

# Buffalo Mid Cap Fund

## Quarterly Commentary as of 12/31/16



Average Annualized Performance (as of 12/31/16) Expense Ratio: 1.02%	1 year	3 years	5 years	10 years	Since Inception (12/17/01)
Buffalo Mid Cap Fund	5.93%	3.71%	10.43%	6.66%	7.58%
Russell Midcap Growth Index	7.33%	6.23%	13.51%	7.83%	8.03%

**Data represented reflects past performance and is no guarantee of future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original value. Current performance may be lower or higher than the performance quoted. Performance current to the most recent month end and quarter end may be obtained by visiting the Funds' website at [www.buffalofunds.com](http://www.buffalofunds.com).**

### Capital Market Review

Capital markets got off to a volatile start in 2016 with the Russell 3000 Index dropping over 11% and West Texas Intermediate (WTI) Crude Oil down almost 30% by mid-February. Concerns about soft Chinese economic growth contributed to equity market weakness early in the year, and the energy complex was struggling to resolve its oversupplied condition. Meanwhile, perceived "safe-haven" assets performed strongly as U.S. 10-year Treasury notes advanced and gold appreciated over 15% during the same time frame. Economic concerns and a falling stock market led the Federal Reserve to adopt a less aggressive stance toward interest rate increases, and falling crude production eventually calmed fears of oversupply. These drivers led to a rebound in prices of both equities and crude oil and began a period of steadily rising prices and declining volatility that would continue from mid-February through the end of the year with only minor interruption. Interestingly, perceived "safe-haven" assets continued to perform strongly as gold and U.S. Treasuries rallied alongside equities into the summer and largely held those gains into the fall. The fourth quarter of 2016 began with this uneasy disequilibrium still largely intact, but sentiment changed dramatically with Donald Trump's surprise election victory on November 8<sup>th</sup>. The election outcome created expectations of pro-growth policies and deregulation that drove accelerating gains in stock prices, higher interest rates and associated declines in the prices of both Treasury bonds and gold, all of which generally persisted through the end of 2016.

The Russell 3000 Index returned 12.74% for the full year. The Russell 3000 Value Index outperformed the Russell 3000 Growth Index by 11.01% during the year, and smaller-capitalization indices such as the Russell Microcap Index, the Russell 2000 Index and the Russell Midcap Index outperformed the large-capitalization Russell 1000 Index by 8.31%, 9.25% and 1.74%, respectively. Much of the outperformance of value stocks can be attributed to the strong performance of the energy sector. Outperformance of small-capitalization stocks was reflective of investor aversion to greater international exposure of larger companies in the face of a rising dollar, as well as increasingly optimistic expectations for the domestic economy and for a lower U.S. corporate tax rate following the election. For the year, Energy and Materials were the best performing sectors in the Russell 3000 Index as expectations for infrastructure investment and increasing investor risk appetite following the election contributed to the reversal of prior-year underperformance that was already underway. Health Care was the worst performing sector for the year, as concerns about political backlash against rising drug prices contributed to declines in Pharmaceutical & Biotech stocks.

For the fourth quarter, the Russell 3000 Index returned 4.21%. The Russell 3000 Value Index outperformed the Russell 3000 Growth Index by 6.04% during the quarter while smaller-capitalization indices such as the Russell Microcap Index and the Rus-

sell 2000 Index outperformed the large-capitalization Russell 1000 Index by 6.22% and 5.00%, respectively. The Russell Midcap Index of mid-sized companies underperformed the Russell 1000 Index by 0.62% in the fourth quarter and was the lone exception to the trend of small outperforming large. Outperformance of more cyclically sensitive value stocks and small-capitalization stocks reflected some of the same drivers that were in place earlier in the year, as well as increasingly optimistic expectations for economic growth, higher interest rates and expectations of a lower corporate tax rate in the U.S. following the election. Financial Services was the best performing sector in the fourth quarter, benefiting from higher interest rates and expectations for a less adversarial regulatory regime under the new Republican administration. The flip-side of greater risk appetite was less demand for stable, "bond-like" equities which was reflected in the lower-risk Consumer Staples sector performing poorly during the quarter. Political risk continued to put pressure on the Health Care sector, as uncertainty regarding potential for drug price regulation and repeal of the Affordable Care Act contributed to Health Care being the worst performing sector during the quarter.

### **Performance Commentary**

The Buffalo Mid Cap Fund generated a return of 1.11% for the quarter which outperformed the Russell Midcap Growth Index return of 0.46%. The Index was primarily driven higher from contributions from the information technology, industrials, and financial sectors. The Fund's relative outperformance was primarily driven by strong stock selection in information technology and energy with the industrial sector underperforming the index.

The fund's largest contributor to performance for the quarter was Harman International Industries which designs, manufactures and markets audio and infotainment solutions for the automotive, consumer, and professional markets. The company reached an agreement to be acquired by Samsung for a 28% premium from where the stock was trading. Harman has been a long time holding of the fund as we believed infotainment would continue to experience increasing penetration in cars.

The information technology sector was a strong contributor to the fund's outperformance with Akamai Technologies and Cognex being the top performers in that sector. Akamai, a global leader in Content Delivery Network (CDN) services, performed well as the company experienced accelerated growth in both Cloud Security and Web Performance Solutions. Meanwhile Cognex, a leader in the machine vision industry, reported a strong quarter driven by the secular movement to automation.

Also contributing to the fund's performance was strong stock selection in the energy sector. The fund's total return in the sector was 16.06% versus -8.39% for the index. The fund's largest contributor in energy was FMC Technologies, a global leader in subsea equipment. The stock performed well in the quarter after the Organization of the Petroleum Exporting Countries (OPEC) announced official oil production cuts.

### **Outlook**

The setup for 2017 appears to bode well for both accelerated economic growth and the positive performance potential of U.S. equities. The new Administration's focus on deregulation, infrastructure spend, and tax reform point to a more pro-growth, business-friendly environment. Factoring in higher interest rates, one can make a case for continued rotation out of fixed income into equities. At the same time, many of the new Administration's proposals are not well-defined and could be difficult to implement in reality. With the market already discounting a more business-friendly environment, we could experience increased market volatility throughout 2017.

We are sharpening our pencils and are prepared to take advantage of opportunities as they present themselves. We continue to take gains on stocks we believe are ahead of their intrinsic value and have a growing list of stocks that we believe are attractive at lower levels. Our focus remains on investing in secular growth companies that we believe are attractively priced with strong balance sheets. We remain convinced that the inefficiencies inherent in the small and mid-cap market spectrum in addition to where we are in the economic cycle are best suited for disciplined, active management of the portfolio and are thankful for your continued support as shareholders.

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*The Fund's investment objectives, risks, charges and expenses must be considered carefully before investing. The prospectus contains this and other important information about the investment company, and it must be obtained by calling 1-800-49-BUFFALO or visiting [www.buffalofunds.com](http://www.buffalofunds.com). Read it carefully before investing.*

As of 9/30/16 the Buffalo Mid Cap Fund's top ten equity holdings were: Cepheid 2.93%, Moody's Corporation 2.37%, Nielsen Holdings Plc 2.14%, Kansas City Southern 2.13%, WhiteWave Foods Co. 2.01%, MSCI Inc. 1.96%, MarketAxess Holdings Inc. 1.95%, CME Group, Inc. 1.95%, Cognex Corp. 1.91% Equinix, Inc. 2.04%.

*Top 10 holdings for the quarter are not disclosed until 60 days after quarter end. Those listed are for the previous quarter.*

The opinions expressed are those of the Portfolio Manager(s) and are subject to change, are not guaranteed and should not be considered recommendations to buy or sell any security. Fund holdings and sector allocations are subject to change and are not recommendations to buy or sell any security.

The U.S. 10-year Treasury Note is a debt obligation issued by the United States government that matures in 10 years. The Russell 3000 Index measures the performance of the 3,000 largest publically held companies incorporated in the U.S. based on market capitalization. The Russell 3000 Value Index is a market-capitalization weighted equity based on the Russell 3000 Index, which measures how U.S. stocks in the equity value segment perform. The Russell 3000 Growth Index includes companies that display signs of above average growth. The Russell Microcap Index is a capitalization weighted index of 2,000 small cap and micro cap companies. The Russell 2000 Index is a small-cap stock market index of the smallest 2,000 stocks in the Russell 3000 Index based on market capitalization. The Russell Midcap Index measures performance of the 800 smallest companies in the Russell 1000 Index. The Russell 1000 Index is a subset of the Russell 3000 Index, which measures the performance of the 1,000 largest publically-held companies incorporated in the U.S. based on market capitalization. The Russell Midcap Growth Index measures the performance of those Russell Midcap companies with higher price-to-book ratios and higher forecasted growth values. You can not invest directly in an index.

**Mutual fund investing involves risk. Principal loss is possible. The Fund invests in smaller companies, which involves additional risks such as limited liquidity and greater volatility. Investments in foreign securities include additional risk such as greater volatility, and political, economic, and currency risks, as well as difference in accounting methods.**

The Buffalo Funds are distributed by Quasar Distributor, LLC.