Buffalo Discovery Fund

QUARTERLY
COMMENTARY

December 31, 2019

Capital Market Overview

The combination of a U.S. Federal Reserve (Fed) interest rate cut, an improving economic outlook, and easing trade tensions, sent equity markets sharply higher in the 4th quarter. The S&P 500 Index advanced 9.10% during the period, which brought the full-year (2019) gain to 31.49%. The Fed cut interest rates three times in 2019, erasing the brief yield curve inversion and assuaging fears of a recession. The economy continued to add new jobs at a strong pace and unemployment declined to 3.5%. Consumer spending remained healthy, and there is optimism for better business investment following the announced "phase one" trade deal with China.

Similar to the S&P 500 Index, the broad-based Russell 3000 Index returned 9.04% during the quarter. Growth outperformed value, as the Russell 3000 Growth Index returned 10.62% compared to a return of 7.41% for the Russell 3000 Value Index. Smaller companies outperformed larger companies, as one would expect in a "risk-on" period. The Russell Microcap Index surged 13.45% and the Russell 2000 Index advanced 9.94%. Large company benchmarks such as the Russell 1000 Index advanced 9.04% while the Russell Midcap Index produced a return of 7.06%. Technology and Health Care were the best performing sectors in the quarter, while more defensive areas of the market lagged such as Real Estate and Utilities. Higher long-term interest rates weighed on high-quality bond proxies – the safe haven 10-year U.S. Treasury Bond produced a return of -1.74% during the quarter.

Performance Commentary

The Buffalo Discovery Fund gained 4.36% during the quarter versus the Morningstar U.S. Mid Growth Index's gain of 8.31%. While the Fund outperformed in Financials and Materials, relative weakness in Consumer, Health Care, Industrials, and Technology weighed on our result versus the benchmark. High-multiple, long-duration growth stocks continued to respond favorably to the Fed's renewed reflationary stance.

Meanwhile, cyclical stocks like Energy companies perked up as trade headwinds dissipated and as the Fed signaled they may let the economy gain a head of steam before contemplating any interest rate increases. The Fund was positioned more conservatively, both cyclically and in terms of relative valuation, than the Index during a quarter that produced strong market returns. The Fund continues to invest in innovative growth companies with attractive valuations, through our internal analysis; a strategy we believe should be a key driver of above-index, risk-adjusted returns over the long term.

Average Annualized Performance (%)

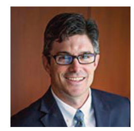
As of 12/31/19	1 YR	3 YR	5 YR	10 YR	15 YR	Since Inception
Investor Class - *BUFTX*	31.63	15.56	11.47	14.30	10.89	9.70
Institutional Class - *BUITX*[1]	31.82	15.73	11.63	14.47	11.06	9.53
Morningstar U.S. Mid Growth Index	36.01	18.29	11.84	14.04	10.27	8.36

[1]For performance prior to 7/1/19 (Inception Date of Institutional Class), performance of the Investor Class shares is used and includes expenses not applicable and lower than those of Investor Class shares. 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.

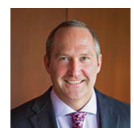
Fund Facts

	Investor	Institutional
Ticker:	BUFTX	BUITX
Inception Date:	4/16/01	7/1/19
Expense Ratio:	1.02%	0.87%
Fund Assets:	$1.80 Billion	
Category:	Mid Cap Growth	
Benchmark:	Morningstar U.S. Mid Growth Index	

Management Team



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



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

BUFFALO FUNDS

↑ Top Contributors

Align Technology, the leading supplier of clear aligners for dental malocclusion, continued to grow at robust rates while fending off new entrants in its market. We believe prosperous growth is sustainable over the intermediate-to-long-term as the company has expanded its products to address nearly 70% of the orthodontic market that continues to convert from metal braces to clear aligners.

Lumentum Holdings manufactures optical and photonic products for the communications networking, commercial laser, and consumer 3D sensing markets. Near-term, interest in the stock has improved with better global trade sentiment while long-term prospects are driven by the rapid proliferation of 3D sensing capabilities in handsets, automobiles, laptops, and tablets. 3D sensors enable face recognition authentication for mobile devices, detect hand and gesture movement, and provide people recognition capability for home systems, robotics navigation, and Advanced Driver-Assistance Systems (ADAS) for vehicles.

↓ Top Detractors

ServiceMaster Global Holdings is a market leader in the pest control industry, which is characterized by favorable secular trends and lucrative business models. During the period, ServiceMaster's stock price was hit by an unexpectedly large spike in termite damage claims in the Mobile, Alabama region. The significant drop in the stock appears to be an over-reaction that discounts an expansion in claims beyond the region and a very dire outcome. Meanwhile, investors are taking a wait-and-see approach until the company can officially quantify the size of potential damage claims, which they expect to do by their 4th quarter 2019 earnings release date.

Expedia Group is a leading online travel network for hotel, air travel, rental car, and cruise vacation bookings. Its stock price fell after it missed and lowered guidance for profitability targets the company attributed to a shift to higher-cost marketing channels, after Alphabet (GOOG) changed its search optimization algorithm.

Outlook

Following strong stock market gains in 2019 driven by multiple expansion, we expect more modest equity market returns in 2020, driven primarily by corporate earnings growth. Despite hearty returns in 2019, we believe the market environment is still constructive for active growth stock investing. Interest rates, inflation, and unemployment remain relatively low by historical standards, while global central bankers have recently pledged additional stimulus measures to boost growth and inflation to keep the long-running economic expansion alive.

Historically-low unemployment conditions in the U.S. suggests to us that greater productivity improvements may be required to offset wage pressure, in order to attain the meaningful gross domestic product (GDP) and corporate earnings growth needed to sustain current valuation multiples. Meanwhile, easing global trade tensions with China and a Fed "on hold" should instill business confidence and catalyze the willingness to spend on these initiatives. Such a backdrop should be favorable to our focus on innovators and market disruptors who are more often than not productivity enablers.

Countering this healthy backdrop are high-growth stock valuations, growing equity market complacency, and market uncertainty related to the upcoming U.S. presidential election. There is also the potential for more on-again, off-again global trade friction with other major trading partners, namely Europe. Asymmetric risk abounds, but so do underappreciated opportunities.

We believe good stock picking over the long term requires the courage to be different. Whether it's the courage to have a long term favorable view in the midst of short term disappointment or the courage to forecast long term growth that conventional wisdom doesn't foresee, both provide opportunity to own attractive, underappreciated companies. Overall, this market environment could favor judicious growth stock investors, where a steady hand and active management, with an eye toward quality, improving-profit cycle dynamics, and attractive risk-adjusted returns could hold an advantage.

Economic conditions may ebb and flow, but our focus is steady; to invest in attractively-priced, financially-strong, well-managed companies that, in our opinion, could benefit from innovative strategies and disruptive megatrends.

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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