BARON CAPITAL

Michael Kass: Catalysts for Emerging Market and International Growth Equities

This is an edited version of a July 21, 2022, Q&A with Michael Kass, portfolio manager of Baron Emerging Markets Fund, Baron International Growth Fund, and 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

- We're seeing emerging catalysts suggesting a reversal or a mean reversion in favor of growth. In our view this is not a time to be reducing growth exposure.
- While the Fed may overshoot, when it does indicate a pause in rate hikes, we should see a significant equity rally and one that could very well be led by growth stocks.
- Despite significant headwinds — Russia's Ukraine invasion and Russian equities being marked to near zero, China equities battling geopolitical headwinds and COVID-related shutdowns, the dollar spiking to a new cycle high —emerging market (EM) equities still managed to modestly outperform the S&P 500 Index year-to-date.
- In our view, the selloff has created attractive investment opportunities. Some of our highest conviction ideas are now trading at reasonable valuations almost entirely due to multiple compression. There's been no change to company fundamentals or earnings durability, the key metrics we track and validate to retain conviction in our investments.

Growth equities have underperformed materially in recent quarters. Can you provide some historical context?

Michael Kass: There have been four or five major cycles of growth underperformance over the last 20 years, so the market shift from growth to value that we've just seen is not out of the ordinary. That said, this recent phase of growth underperformance is as large or larger than any on record. To us, that signifies the repricing is largely behind us. Near term, we think there's a greater likelihood that growth will begin to recover and outperform rather than extend its underperformance. We're already seeing emerging catalysts suggesting a reversal or a mean reversion in favor of growth. In our view this is definitely not the time to be reducing growth exposure.

What are the catalysts driving this inflection point?

Michael Kass: While the Fed has more work to do to get to the endgame, what matters most is what's already been priced in. During much of the year-to-date period, the market perceived the Fed as being behind the curve. Later in the second quarter, the Fed took a much more aggressive tone and committed to taming inflation at the expense of employment growth. Fed funds rate expectations rocketed higher to about a peak of 3.75%, easily 100 basis points higher than it was previously.

In other words, in shifting to a single mandate targeting inflation, the Fed re-established its inflation-fighting credentials with the market. Coincident with this, we saw a major inflection point in sentiment;

the market shifted from worries about inflation to worries about a recession. Evidence is mounting that, since reaching a peak in recent months, five-year breakeven inflation expectations have come down from over 3.7% to about just over 2.6% at the end of the second quarter. Two-year inflation forecasts dropped from almost 5% to 3.3%. We've seen oil, copper, and lumber stock prices down 15% to 40%, 10-year Treasury yields declining from 3.5% to just under 3%, and real Treasury yields down materially.

This happened at the same time the risk of COVID-related lockdowns in China lessened, which further supports the idea that we are now past peak inflation panic. Together, these are the major catalysts for a recovery of growth’s relative performance. Indeed, that's what we saw begin to play out in June. As a result, we feel much better about the prospect of growth outperformance relative to value.

The question for absolute returns over the near- and intermediate-term is whether the Fed will pause or pivot before the odds of a recession hit 100%. We think the Fed will not raise rates as much as what has already been priced in. While the Fed may overshoot, when it does indicate a pause in rate hikes, we should see a significant equity rally and one that could very well be led by growth stocks.

International and EM equities are perceived as vulnerable in periods of rising inflation, rising interest rates, and a strong dollar. How should investors be thinking about ex-U.S. equities?

Michael Kass: In our view, a taper tantrum, if you will, has already occurred. We’ve already seen EM and international equities markedly underperform.

China and other EM countries had already tightened financial conditions and liquidity long before the Fed began to move. China, the largest weight and an anchor for the EM asset class, is now well into an easing campaign. Because inflation is contained, we see China's economic and earnings growth outlook improving while the outlook for the U.S. and many other countries is now deteriorating. Brazil has already hiked rates by over 1,100 basis points in just over a year, way ahead of the Fed. In China, Brazil, and India, at least on a two-year basis, real rates have already adjusted to positive or near positive.

The Fed was terribly behind the curve; it's now catching up, which has led to a huge dollar rally. That rally has already hurt ex-U.S. equity performance. While the strong dollar is perceived as a headwind, so much has already been priced in. From a longer-term investment view, we would suggest the dollar is likely well overvalued now. As soon as the market sniffs out that the Fed is nearing a pause, we expect the dollar may experience a major letdown. Given the historic discounts in international and EM valuations, we see improving relative earnings growth prospects for ex-U.S. countries.

Even with significant headwinds — Russia’s invasion of Ukraine and Russian equities being marked to near zero, China battling geopolitical and COVID-related concerns, the dollar spiking to a new cycle high — as of June 30th, EM equities modestly outperformed the S&P 500 year-to-date and materially outperformed the U.S. and global indexes in the second quarter. That outperformance is unusual in a bear market environment and is likely signaling that we're nearing a potential major long-term inflection point with relative performance shifting in favor of ex-U.S. equities, in our view.

India underperformed in the second quarter. What triggered this?

Anuj Aggarwal: We retain high conviction in India as a standout long-term investment destination. Shorter-term, our India investments underperformed this quarter as part of the global growth equity selloff. Inflationary pressure, especially driven by high oil and other commodity prices, was the key driver of the underperformance. India imports 80% to 85% of its oil. Clearly, that created pressure from a government fiscal and currency perspective and near-term earnings headwinds for a lot of businesses.

That said, we remain encouraged by the economic reforms being implemented in India. In addition, India stands to benefit from the tectonic geopolitical shifts playing out in the aftermath of the Russian invasion of Ukraine and growing trade and geopolitical tensions between China and the U.S. India has increasingly pivoted towards the U.S. and other Western powers, both from an economic and military perspective, which the West is viewing as a strategic counterweight to a rising China in the Asian region.

The market selloff has created attractive investment opportunities in India. Some of our highest conviction ideas are now trading at reasonable valuations due largely to multiple compression. There's been no change to company fundamentals or earnings durability, the key metrics we track and validate.

One example is **Bajaj Finance Limited,** a top 10 position in the EM strategy. We see Bajaj as a best-in-class business run by a best-in-class management team. It's a high-growth, non-banking financial institution that is transforming into India's largest fintech platform with an omnichannel sales and distribution strategy. Bajaj is part of our India consumer finance theme, which we believe will be a high-growth sector for a couple of decades due to very low penetration levels for consumer credit in India — about 13% compared to the U.S. at 75% to 80%. While company fundamentals have arguably improved with increased earnings visibility and stellar asset quality coming out of COVID, Bajaj sold off by about 25% to 30% during the quarter and started trading at a PEG [price/earnings-to-growth] valuation of about 1X, an attractive level for a high-growth, high-quality, consumer-facing franchise generating in excess of 20% plus ROEs. We expect Bajaj to sustain 25% earnings growth over the next three to five years and believe we can double or triple our investment in that time.

We've owned **Titan Company Limited** for the past few years. Titan is India's largest organized retailer of jewelry and related accessories. It's a $30 billion-plus industry but extremely fragmented. Titan is the largest player but only commands about 7% to 8% market share, creating an opportunity for double-digit earnings growth for years as Titan gains dominance and consolidates the industry. Market share gains are also being driven by structural reforms, such as the Goods and Services Tax and Anti-Money Laundering Act that disproportionately favor organized retailers with good corporate governance standards such as Titan. Titan has solid brand recall among consumers and stellar business execution in terms of new store rollouts, product design, and development, which has generated 20% revenue growth over the past five years. Management anticipates 20% growth over the next five years as well.

China outperformed in the quarter, which probably surprised many investors. Do you think that strength is sustainable?

Michael Kass: While we never adhered to the popular sentiment that China had become "uninvestable" – and stayed invested in the country -- we were also somewhat surprised by how quickly Chinese equities have begun to recover and sentiment is improving.

China is probably the one jurisdiction staring at improving economic growth and corporate earnings in the near term. Valuations, even after solid recent outperformance, remain quite depressed in our view. Barring another major COVID wave that triggers a complete lockdown, which we see as a near zero probability, we believe the rally that began in the second quarter is sustainable.

Our China portfolio has three major buckets. The first is digitization. Global investors have already capitulated on fears of regulatory tightening and potential delisting in the U.S. Just a couple months beyond that capitulation, we see cause for optimism on both fronts. We think earnings growth is poised to pick up in the second half and beyond.

The second bucket is China value-added. China's economic and policy priorities have shifted to areas like electronic vehicles, the semiconductor ecosystem, software, automation, biopharma, and advanced manufacturing. We believe China's leaders in these industries will gain share at the expense of global multinationals for the next decade and beyond.

The third bucket is consumer. We own high-quality beneficiaries of domestic consumption and rising per capita income. China is one of the few regions where consumption has already been depressed and is likely to begin to recover.

We have some additional investments that relate to our sustainability, decarbonization and clean environment theme. We really like those as well.

Russia's invasion of Ukraine triggered a serious energy crisis in Europe. Does this impact your positioning?

Michael Kass: In the short term, Europe is probably more vulnerable to a recession, or at least weaker earnings for companies exposed to discretionary consumption. Higher energy costs will likely take a considerably greater share of disposable income. Longer term, the crisis is symptomatic of a global pivot in which countries will seek more self-sufficiency. We think this trend will give rise to many investment opportunities. We are investing in companies that should benefit from shoring up the security of energy and commodity supplies and diversifying supply chains. We see a major global capital investment cycle ahead that will translate to greater pricing power for companies that facilitate this de-globalization. We view this as a partial unwinding of the WTO globalization wave over the past 20 to 30 years, which was about outsourcing, offshoring, and reducing capital investment. This is a regime shift that represents, to a degree, a transfer of wealth and earnings power from Western consumers to the owners of real assets and beneficiaries of that capital investment cycle. This type of cycle has always favored ex-U.S. economies and equities because they are more sensitive or weighted towards that type of activity.

What other themes or investments would you highlight?

Anuj Aggarwal (India): **WuXi Biologics Cayman Inc.**, part of our China value-added theme, is China's largest contract manufacturer of biologics, with a 75% to 80% market share, and the second largest in the world. The stock sold off significantly due to geopolitics and investor fears on China, but there had been no material change in company fundamentals. We viewed this as an attractive buying opportunity.

Chingiz Gadimov (research analyst, international industrials): **Estun Automation Co., Ltd.**, also part of our China value-added theme, is one of China's largest industrial robot manufacturers and, in our view, its most advanced robotics player with the highest quality customer base. It commands up to a 20% premium relative to domestic competitors. We like the growth opportunity for robotics in China due to secular trends including its aging labor force and low penetration of robots. Estun is well positioned to consolidate the local robotics market and should grow from less than 4% market share last year, when we initiated a position, to 12% by 2025. We also expect margin expansion and ROE growth from mid-single digits to 20% due to increased scale and vertical integration with domestic suppliers. Shares were down almost 50% because of fears of the global slowdown and lockdowns in China, yet Estun gained market share and grew volumes more than 25% in the first quarter. We think it will grow 50% in 2022.

Full Truck Alliance Co., Ltd. is the world's largest digital freight platform by gross transaction value. It has transformed China's road transportation industry by pioneering a digital platform that connects shippers with truckers to fulfill shipments across geographies. Legacy solutions are still very inefficient, often resulting in long idle times and empty return trips which are also bad for the environment. Full Truck solves these issues by optimizing loads and removing expensive middlemen, the key source of its pricing power. We think it can double its user base over the near term based on major pent-up demand.

Jose Barria (research analyst, international financials): We reinvested in **Dlocal Limited**, part of our fintech and digitization themes, after a 65% drop in the share price over the last year. Dlocal is a Uruguay-based company that facilitates cross-border payments in emerging markets for global merchants. It’s often very difficult for foreign companies to accept payments in EM countries as they must set up a local legal entity, navigate complex regulatory and taxation requirements, find local partners for processing, and find a way to minimize fraud and maximize conversion rates, a complex and cumbersome process. Dlocal can do all that. A handful of companies do this globally, but none can access as many emerging markets as Dlocal. The company scores highly in customer service and transaction conversion rates, or the percentage of transactions initiated approved for payment. Dlocal's client list includes global enterprise players like Google, Facebook, Netflix, and Spotify. We think there's a massive opportunity for Dlocal to grow its payment volumes over time.

The total value of e-commerce transactions in countries where Dlocal operates was about $1.2 trillion in 2020. We expect that value to grow at a roughly 30% CAGR over the next five years, driven by the globalization and digitization of commerce, particularly in EM, the shift from cash to digital payments, increasing purchasing power of the growing middle class in these markets, and the search for new markets for companies that traditionally started in the developed world.

Hong Kong Exchanges and Clearing Limited (HKEX) operates the only stock and futures exchanges in Hong Kong. Its earnings tend to be tied to the capital market cycle, but we see several structural tailwinds. We took advantage of the China-related selloff to build a position in in all three portfolios.

We're seeing signs of an improving regulatory environment in China, as we reach the end of the anti-monopoly and cybersecurity reviews conducted earlier this year. We believe this loosening should open the door for a rebound in capital raising activity across key categories such as internet and technology, which, in turn, should drive higher volumes for HKEX in the near term. Longer term, we think ongoing U.S.-China tensions will increase the appeal of HKEX as a primary listing destination for major Chinese ADRs and IPOs. We believe this migration of liquidity from the U.S. exchanges to Hong Kong will drive a material enhancement in the company's earnings power over the next couple of years.

Eric Guzman (research analyst, international consumer): Coupang, Inc., a new position for us, operates the largest e-commerce portal in South Korea. We think of it as the Korean Amazon. Coupang is an example of how we opportunistically invest in high-quality companies when valuations get dislocated. Coupang IPO'd in early 2021 at the relative peak of high-growth internet stocks and subsequently sold off, in part due to some COVID-related earnings misses but more due to multiple compression across its peer group. By 2Q22, the stock was trading more than 70% below its IPO price.

Coupang has one of the deepest proprietary logistics networks in any market globally. It has its own warehouses, trucks, and couriers that deliver orders and pick up returns door-to-door several times a day. Its scale and drop density allows Coupang to offer unmatched delivery speeds and service levels. We have seen this type of high service level become a key driver of market share in other countries and believe it is a durable competitive advantage for Coupang that was no longer reflected in its valuation.

Coupang's 1Q22 earnings results offered reassurance that the COVID-related headwinds plaguing its 2021 results were subsiding. Margins in its core e-commerce business turned a corner and started to rise. Coupang's revenue growth, which has historically been based on selling low-margin staples, is mixing toward higher-margin streams, like third-party marketplace sales, advertising, and subscription, which bodes well for long-term profitability. We think Coupang is a best-in-class e-commerce business on route to dominating its home market that was trading at distressed levels, and we took advantage of that to build a long-term position.

Eitan Chemerenski (research analyst, international technology): As part of our China value-added theme, I would like to highlight **ACM Research, Inc.,** a leading Chinese supplier of semiconductor production equipment, the tools used to manufacture semiconductors. Last year, China spent around $25 billion on this equipment, nearly a quarter of global spend and almost twice as much as the U.S. Although China is one of the biggest consumers of this equipment, it imports 90%.

As China considers semiconductor self-sufficiency a critical strategic and economic priority, it is supporting a technological and industrial upgrade to localize more of this business. We expect China's semiconductor production capacity to double over the next five years as a result of this initiative. This massive capacity expansion, coupled with the push to replace foreign equipment suppliers, represents a major growth opportunity for ACM, as it is one of the few China-based equipment companies with truly differentiated, globally competitive technology. ACM is best known for its unique megasonic technology, a cleaning tool that removes contaminants from the semiconductor wafer surface, increasing chip yield. We believe ACM's cleaning tool is more effective than conventional methods. Its competitive advantage is reflected in ACM's above-industry gross margins and orders from top chip makers. ACM has expanded its product line to include other tools, such as electroplating and furnace systems, and is also expanding internationally. We believe ACM's differentiated technology, significant market share gain opportunities, and impressive management team will drive double-digit earnings growth for years to come.

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 June 30, 2022: 1-year, -29.20%; 5-years, 4.99%; 10-years, 7.26%; since fund inception (12/31/2008), 9.26%. 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 June 30, 2022: 1-year, -19.42%; 5-years, 2.50%; 10-years, 4.83%; since fund inception, 6.14%. **MSCI ACWI ex USA IMI Growth Index** annualized returns for the as of June 30, 2022: 1-year, -26.02%; 5-years, 3.37%; 10-years, 5.78%; since fund inception, 7.12%.

Baron Emerging Market Fund's annualized returns for the Institutional Shares as of June 30, 2022: 1-year, -30.88%; 5-years, 1.15%; 10-years, 4.96%; Since inception (12/31/2010), 3.22%. Annual expense ratio for the Institutional Shares as of December 31, 2021, was 1.08%. **MSCI EM Index** annualized returns for the as of June 30, 2022: 1-year, -25.28%; 5-years, 2.18%; 10-years, 3.06%; since fund inception, 1.20%. **MSCI EM IMI Growth Index** annualized returns for the as of June 30, 2022: 1-year, -30.30%; 5-years, 3.00%; 10-years, 4.44%; since fund inception, 2.27%.

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 Emerging Markets Fund's 3- and 5-year and **Baron International Growth Fund's** 3- and 5-year historical performance were impacted by gains from IPOs and there is no guarantee that these results can be repeated or that the Funds' 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 June 30, 2022, for securities mentioned are as follows: Bajaj Finance Limited - Baron Emerging Markets Fund (1.7%); Baron International Growth Fund (1.0%); **Titan Co. Ltd.** –Baron Emerging Markets Fund (0.5%); **WuXi Biologics Cayman Inc.** -- Baron Emerging Markets Fund (1.1%); Baron International Growth Fund (0.6%); **Full Truck Alliance Co. Limited** – Baron Emerging Markets Fund (1.5%), Baron International Growth Fund (1.0%); **DLocal Limited** – Baron International Growth Fund (0.5%); **Hong Kong Exchanges and Clearing Limited** – Baron Emerging Markets Fund (1.5%), Baron International Growth Fund (0.8%); **Coupang, LLC**– Baron Emerging Markets Fund (0.8%), Baron International Growth Fund (0.7%).

Top 10 holdings as of June 30, 2022

Baron International Growth Fund

Holding	% Assets
AstraZeneca	2.7
argenx SE	2.3
Arch Capital Group Ltd.	2.2
Nestle S.A.	2.0
Linde plc	2.0
Constellation Software, Inc.	1.7
Korea Shipbuilding & Offshore Engineering Co. Ltd	1.7
Reliance Industries Limited	1.6
Koninklijke DSM N.V.	1.6
BNP Paribas S.A.	1.6
Total	19.4

Baron Emerging Markets Fund

Holding	% Assets
Taiwan Semiconductor Manufacturing Company Ltd.	4.4
Tencent Holdings Limited	3.6
Alibaba Group Holdings Limited	3.3
Samsung Electronics Holdings Limited	3.2
Reliance Industries Limited	2.7
Korea Shipbuilding & Offshore Engineering Co. Ltd	2.1
Baidu, Inc.	2.1
Suzano S.A.	1.8
Bajaj Finance Limited	1.7
Yum China Holdings, Inc.	1.6
Total	26.5

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.

The **MSCI EM (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.