

Discovery Fund

PM Commentary as of December 31, 2017



CAPITAL MARKET OVERVIEW

Equity markets ended 2017 on a strong note. The 4th quarter saw a continuation of trends that have influenced the market all year. Investor optimism about improving global economic growth and strong corporate earnings led to another quarter of higher stock prices and low volatility. Strong holiday sales and the passage of tax reform legislation also provided tailwinds to equity markets during the period. The Chicago Board of Options Exchange Volatility (CBOE) Index continued to hover near record lows, and, for the first time since 1958, the S&P 500 Index delivered positive returns in every single month of the year.

The Russell 3000 Index produced a total return of 6.34% in the 4th quarter. Growth continued to outperform value, as the Russell 3000 Growth Index advanced 7.61% and outperformed the Russell 3000 Value Index return of 5.08%. Large companies generally outperformed smaller companies during the quarter. The Russell 1000 Index returned 6.59%, the Russell Midcap Index returned 6.07%, the Russell 2000 Index returned 3.34%, and the Russell Microcap Index returned 1.80%. Consumer discretionary and technology were the best performing sectors while utilities, health care, and consumer staples underperformed in the quarter.

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 gained 4.44% during the quarter, underperforming the benchmark Russell Midcap Growth Index, which advanced 6.81%. Gains were widespread within the index with all sectors producing positive returns, as tax reform and better global growth broadly lifted markets.

The fund outperformed in Technology, Materials and Consumer Staples, mainly through positive stock selection. However, it failed to keep up with the strong returns posted by the Consumer Discretionary, Industrials, Energy and Financials sectors where the factor most influential to returns was the degree to which tax cuts would benefit future earnings per share.

Additionally, our overweight in Healthcare was a headwind as that sector underperformed the Index and experienced adverse stock selection. In spite of the relative underperformance during the quarter, the Fund outperformed its benchmark for the calendar year 2017.

Average Annualized Performance (%)

As of 12/31/17	1 YR	3 YR	5 YR	10 YR	Since Inception
Buffalo Discovery Fund	25.44	11.84	16.16	11.46	9.37
Russell Midcap Growth Index	25.27	10.30	15.30	9.10	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 CONTRIBUTORS

Align Technology the maker of clear aligners for dental malocclusion and a long term holding in the fund, continued to grow in excess of expectations. We believe robust growth is sustainable over the intermediate to long term as less than 10% of the orthodontic market has converted from metal braces to clear aligners.

Akamai Technologies surged on news Wall Street activist Elliott Management announced they've built a position in the stock and intend to advocate for positive operational and strategic change in the interest of shareholders. We believe Akamai's globally distributed network presence with servers and software embedded at data centers and network interconnect sites around the world is a unique asset that is well suited to serve and protect global media content and cloud based applications.

TOP DETRACTORS

Nevro makes 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 share gains and sales force productivity did not keep up with high expectations.

Evolent Health offers software tools and services to healthcare providers to manage populations of patients, with a goal of decreasing the cost of care, while maintaining or improving the quality of care. Market uncertainty related to the repeal of the Affordable Care Act has left many providers cautious on executing new contracts. Consequently, investors were concerned about the company's near-term growth prospects, leading to a sell-off in the stock. We remain optimistic that the strong management team will navigate the near-term uncertainty with the long-term opportunity intact.

PORTFOLIO POSITIONING & OUTLOOK

The market environment for equities remains favorable in our view. Interest rates, inflation and unemployment remain low while corporate earnings grind higher buoyed by broadening global growth and recent U.S. corporate tax reform. Growing cash flows combined with foreign cash repatriation should drive improved business investment and more aggressive capital allocation activity including merger and acquisition (M&A), buybacks and dividend increases. In our opinion, the fund holds many high quality smaller and mid cap growth companies that could make very promising acquisition candidates if M&A activity does indeed pick up.

As growth strengthens, inflation expectations and the pace at which the Fed intends to normalize interest rates and the central bank balance sheet could introduce market volatility. We stand poised to capitalize when and where we see an opportunity to improve 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. 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 buffalofunds.com. Read it carefully before investing.

As of 9/30/17 the Buffalo Discovery Fund's top ten equity holdings were: Align Technology, Inc. 2.53%, Nevro Corp. 1.90%, Xylem, Inc. 1.90%, FMC Corporation 1.86%, WABCO Holdings, Inc. 1.83%, MSCI, Inc. 1.82%, BlackBerry Ltd. 1.76%, Praxair, Inc. 1.68%, Mastercard Inc., 1.67% & Intercontinental Exchange, Inc. 1.66%.

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 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 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 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 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. 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. You cannot invest directly in an index. Earnings per share (EPS) is the portion of a company's profit allocated to each outstanding share of common stock. Earnings per share serves as an indicator of a company's profitability. Cash flow is a measure of the cash produced by the firm in a given period on behalf of equity holders. The true measure of the value of a firm's equity is considered to be the present value of all free cash flows.

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.