Buffalo Discovery Fund

QUARTERLY
COMMENTARY

December 31, 2018

Capital Market Overview

The 4th quarter of 2018 was a rough period for equity markets, with steep declines dragging full year returns into negative territory. The S&P 500 Index declined -13.52% during the quarter, driven by fears of tightening monetary policy, escalating trade tensions, slowing global economic growth, and margin pressure from higher labor and freight costs. Investors sought safety in government bonds, driving the yield on the 10-year Treasury down from 3.06% at the end of the 3rd quarter to 2.68% at the end of the 4th quarter.

In a reversal of the year-to-date trend, value outperformed growth in the period, as the Russell 3000 Value Index declined -12.24% compared to a -16.33% drop in the Russell 3000 Growth Index. Large companies held up better than smaller companies during the quarter, as the Russell 1000 Index fell -13.82%, the Russell Midcap Index was down -15.37%, and the small cap Russell 2000 Index was down -20.20%. The only sector to post a positive return in the 4th quarter was Utilities. Real Estate, Consumer Staples, and Health Care were down but outperformed the market. Energy was the worst performing sector, driven by steep declines in crude oil. Technology, Industrials, and Consumer Discretionary also underperformed the broad market.

Performance Commentary

In the midst of this more unsettled market environment, the Buffalo Discovery Fund outperformed its benchmark during the quarter, declining -15.76% vs -17.26% for the Morningstar U.S. Mid Growth Index. Positive stock selection within the Technology, Health Care, and Industrials sectors and our underweight in Energy, the worst performing sector during the quarter, were contributing factors to relative performance.

Technology experienced relatively strong individual stock performance from Red Hat and Xilinx, while also experiencing more general positive attribution from our relative underweight in both semiconductors and high valuation tech stocks. Within Health Care, Agilent Technologies and Cooper Companies contributed strong relative performance, adding to the positive allocation effect of our underweight in biotech and high valuation Health Care stocks.

Meanwhile, the Consumer Discretionary sector was the only meaningful headwind to performance during the quarter. Here, our focus on innovation typically leads us to companies that tend to have more international exposure than the benchmark, such as companies with exposure to electronic gaming, e-commerce, electrification of vehicles, etc. Consequently, near term global trade concerns acted as a headwind for stock selection. The Fund continues to invest in innovative, disruptive growth stocks with attractive valuations, by our internal analysis, which we believe should be a key driver of above-index risk-adjusted returns over the long term.

Average Annualized Performance (%)

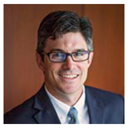
As of 12/31/18	1 YR	3 YR	5 YR	10 YR	Since Inception
Buffalo Discovery Fund	-6.54	7.36	7.67	15.92	8.40
Morningstar U.S. Mid Growth Index	-3.16	9.02	7.15	14.54	6.98
Russell Midcap Growth Index	-4.75	8.59	7.42	15.12	7.96

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 may be obtained by visiting the Funds' website at buffalofunds.com.

Fund Quick Facts

Ticker:	BUFTX
Inception Date:	4/16/2001
Net Assets:	$1.63 Billion
Expense Ratio:	1.02%
Category:	Mid-Cap Growth
Benchmark:	Morningstar U.S. Mid Growth Index

Management Team



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Top Contributors

Red Hat shares jumped higher when the company announced it agreed to be acquired by IBM for a substantial premium.

Xilinx was another exceptional performer during the quarter, as the company reported results above expectations, driven by its data center and communications business segment, and appeared poised for strong performance in these business lines in coming quarters.

Top Detractors

Align Technology shares sold off after issuing lower than expected 4th quarter 2018 guidance, driven by a near term mix shift to lower complexity, less profitable case volumes. Revenue mix can be variable quarter-to-quarter, but we believe continued robust growth is sustainable over the intermediate to long term as the company has expanded its products to address nearly 70% of the orthodontic market, while less than 15% of the orthodontic market has converted from metal braces to clear aligners.

Electronic Arts shares were weak after it first delayed the new release of Battlefield V amid a crowded Fall '18 new release cycle within the industry, followed by concern about the uptake of the new FIFA Ultimate Team mode where early monetization results disappointed high initial expectations. Near term, Fortnite's popularity and a dearth of new competitive releases likely delayed monetization. The company remains a prime beneficiary of the positive business model effects of downloadable games and in-game content combined with a favorable outlook for growth in new users and engagement, especially as live services like FIFA Ultimate Team gain more adoption.

Outlook

The market environment appears fertile for active growth stock investing. Interest rates, inflation, and unemployment remain relatively low by historical standards, providing a healthy backdrop for consumers and businesses. We don't see a recession on the horizon nor a significant collapse in corporate earnings. However, tighter financial conditions via higher rates and quantitative tightening measures have partially rescinded the extraordinary monetary easing and volatility-dampening measures deployed during and after The Great Recession. Additionally, the broadly-positive stock market effects of both lower taxes and regulation are starting to wane, leaving the more immediate and ever volatile global trade negotiations at center stage in the first half of 2019.

Combined, tighter financial conditions, less synchronized global growth, a divided Congress, and global trade concerns appear to have rattled the market while also placing the U.S. Federal Reserve in a watchful, data-dependent holding pattern. These concerns, along with the negative wealth effects of the 4th quarter's market swoon, may cause business and consumer spending to shift incrementally more cautious in the near term. After the potential for a 1st quarter earnings reset, we suspect a backup in rates and a trade deal with China could put the market into bullish mode sometime after 1st quarter earnings. Later in the 2nd half of 2019, market pundits will likely return their focus to the Fed's interest rate normalization process.

Taking all of this together, we believe a volatile, more discerning market is before us in 2019, giving benefit to more judicious growth stock investors, where a steady hand and active management with an eye toward quality, improving profit cycle dynamics, and relatively attractive risk-adjusted returns could hold advantage.

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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. 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:

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