

Discovery Fund

PM Commentary as of March 31, 2018



CAPITAL MARKET OVERVIEW

The long streak of low volatility and positive stock market returns ended in the 1st quarter of 2018. Strong gains in January were erased in February and March, leaving the S&P 500 Index down 0.76% for the quarter. Volatility as measured by the Cboe Volatility Index (VIX) was up about 80% in the 1st quarter after falling for the last three years. Investor worries about increasing interest rates, possible trade wars, and threatened government action against large technology companies, offset generally strong economic data and corporate earnings growth.

The Russell 3000 Index declined 0.64% in the quarter, and, broadly speaking, small cap companies outperformed large cap companies during the period. The Russell Microcap Index advanced 0.68% and the Russell 2000 Index finished the period nearly flat, edging down just 0.08%. Moving up the market cap spectrum, performance worsened – the Russell Mid Cap Index was down 0.46% and the larger cap Russell 1000 Index declined 0.69%. Growth outperformed value by a wide margin during the quarter as the Russell 3000 Growth Index advanced 1.48% compared to a decline of 2.82% for the Russell 3000 Value Index. Technology and Consumer Discretionary were the best performing sectors, while Consumer Staples and Energy were the worst performing.

PORTFOLIO MANAGEMENT TEAM



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Co-Manager since 2004
B.S. – Kansas State University



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PERFORMANCE COMMENTARY

For the 1st quarter of 2018, the Buffalo Discovery Fund returned 1.24%, underperforming the Russell Midcap Growth Index which returned 2.17%. The Fund's underperformance versus the benchmark was primarily driven by stock selection in our healthcare and industrial holdings. Sector allocation had limited impact on relative returns.

TOP CONTRIBUTORS

Top contributors in the period were **Nevro, Zebra Technologies, and MSCI, Inc.** Both Nevro and MSCI are top 5 holdings in the Fund.

Nevro developed and markets a device to treat lower back and leg pain. The Nevro device was determined to be superior to traditional devices in a well-designed clinical trial and consequently earned a superiority claim on its U.S. Food & Drug Administration (FDA) label. The device has had a strong launch, garnering about 15% market share in its first two years on the market in the United States. Recent strength in the launch led the stock to appreciate in the period.

Zebra had a better-than-expected quarter driven by its exposure to enterprise spending. Zebra's enterprise segment includes products for mobile computing, data capture, radio-frequency identification, and related services and has benefited from the digitalization of work flow.

MSCI's revenue and earnings growth accelerated, driven by the company's highly profitable indexing business.

Average Annualized Performance (%)

As of 3/31/18	1 YR	3 YR	5 YR	10 YR	Since Inception
Buffalo Discovery Fund	17.35	9.62	14.55	13.44	9.30
Russell Midcap Growth Index	19.74	9.17	13.31	10.61	8.77

Expense ratio 1.03%. Inception Date 4/16/2001. 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.

TOP DETRACTORS

Top detractors in the period were **Portola Pharmaceuticals, WageWorks, and FMC Corporation.**

Portola has a drug under review with the FDA that is an antidote to commonly prescribed blood thinners (factor Xa inhibitors) in patients who present to the hospital with life threatening bleeds. We expect the drug to be approved in the next several months. However, during the quarter, some feedback company management shared from the FDA called this timeline into question for some investors, leading to a sell-off in the stock. We remain optimistic about the potential for FDA approval given the significant unmet need and strong clinical data.

WageWorks is a business services firm that provides comprehensive solutions for the management of employee benefits such as flexible spending accounts, health reimbursement accounts, and health savings accounts. The company's stock declined during the period due to a delay in filing the 10-K as a result of a minor discreet revenue recognition issue in 2016. The fallout of this error is a shake-up of the executive management team. The Board of Directors will replace the CEO, CFO, and General Counsel. We believe the business fundamentals remain strong and the stock should recover over the next 9 to 12 months.

FMC Corporation sells lithium to battery manufactures. The price of lithium appreciated in 2017, and, as a result, lithium capacity was added by industry participants. Concerns about these capacity expansions led to a sell-off in FMC's stock in the first quarter of 2018.

PORTFOLIO POSITIONING & OUTLOOK

We ended the quarter with 85 stocks in the Fund representing 84 companies, as we hold both the Class A and B shares of Lions Gate Entertainment. We exited 11 positions and added 10 stocks to the portfolio in the quarter. The cash position ended the period at about 5.5% of Fund assets.

Over the past 6 months, earnings growth expectations for companies within the S&P 500 have accelerated, from a 10% growth rate to an 18% growth rate for 2018, partially aided by the benefit from recent tax reform. As growth expectations have risen so have concerns related to inflation and rising interest rates, which has broadly strained sentiment in the bond proxy and rate sensitive sectors. In addition, companies experiencing downward earnings revisions in the face of tax reform, that has more generally provided a lift to corporate earnings, have not been well-received. Adding to this equation, rhetoric around trade wars has modestly impacted business confidence. These concerns led to increased market volatility in the 1st quarter of 2018. In February and March of 2018, U.S. equity markets gyrated up and down with no clear direction.

Yet we remain optimistic that this business cycle has legs. We expect inflation to remain tame and interest rates to rise at a measured pace. We are also optimistic that the current posturing related to international trade and tariffs will give way to a reasonable compromise, an outcome we believe is in the best interest of the disputing parties. As the dust settles on these concerns over the next several months, we expect U.S. equity markets to rise, driven by solid economic fundamentals.

In the meantime, the Buffalo Discovery Fund is capitalizing on the volatility, using the strength to trim or exit holdings in which we have modest expectations for risk adjusted returns, and using the pull backs to add to higher conviction stocks in which we believe will generate superior risk-adjusted returns.

Other market participants may also use the volatility to their advantage. Eight-plus years into economic expansion, and as a result of tax reform coupled with repatriation, corporations are flush with cash. We expect capital allocation in the form of merger and acquisition activity to increase in 2018.

Economic conditions may ebb and flow, but our focus remains steadfast on investing in attractively priced, financially strong, well-managed companies with innovative strategies, fueled by the Buffalo Secular Growth Trends. We believe this discipline could lead to superior returns over the intermediate to long term. ◀

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

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 buffalofunds.com. Read it carefully before investing.

As of 12/31/17 the Buffalo Discovery Fund's top ten equity holdings were: Align Technology 2.09%, Xylem 1.90%, MSCI 1.81%, FMC 1.81%, BlackBerry 1.74%, Praxair 1.70%, Verisk Analytics 1.68%, Intercontinental Exchange 1.66%, MasterCard 1.64%, Danaher 1.64%. 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 publicly held companies incorporated in the U.S. based on market capitalization. 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 publicly-held companies incorporated in the U.S. based on market capitalization. The Russell Mid Cap Growth Index measures the performance of those Russell Midcap companies with higher price-to-book ratios and higher forecasted growth values. The Russell Mid Cap Index measures performance of the 800 smallest companies in the Russell 1000 Index. The Chicago Board of Options Exchange Volatility (CBOE) Index measures the market expectations of near-term volatility conveyed by S&P 500 stock index option prices. The S&P 500 is a capitalization weighted index of 500 large capitalization stocks which is designed to measure broad domestic securities markets. The Russell Micro Cap Index is an unmanaged capitalization weighted index of 2,000 small cap and micro cap companies. The Russell 2000 Index is an unmanaged index that consists of the smallest 2,000 securities in the Russell 3000 Index, representing approximately 10% of the Russell 3000 total market capitalization. It is not possible to 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 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.

Kornitzer Capital Management is the advisor to the Buffalo Funds, which are distributed by Quasar Distributors, LLC.