# Discovery Fund

*June 30, 2017*

## Average Annualized Performance

| (As of 6/30/17) *Expense Ratio: 1.02%* | 1 YR | 3 YR | 5 YR | 10 YR | Since Inception (4/16/01) |
|---|---|---|---|---|---|
| **Buffalo Discovery Fund** | 20.49% | 9.16% | 15.04% | 9.98% | 9.00% |
| **Russell Midcap Growth Index** | 17.05% | 7.83% | 14.19% | 7.87% | 8.27% |

*Data represented reflects past performance and is no guarantee of future results. The invest-ment 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 may be obtained by visiting the Funds' website at www.buffalofunds.com.*

## CAPITAL MARKET OVERVIEW

Equity markets continued their strong start to the year during the second quarter, primarily driven by strong corporate earnings growth. The Russell 3000 Index advanced 3.02% in the second quarter. As reported during the June 30 period, earnings from S&P 500 Index companies were up 14% year-over-year in the first quarter, the strongest growth reading since 2011.

Broadly speaking, growth stocks continued their outperformance relative to value stocks, while cyclical stocks that rallied to end 2016 underperformed as investors continue to discount the likelihood of government infrastructure spending and comprehensive tax reform.

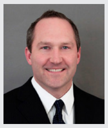
The yield on the U.S. 10-year Treasury ended the June 30 period at 2.298%, a decline from its recent high of 2.609% in March due in large part to weaker inflation readings. In contrast, the outlook for growth and interest rate expectations improved in much of the rest of the world, which has driven the trade weighted U.S. dollar down 5.6% year to date. Oil entered bear market territory, with crude prices declining 9% during the quarter in response to stronger than expected inventory levels and rising U.S. production.

As mentioned above investors continued to favor growth over value, and the Russell 3000 Growth Index climbed 4.65% during the period compared to the more modest gain of 1.29% for the Russell 3000 Value Index. By size, microcaps were the best performers with the Russell Microcap Index gaining 3.83%. Meanwhile the large cap Russell 1000 Index gained 3.06%, followed by the Russell Midcap Index at 2.70% and the Russell 2000 Index finishing with a gain of 2.46% during the period.

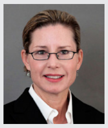
In general health care was the best performing sector as the chances for legislation to repeal or reform the Affordable Care Act appeared to diminish, and investors reacted by bidding up health care stocks. The technology sector was also a strong performer as the market continued to reward the strong earnings growth produced in this area. Conversely, energy was the worst performing sector driven by the decline in oil prices mentioned above.

## PORTFOLIO MANAGEMENT TEAM

**Clay Brethour, CFA**
Co-Manager since 2004
B.S. – Kansas State University



**Dave Carlsen, CFA**
Co-Manager since 2004
B.B.A. – Univ. of WI-Madison



**Elizabeth Jones, MD, CFA**
Co-Manager since 2004
M.D. – Vanderbilt University
M.B.A. – Arizona State University
B.S. – Georgetown University

## PERFORMANCE COMMENTARY

The Buffalo Discovery Fund produced a return of 4.99% during the period and outperformed the Russell Midcap Growth Index return of 4.21%. Overall the outperformance was fueled by our growth stock bias and strong portfolio results in the consumer and healthcare sectors. The Fund experienced strong consumer stock selection and a positive sector allocation effect despite a relatively weak consumer group overall. While the consumer discretionary and consumer staples sectors in the Russell Midcap Growth Index underperformed the broad market and produced negative total returns, both segments generated positive total returns for the Fund and made a positive performance contribution respectively. Standouts included gaming companies **Electronic Arts** and **Take-Two Interactive** where Wall Street gained newfound appreciation for the continued evolution toward recurring digital subscriptions and high margin in-game content.

Healthcare was the best performing sector for the Fund during the quarter as our relative overweight position combined with constructive stock selection made a strong positive contribution. Healthcare has bounced back in calendar year 2017 as political and populist backlash against drug pricing has faded along with the near term prospects for meaningful healthcare reform. Noteworthy contributors here included long-time holding **Align Technologies**, which continues to exceed analyst expectations for growth and share gain in the clear dental aligner market, and **Portola Pharmaceuticals**, a relatively new addition to the Fund. Shares of Portola were up sharply in the quarter after it received U.S. Food and Drug Administration (FDA) approval for its oral blood thinning drug which promises a more effective and convenient treatment than the injectable drugs currently in use.

To the downside, the energy and information technology sectors detracted from performance results during the quarter. Energy, as mentioned above, was the worst performing sector of the market and while our exposure was small at less than 3% of Fund assets it was a headwind to results given a decline of 17% for the sector during the period. Meanwhile information technology suffered from stock selection in the quarter as price and earnings momentum factors led benchmark returns and the Fund did not own enough of the index's more significant performers where valuations have exceeded our definition of an attractive risk vs. reward tradeoff. Our largest individual detractors were **Nevro Corporation** and **TechnipFMC** during the period. Nevro offers high frequency spinal cord stimulation (SCS) devices that treat back and leg pain more effectively than competing low frequency SCS devices. As a result it has rapidly gained nearly 15% market share and remains well positioned for further gains. It stumbled in the quarter as its sales force expansion and productivity did not keep up with rising growth expectations. TechnipFMC is an energy services company that was negatively impacted by declining oil prices and a delay in subsea drilling activity.

## OUTLOOK

Looking ahead, we see a number of tailwinds for equity investors in the second half of 2017. Interest rates and inflation remain low, consumer spending is improving, business investment is trending up, employment is strong, and major international economies have joined the U.S. in recovery. Corporate earnings and the world economy should grind higher at a deliberate pace of growth under the watchful eye of global policy makers who promise to do what it takes to ward off volatility and a crisis of confidence. The tepid, not too hot, nor too cold economic environment combined with a perceived central bank backstop should continue to foster lower interest rates, modest corporate earnings growth and stability with respect to above average equity valuation levels. We believe this scenario should favor growth stock investing.

Meanwhile, pro-growth Trump administration policies like tax reform, infrastructure investment and lower regulation, if ultimately passed, promise to have a widespread positive economic impact that could kick up growth rates, inflation expectations and the pace at which the U.S. Federal Reserve normalizes interest rates and reduces the central bank balance sheet. The market would likely broaden and rotate to favor stocks with a more growth cyclical bent if this scenario unfolds. We own both cyclical growth and secular growth companies and don't spend too much time attempting to forecast which environment will unfold in the near future. Instead we focus on what the market offers us in value today relative to our belief in the long term earnings prospects of the premier innovators in our growth universe. As the market continues to gyrate between growth and cyclical growth we have benefitted from our bottom up approach, primarily through focusing on high quality growth companies and buying them when the long term risk / reward is favorable.

As always, we stand poised to capitalize when and where we see an opportunity to improve the risk-adjusted expected returns within the portfolio. Economic conditions may ebb and flow, but our focus remains steadfast on investing in attractively priced, financially strong, well-managed companies whose innovative strategies should fuel secular growth opportunities, in our view. We seek those opportunities where thoughtful management teams are in a favorable position to use innovation for market advantage and sustained value creation. Successful innovation may often lead to disruptive share gains in large existing markets, or the creation of large new market opportunities, a strategy which we believe is less dependent on the overall macro environment for growth.

**INTERESTED IN MORE INFO?**

For questions or to speak with a relationship manager about adding any of the 10 Buffalo Funds to your portfolio, contact:

**Scott Johnson**
sjohnson@buffalofunds.com
(913) 754-1537

**Joe Pickert**
jpickert@buffalofunds.com
(913) 647-9875

*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 can be obtained by calling (800) 49-BUFFALO or visiting www.buffalofunds.com. Read it carefully before investing.*

As of 3/31/17 the Buffalo Discovery Fund's top ten equity holdings were: Align Technology, Inc. 1.92%, Verisk Analytics, Inc. 1.85%, MSCI, Inc. 1.81%, Danaher Corp. 1.78%, Nielsen Holdings Plc. 1.78%, Nasdaq, Inc. 1.73%, Intercontinental Exchange, Inc. 1.73%, FMC Corp. 1.73%, Republic Services, Inc. 1.72%, & Garmin Ltd. 1.72%.

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 Russell 3000 Index measures the performance of the 3,000 largest publically held companies incorporated in the U.S. based on market capitalization. The S&P 500 Index is a free-float capitalization-weighted index published since 1957 of the prices of 500 large-cap common stocks actively traded in the United States. The 10-year Treasury Note is a debt obligation issued by the United States government that matures in 10 years. Yield is the income return on an investment. This refers to the interest or dividends received from a security and is usually expressed annually as a percentage based on the investment's cost, its current market value or its face value. The Russell 3000 Growth Index is a market-capitalization weighted index that measures the performance of those Russell 3000 Index companies with higher price-to-book ratios and higher forecasted growth rates. The Russell 3000 Value Index is based on the Russell 3000 Index, of companies with lower price-to-book ratios and lower expected growth rates which measures how U.S. stocks in the equity value segment perform. 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 Index measures performance of the 800 smallest companies in the Russell 1000 Index. 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 2000 Growth Index measures the performance of those Russell 2000 Index companies with higher price-to-book ratios and higher forecasted growth values. The Russell Microcap Index is a small-cap and micro-cap stock market index of the smallest 2,000 companies in the Russell 3000E Index 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 rates. You cannot invest directly in an index.

**Earnings growth is not representative of the fund's future performance.**

Market capitalization is the total value of the shares outstanding of a publically traded company.

**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 than larger companies. Investments in foreign securities involve greater volatility and political, economic and currency risks and differences in accounting methods. This risk is greater in emerging markets.**

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