# Michael Kass and Anuj Aggarwal: Catalysts for International and EM Growth Equities

This is an edited version of an April 20, 2023, update 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 and assistant portfolio manager of Baron Emerging Markets Fund. Additional commentary from Chingiz Gadimov, a member of the EM/International research team, is included. To access the video, please visit our website.

## Executive Summary

- We continue to believe that international and emerging markets, now at 20- to 30-year valuation lows, have entered a period of relative outperformance, with improving earnings growth likely to surprise and sustain in the near term and over the longer term.
- Recent developments suggest that China's leadership supports re-engagement in entrepreneurial activity and domestic retail investment in the technology and platform economy. We expect to see an uptick in IPO listings across mainland China and Hong Kong.
- We think a prolonged Ukraine/Russia conflict is the base case priced in the market. In our view, this highlights the need for greater investment in energy independence around the world.
- We retain high conviction in India as the most attractive long-term global investment jurisdiction given its durable, improving earnings growth.

## Introduction

Michael Kass joined Baron in 2007 as a portfolio manager and has 36 years of research experience. He has been portfolio manager of Baron Emerging Markets Fund, Baron International Growth Fund and Baron New Asia Fund since their inceptions.

Anuj Aggarwal joined Baron in 2012 as a research analyst and was named assistant portfolio manager of Baron Emerging Markets Fund in 2020 and portfolio manager of Baron New Asia Fund since its inception in 2021. He has 15 years of research experience.

## Q&A with Michael Kass and Anuj Aggarwal:

***Emerging market and international equities started strong in the first quarter of 2023, but then stumbled. Can you discuss what happened?***

**Michael Kass:** It was a volatile quarter. In January, a recovery in global equities gathered pace, supported by downward pressure on bond yields and the dollar. Wage inflation readings then reignited fear of the Fed and worry around bond yields and central bank rate hikes. Yields on the two-year U.S Treasury note moved above 5% for the first time in 15 years. With that, the dollar rose and EM and international equities retreated, reversing the relative gains seen in January.

In early March, the liquidity and solvency challenges of several U.S. banks sparked deposit flight concerns across the global banking sector. This provoked an aggressive policy response and an implied (albeit non-formalized) deposit guarantee in the bank sector. Massive liquidity facilities availed U.S. banks, and bond yields retreated in response to the likelihood of tightening lending standards among banks.

International and EM equities underperformed amid uncertainty throughout the first quarter but finished on a positive note by quarter end, with all of our strategies delivering low single-digit gains.

***Your outlook was turning more optimistic in your year-end update. Has that changed?***

**Michael Kass:** We maintain conviction that a dollar bear market and an international and EM equity relative bull market lie ahead. In the wake of the banking crisis, investors have embraced the emergency liquidity measures, a bullish signal that the Fed will not trigger debt deflation and that tail risk is off the table. The bank collapse also suggests that we are likely to see further credit tightening and slowing economic growth— this has helped lower market rates. Although the inflation and central bank tightening fever appears to be breaking, the question of *where* and *how much* earnings will retreat remains.

Fed rate cuts have created another short-term challenge. Although we believe easing is appropriate, we fear the Fed may be too patient with cuts, potentially prolonging this period of heightened earnings vulnerability. That risk is more acute for U.S. or global equities, in our view, given China is recovering and many other international and EM jurisdictions began rate hike cycles ahead of the U.S., have faced less inflation challenges, and are well positioned as we continue to pass through peak hawkishness. We believe ex-U.S. markets are poised to outperform in the near term and over the longer term.

China, a large part of our EM exposure, began the year strong on enthusiasm over reopening and policy support. We expect some conflicting economic and consumption signals given the abrupt end to zero-COVID policies, and it will take time to restore consumer confidence. However, we see a recovering revenue growth environment, combined with recent quarterly cost and capital discipline, driving material earnings outperformance against very subdued expectations this year. We believe a restructuring announcement by **Alibaba Group Holdings Limited,** following on the heels of shareholder friendly moves by **Tencent Holdings Limited** over the last several months, suggest that the government supports a re-engagement of entrepreneurial activity in China. Our takeaway is that China's leadership now views the technology and platform economy as suitable for domestic retail investors. We expect to see many IPO listings in mainland China and Hong Kong this year and into 2024.

India, one of the weaker equity markets during the first quarter, registered a modest decline among solid positive gains for global equities, affecting relative performance across all of our strategies. We believe the weakness can be largely attributed to previous outperformance and, to a lesser extent, allegations of aggressive practices by **Adani Enterprises Limited** and related companies (none of which we hold). In our view, India still represents the most attractive long-term global investment jurisdiction. Following mean reversion over the last two quarters, growth in India has improved significantly. We are enthusiastic about many of our investments in the market.

International and EM equities are now at 20- to 30-year relative valuation lows, with improving earnings growth likely to surprise and sustain, especially given modest investor and allocator expectations for these markets. We see four growth drivers predominately powering durable upside surprise in earnings.

- The first is the U.S. dollar bull market that should give way to a dollar bear market.
- The second is the global capital expenditure cycle that's necessary to fund de-globalization and energy, commodity, agriculture, and defense security restoration around the world, likely favoring ex-U.S. markets that are more heavily weighted towards industrials and real assets.
- The third is India's productivity miracle that's reaching escape velocity.
- The last is China's shift to value-added economic activity.

***What worked or didn't work in the first quarter?***

**Anuj Aggarwal:** Baron Emerging Market Fund modestly underperformed its primary benchmark, the MSCI EM Index, as well as our all-cap growth proxy, the MSCI EM IMI Growth Index. Some of our biggest detractors this quarter were our Financials stocks— primarily our Indian investments in the consumer finance and wealth management spaces— including **Bajaj Finance Limited** and **SBI Life Insurance Limited**, two of our long-term investments. Select holdings in the energy space, namely **Tenaris S.A.** and **Reliance Industries Limited**, as well as weak stock selection in Korea, also detracted from the Fund's performance.

Solid stock selection in industrials partially offset relative underperformance, driven primarily by investments in our China value-added theme. Leading Chinese robotics company **Estun Automation Co., Ltd.** is positioned to grow more than 25% to 30% over the next three to five years. We are encouraged by China, our leading contributor to performance in the quarter, and remain optimistic about continued recovery and earnings growth.

Although India was a key drag this quarter, it remains one of the best performing markets globally on a rolling three-year basis, even outpacing S&P 500 Index returns. We are enthusiastic about India due to economic reforms implemented by the government over the past few years. We think these reforms position India for higher GDP growth and will likely accelerate the economy's formalization and digitization. From a bottom-up stock perspective, we see attractive, durable opportunities for long-term investors.

Good stock picks and an underweight position in South Africa, as well as our investment in leading factory automation equipment supplier **Keyence Corporation**, our single investment in Japan, also helped the Fund's relative performance.

Baron International Growth Fund also underperformed its primary benchmark, the ACWI ex USA Index, as well as the ACWI ex USA IMI Growth Index. One of our biggest quarterly detractors was **WANdisco plc**., accounting for nearly one-third of the Fund's underperformance. Stock trading was halted after management disclosed certain allegedly fraudulent practices by a rogue senior salesperson in March, and we marked down shares by approximately 85%.

From a thematic perspective, stock selection relating to our sustainability and Japanese staffing themes, as well as several investments in health care, were key detractors. However, solid consumer discretionary selections across various themes contributed to performance, including **eDreams ODIGEO SA** and **B&M European Value Retail S.A.**

At the country level, stock selection in the UK detracted from performance, led by WANdisco. Certain investments in France and Netherlands, as well as negative allocation and adverse selection in Germany, India, and Brazil, also accounted for the Fund's underperformance. On the contribution side, overweight positioning in Spain and strong stock selection in Japan, Switzerland, and China stood out.

Baron New Asia Fund experienced the same performance trends as Baron Emerging Markets Fund.

***Tell us about some of your new investments.***

**Chingiz Gadimov:** Two new investments in our sustainability theme are in the electric vehicle (EV) battery material space based in Korea: **Samsung SDI Co., Ltd**. and **LG Chem, Ltd**. As a firm, we are bullish on the EV energy storage space. We expect large-scale battery demand to grow by more than 20% per year over the next decade. We believe our holdings in the space are positioned to be key beneficiaries of this trend. Having followed these companies and met with the management teams over time, we see evidence of sustained higher pricing power, strong returns, and market share gains.

Samsung SDI, one of the world's largest lithium-ion battery cell makers, is a well-managed leader in the development of high-energy density performance batteries, including next-generation cylindrical and solid-state batteries. It has some of the strongest margin and return profiles among battery cell manufacturers, yet it trades at a discount to its peers. Management is conservative when it comes to costs, focusing on protecting returns through long-term, multi-year supply agreements whereby they pass on most commodity and metals price increases and other external risks to customers.

LG Chem is the parent company of **LG Energy Solution** (LGS), the world's leading EV ESS battery manufacturer outside of China. It has strong pricing power and a diversified global customer base with leading original equipment manufacturers (OEM)s such as **Tesla, Inc.** LG Chem trades at a meaningful discount to the sum of its parts. We believe its 82% stake in LGS alone is worth nearly twice its current market capitalization. We see a significant upside from strong growth and high margins in the advanced battery material segment. In our view, LG Chem's cathode market share should grow over time due to further vertical integration within its captive supply chain, as well as third-party order wins.

***How do you see a prolonged Ukraine war affecting international performance?***

**Michael Kass:** We think a prolonged conflict is now the base case priced in the market. In our view, this highlights the need for greater investment around the world to restore energy independence, which is part of our global security theme. Since the invasion last year, we've seen a shift in the pattern of where energy, oil, and carbon flows. Western countries are buying substantially less Russian energy, while India and China, among others, are benefiting from the redirection of those flows and purchasing at a discount. Despite concerns about near-term consequences for Europe, we did not see a total embargo nor a massive price increase. Energy prices peaked in the immediate aftermath of the invasion, suggesting that Europe will be able to manage even if the conflict is extended.

***What about a China/Russia alliance?***

**Michael Kass:** China's alliance with Russia was in the works long before Russia's invasion. In our view, the alliance is as economic as it is geopolitical. Traditional export channels are beginning to shift, and China sees Russia as an important source of demand for products that may be diverted away from the U.S. or Europe. China has rejected the idea of providing direct support to Russia, and we see more than a year's worth of evidence that China is not willing to directly engage in the country's war campaign. Rather, China is supportive of Russia broadly. The government views Russia's support of China's Renminbi (RMB) as a potential reserve currency favorably. From a global trade commodity flow perspective, an alliance is forming between Russia, the Middle East, and China, which furthers the notion that the RMB can stand as an alternative to the dollar.

Although there are additional concerns regarding China's possible invasion of Taiwan, we believe an invasion would directly undermine China's intentions and progress over the last 20 years— certainly with regard to the RMB's status as a potential reserve currency.

We think the market is bearish on international exposure due to disruptions stemming from the Ukraine/Russia war, and has taken a negative view of China due to the country's alliance with Russia. However, these concerns are already fully baked into market multiples, in our view, and we see more upside than downside potential at this point.

***What are your thoughts about reducing exposure to India and re-buying at generally better relative valuations?***

**Anuj Aggarwal:** We are long-term investors. In terms of relative valuations among countries, we don't try to play one quarter or another. Instead, we focus on an opportunity set that spans three, five, or even 10 years. Although we trimmed some of the portfolio's exposure to India based on our assessment of extended valuations, we do not make outsized reallocations based on near-term valuations. Earnings projections for many of our investments in India have been upgraded this year, while projections for many Korean and Taiwanese businesses have been downgraded. We remain largely focused on fundamentals and earnings, and durability of earnings growth continues to improve in India.

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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](http://www.BaronFunds.com). Please read them carefully before investing.*

**Baron International Growth Fund**'s annualized returns for the Institutional Shares as of March 31, 2023: 1-year, -11.63%; 5-year, 2.51%; 10-year, 6.72%; Since Fund Inception (12/31/2008), 9.15%. Annual expense ratio for the Institutional Shares as of December 31, 2022, was 0.99%, but the net annual expense ratio was 0.95% (net of the Adviser's fee waivers). The **MSCI ACWI ex USA Index**'s annualized returns as of March 31, 2023: 1-year, -5.07%; 5-year, 2.47%; 10-year, 4.17%; Since Fund Inception (12/31/2008), 6.52%. The **MSCI ACWI ex USA IMI Growth Index**'s annualized returns as of March 31, 2023: 1-year, -7.29%; 5-year, 3.13%; 10-year, 5.11%; Since Fund Inception (12/31/2008), 7.50%.

**Baron Emerging Market Fund**'s annualized returns for the Institutional Shares as of March 31, 2023: 1-year, -11.32%; 5-year, -2.34%; 10-year, 3.14%; Since Inception (12/31/2010), 2.93%. Annual expense ratio for the Institutional Shares as of December 31, 2022, was 1.12%. The **MSCI EM Index**'s annualized returns as of March 31, 2023: 1-year, -10.70%; 5-year, -0.91%; 10-year, 2.00%; Since Fund Inception (12/31/2010), 1.19%. The **MSCI EM IMI Growth Index**'s annualized returns as of March 31, 2023: 1-year, -11.96%; 5-year, -0.47%; 10-years, 3.10%; Since Fund Inception (12/31/2010), 2.21%.

**Baron New Asia Fund**'s annualized returns for the Institutional Shares as of March 31, 2023: 1-year, -11.37%; Since Inception (7/30/2021), -14.91%. Annual expense ratio for the Institutional Shares as of December 31, 2022, was 7.22%, but the net annual expense ratio was 1.20% (net of the Adviser's fee waivers). The **MSCI AC Asia ex Japan Index**'s annualized returns as of March 31, 2023: 1-year, -8.90%; Since Fund Inception (7/30/2021), -11.79%. The **MSCI AC Asia ex Japan IMI Growth Index**'s annualized returns as of March 31, 2023: 1-year, -10.31%; Since Fund Inception (7/30/2021), -14.88%.

*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 or may reimburse certain Funds expenses pursuant to a contract expiring on August 29, 2033, unless renewed for another 11-year term and the Funds' 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](http://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 5-year 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, 2023, for securities mentioned are as follows: Alibaba Group Holdings Limited** – Baron International Growth Fund 1.3%; **Tencent Holdings Limited** – Baron International Growth Fund 0.7%; **Bajaj Finance Limited** – Baron International Growth Fund - 0.6%; **SBI Life Insurance Company Limited** – Baron Emerging Markets Fund 1.1%, Baron New Asia Fund 1.5%; **Tenaris S.A.** – Baron Emerging Markets Fund 1.0%, Baron International Growth Fund 1.0%; **Reliance Industries Limited** – Baron Emerging Markets Fund 1.6%, Baron International Growth Fund 1.0%; **Estun Automation Co., Ltd.** – Baron Emerging Markets Fund 1.6%, Baron International Growth Fund 0.7%, Baron New Asia Fund 1.7%; **Keyence Corporation** –Baron Emerging Markets Fund 1.3%; **WANdisco plc** – Baron International Growth Fund 0.3%; **B&M European Value Retail S.A.** – Baron International Growth Fund 1.0%; **Samsung SDI Co., Ltd.** – Baron Emerging Markets Fund 0.3%, Baron New Asia Fund 0.3%; **LG Chem, Ltd.** – Baron Emerging Markets Fund 0.3%, Baron New Asia Fund 0.3%.

Baron Emerging Markets Fund, Baron International Growth Fund, and Baron New Asia Fund did not own shares of **Adani Enterprises Limited** as of March 31, 2023.

**Top 10 holdings as of March 31, 2023**
**Baron International Growth Fund**

| Holding | % Assets |
|---|---|
| Meyer Burger Technology AG | 2.7 |
| Linde Plc | 2.5 |
| Arch Capital Group Ltd. | 2.3 |
| Keyence Corporation | 2.2 |
| AstraZeneca PLC | 2.2 |
| argenx SE | 2.2 |
| Taiwan Semiconductor Manufacturing Company Limited | 2.1 |
| Constellation Software, Inc. | 2.0 |
| Pernod Ricard SA | 1.9 |
| eDreams ODIGEO SA | 1.9 |
| Total | 22.0 |

**Baron Emerging Markets Fund**

| **Holding** | **% Assets** |
|---|---|
| Taiwan Semiconductor Manufacturing Company Limited | 6.7 |
| Samsung Electronics Co., Ltd | 4.4 |
| Alibaba Group Holdings Limited | 3.8 |
| Tencent Holdings Limited | 3.2 |
| HDFC Bank Limited | 2.0 |
| Yum China Holdings Inc. | 1.8 |
| Suzano S.A. | 1.7 |
| Bajaj Finance Limited | 1.7 |
| Delta Electronics, Inc. | 1.7 |
| Kingsoft Corporation Ltd. | 1.7 |
| Total | 28.8 |

**Baron New Asia Fund**

| Holding | % Assets |
|---|---|
| Taiwan Semiconductor Manufacturing Company Ltd. | 7.1 |
| Samsung Electronics Co., Ltd. | 4.9 |
| Tencent Holdings Limited | 4.0 |
| Alibaba Group Holdings Limited | 3.9 |
| HDFC Bank Limited | 2.7 |
| Yum China Holdings Inc. | 2.4 |
| Bajaj Finance Limited | 2.1 |
| Reliance Industries Limited | 2.0 |
| Keyence Corporation | 2.0 |
| Kingsoft Corporation Ltd. | 1.9 |
| Total | 32.9 |

**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 Emerging Markets Index Net** 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** 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** 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** measures the performance of large, mid and small cap growth securities across developed and emerging markets, excluding the U.S. The **MSCI AC Asia Ex-Japan Index Net** and the **MSCI AC Asia Index Net** are unmanaged, free float-adjusted market capitalization weighted indexes. The **MSCI AC Asia Ex-Japan Index Net** measures the performance of large and mid cap equity securities representation across 2 of 3 developed markets countries (excluding Japan) and 9 emerging markets countries in Asia. The **MSCI AC**

**Asia Index Net** measures performance of large and midcap securities representation across developed and emerging markets countries in Asia, including Japan. 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.