

## Q&A

# 6 Fast-Growing Stocks From Around the World

*Baron Funds manager Michael Kass is beating 97% of competitors with picks such as the Google of Russia*

By Teresa Rivas

Emerging-market stocks have taken a beating lately, leading some contrarian strategists to suggest it's time to buy. They'll get no argument from portfolio manager Michael Kass, but he recommends a selective approach. As might be expected from a stockpicker, he eschews the index, weighted as it is toward the biggest companies and the biggest, most mature economies. Indexing, he says, will load your portfolio with yesterday's winners—Emerging Markets 1.0.

Emerging-market indexes tend to be weighted toward banks, energy and materials sectors—which are usually under state control and can be capital intensive—while Kass sees opportunity in sectors driven by consumption, such as technology, logistics and business services. Further, indexes are heavy on Korea and Taiwan, nations that are more developed and whose domestic growth has slowed. Kass prefers the long-term outlook for less mature and faster-growing countries such as India, Indonesia and the Philippines.

He seeks out entrepreneurial organizations that operate in a capital efficient manner with shareholder-friendly corporate governance and long-term competitive advantages. Today he sees opportunity across a range of countries and markets, from the Google of Russia to the second-largest furniture retailer in Europe.

As portfolio manager of the Baron Emerging Markets Fund (ticker: BEXFX), Kass' focus on Emerging Markets 2.0 has paid off: The fund earns a five-star rating from Morningstar and has

beaten 97% of funds in the category for the past one- and three-year periods. It boasts 5.5% annual returns since its inception in late 2010, a period in which the MSCI EM IMI Growth Index has been in the red.

Read excerpts from his interview with Barrons.com below.

**Barrons.com:** Let's start with a couple of ADRs: Sina (SINA) and Yandex (YNDX).

**Kass:** Sina announced an initial public offering of Weibo.com, which is their Twitter-like business in China. But in general we believe it is a strategic asset, and Alibaba.com, which is the leading e-commerce platform in China, has taken a large position in the company and they are integrating it into their e-commerce business. It is a strategic way for Alibaba's merchants to access Weibo users and to specifically target and advertise with very defined demographics. So it's a high-return advertising opportunity for Alibaba. But it remains to be seen exactly what kind of return that advertising is going to generate. It is kind of at the early stages of modernization. But unlike Twitter (TWTR), which does not have a partner like an Alibaba to drive that flow of advertising dollars, we think it is the combination of that relationship that makes this really attractive.

Yandex is the Google of Russia. It's our only investment in Russia right now. In general we don't like the corporate institutional governance in Russia, and Putin is definitely reminding the world why Russian equities get a discount to other markets. But this is a case where the bottom/up company opportunity looks very attractive. They compete against Google, but because they are really a

## Manager's Bio



**Name:** Michael Kass

**Title:** Portfolio manager

**Education:** B.A. in economics, Tulane University

**Hobbies:** Basketball, spending time with his three children

dedicated local operator they've got many advantages in the way they are customized. They have an e-commerce business, and a mapping business that is all geared to the local Russian market, which gives them huge local advantages. The penetration of broadband Internet is roughly a third of what it is in the U.S. So we think a lot of growth will come, and they're at an earlier stage of penetration. We think Yandex has the opportunity to become the leading e-commerce platform in Russia much the way Alibaba is in China. So the core search business is very attractive, trading at something like 22 times this year's earnings, 18 times next year's earnings, growing at 25% to 30% – and that's really before they start to monetize the e-commerce opportunity. Obviously there are some risks related to Russia for foreign investors, but we think this is worth those risks.

**Steinhoff International Holdings (SHF, South Africa) was your largest position at the end of the first quarter.**

*(over please)*

## Fund Facts

(as of April 9, 2014)

Baron Emerging Markets Fund (BEXFX)

Assets: \$624.3 million

Expense Ratio: 1.50%

Front Load: None

Annual Portfolio Turnover: 15%

Yield: None

Source: Morningstar

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## Top 10 Holdings

(as of March 31, 2014)

|                                    |                  |
|------------------------------------|------------------|
| Steinhoff International Holdings   | SHF.South Africa |
| Biostime International Holdings    | 1112.Hong Kong   |
| Smiles                             | SMLE3.Brazil     |
| Kroton Educational                 | KROT3.Brazil     |
| KIA Motors                         | 000270.Korea     |
| Cetip-Mercados Organizados         | CTBPF            |
| M. Dias Branco                     | MDIA3.Brazil     |
| Tower Bersama Infrastructure       | TBIG.Indonesia   |
| Taiwan Semiconductor Manufacturing | TSM              |
| Fomento Economico Mexicano         | FMX              |

Source: Baron Funds

It is an integrated manufacturer and retailer of furniture with most of their revenue in Europe, but they started as a South African business. They've become the second-largest retailer in Europe in furniture behind Ikea. They've been able to acquire regional operators and brands in France, Germany, the U.K., and take their integrated global sourcing and logistics advantage to significantly drive up the margins of those businesses. So we are really excited about using logistics as an opportunity when it comes to emerging markets because often that is a barrier and these smaller local and regional operators don't have anywhere near the

kind of scale and sophistication to compete on this level. Because there was a downturn in Europe in the last several years, the businesses were suffering. Steinhoff was able to acquire companies that had very attractive real-estate assets that could not be duplicated today. This has been a very entrepreneurial management team that's been in place for many years, and collectively the chairman and CEO own a large piece of the company.

### Turning to Brazil, Smiles (SMLE3.Brazil) is another large holding for you.

Smiles is a miles program—it is a reward program, and they are affiliated with one of the two major airlines in Brazil, called Gol. Gol sold its stake in this company in an IPO last year, and there's a competing affiliation company called Multiplus, which is affiliated with Latam Airlines, a competitor in Chile and Brazil. What's interesting is that Gol has signed a long-term agreement to sell airline seats to Smiles at a significant discount to what Multiplus is able to buy seats at, so they've got this long-term advantage. Smiles has about a 20% to 25% market share, even though Gol Airlines has about a 40% market share of miles flown in the country. [But] essentially Smiles has a more attractive offering, at a higher margin, [so its market share] should grow over the next several years into something at least equal to Gol's share of total the domestic airline market.

**A lot has been made of the slowdown in China, but you like Haitong Securities (600837.China).**

Haitong is the second-largest securities and brokerage firm in China. Roughly 90% of the financing of the Chinese economy is issued by the state-controlled banks, and that is extremely high by any measure anywhere in the world. We think that the government's reform is all about migrating from a state-bank administered financing mechanism toward a more market-driven credit-sensitive system. Why? Because the existing system has misallocated resources toward the least efficient agents of the economy, where the productivity of the capital is going down, so that you are issuing greater and greater debt for less and less incremental economic growth. That is an unsustainable relationship. So with the reforms we start getting a more productive allocation of credit and capital overall, and the securities industry to me is the principal mechanism to which you can affect that that change. So what's going to happen, we think, over the next five to 10 years, is a much larger share of credit issuance will go through the securities industry in the form of bonds, (as of Feb. 26, 2014) asset-backed finance, equity finance. And the share held by state-controlled banks that have been allocating based on political relationships is going down. The plan is that the resources, opportunities, credit will flow toward the private sector and entrepreneurial entities rather than the state-owned enterprises, which have historically been subsidized. Now there is a transition phase, which is what has people somewhat anxious about China. We can't tell you it's going to be a smooth, easy transition. We think the transition is a very attractive opportunity in the long term, and so Haitong is a direct beneficiary. As a leading securities and brokerage firm, the government is deregulating and allowing them to enter more businesses.

Thanks.

As of 3/31/2014, for both the one year (621 funds in category) and three-year (424 funds in category) periods, Morningstar ranked Baron Emerging Markets Fund - Institutional Share Class in the 2<sup>nd</sup> percentile. Baron Emerging Markets Fund is in Morningstar's US OE Diversified Emerging Mkts category. These rankings are based on total returns.

For the 3 year period ended 3/31/2014 and overall, Baron Emerging Markets Fund was named a Morningstar 5 star fund based on risk adjusted returns with 424 funds in the Morningstar US OE Diversified Emerging Mkts Category.

**Baron Emerging Markets Fund Retail Shares'** annualized returns as of March 31, 2014: 1-year, 14.09%; 3-year, 6.38%, Since Inception (12/31/2010), 5.45%; As of the last fiscal year ended December 31, 2013, annual operating expense ratio for the Retail Shares was 1.90%, but the net annual expense ratio was 1.50% (net of the Adviser's fee waivers).

**Baron Emerging Markets Fund Institutional Shares'** annualized returns as of March 31, 2014: 1-year, 14.49%; 3-year, 6.66%, Since Inception (12/31/2010), 5.71%; As of the last fiscal year ended December 31, 2013, annual operating expense ratio for the Institutional Shares was 1.80%, but the net annual expense ratio was 1.25% (net of the Adviser's fee 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 Fund expenses (by contract as long as BAMCO, Inc. is the adviser to the Funds) 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.*

Top Ten Fund Holdings based on net assets. Portfolio holdings as a percentage of net assets as of March 31, 2014 for securities mentioned are as follows: **Sina Corporation** - 1.7%; **Yandex N.V.** - 1.3%; **Haitong Securities Co., Ltd.** - 1.7%. Portfolio holdings may change over time.

For each fund with at least a three-year history, Morningstar calculates a Morningstar Rating based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a fund's monthly performance (including the effects of sales charges, loads, and redemption fees), placing more emphasis on downward variations and rewarding consistent performance. The top 10% of funds in each 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. (Each share class is counted as a fraction of one fund within this scale and rated separately, which may cause slight variations in the distribution percentages.) The Overall Morningstar Rating is a weighted average of the available three-, five-, and 10-year ratings.

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 Fund 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.

Baron Emerging Markets Fund's benchmark is the **MSCI EM (Emerging Markets) IMI Growth Index Net USD** which is a free float-adjusted market capitalization indexes designed to measure equity market performance of large-, mid- and small-cap securities in the emerging markets and which screens for growth-style securities.

*Investors should consider the investment objectives, risks, and charges and expenses of the investment carefully before investing. The Baron Family of Funds is described in prospectuses and summary prospectuses, which contain this and other information about the Funds. You should carefully read them before investing. You can read, print, or download them by [clicking here](#). Baron Capital, Inc. is the distributor of the Baron Funds.*