9
argenx SE	2.6
Nokia Corporation	2.5
Danone SA	2.2
Constellation Software, Inc.	2.2
Mellanox Technologies Ltd.	2.1
Golar LNG Ltd.	1.8
Linde Public Limited Company	1.6
Aena SME, S.A.	1.6
Abcam plc	1.6
Total	21.1

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