

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

The Buffalo Flexible Income Fund declined -11.74% during the 4th quarter. The Fund outperformed the S&P 500 Index's loss of -13.52% but underperformed the ICE Bank of America Merrill Lynch U.S. High Yield Index ("Index") which declined -4.67%. The Fund's peer group index, the Lipper Mixed-Asset Target Allocation Moderate Funds Index, produced a return of -7.45% for the quarter.

The equity portion of the portfolio declined -12.20% for the quarter but outperformed the S&P 500 Index. The relative outperformance was primarily driven by our investments in the Consumer Staples, Technology, and Health Care sectors. The outperformance within the Consumer Staples segment was driven by both the Fund's overweight relative to the sector and security selection.

The fixed income portion of the Fund declined -4.92% and slightly underperformed the Index return of -4.67%. Relative performance was driven by the Technology, Energy, and Health Care sectors.

Average Annualized Performance (%)

As of 12/31/18	1 YR	3 YR	5 YR	10 YR	15 YR	Since Inception
Buffalo Flexible Income Fund	-7.00	4.99	3.28	9.27	6.67	6.80
Morningstar Combined Index	-2.97	8.68	6.80	12.17	12.17	8.34
Morningstar U.S. Large Cap Index (60%)	-3.44	9.62	8.78	12.96	12.96	9.07
ICE BofAML U.S. High Yield Index (40%)	-2.26	7.27	3.82	10.99	10.99	7.24
BofA ML Combined Index	-3.53	8.46	6.62	12.27	7.42	8.48
S&P 500 Index (60%)	-4.38	9.26	8.49	13.12	7.77	9.31
ICE BofAML U.S. High Yield Index (40%)	-2.26	7.27	3.82	10.99	6.89	7.24
Lipper Mixed-Asset Target Allocation Moderate Funds Index	-5.15	4.94	3.85	8.01	5.14	6.56

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:	BUFBX
Inception Date:	8/12/1994
Net Assets:	\$590.58 Million
Expense Ratio:	1.01%
Category:	Large-Cap Value
Benchmark:	60% Morningstar U.S. Large Cap Index 40% ICE BofAML U.S. High Yield Index

Management Team



John Kornitzer

Manager since Inception
B.A. – St. Francis Univ. (PA)



Paul Dlugosch, CFA

Co-Manager since 2007
B.S. – University of Iowa

↑ Top Contributors

Specific securities that contributed to the outperformance in the Consumer Staples sector included **Proctor and Gamble**, **Coca Cola**, and **Clorox**. These companies possess business models which are less cyclical relative to most other segments of the Index. Within Technology the outperformance was driven by the sector allocation impact as the Fund was underweight the poor performing sector while specific securities we own, including **Intel** and **Microsoft**, added to the relative performance results. The outperformance within Health Care was primarily due to security selection, including **GlaxoSmithKline** and **Eli Lilly**, which contributed to the relative performance.

Overall, the top three contributors to the Fund's performance during the quarter were **Proctor and Gamble**, **Verizon**, and **Coca Cola**. The top individual contributors to the Fund's fixed income performance included **Nuance** 5.375% senior notes, **Charter** 5.250% senior notes, and **Transdigm** 5.500% senior notes.

↓ Top Detractors

Within the Technology sector the primary driver of underperformance was our investment in **Nuance Communications** convertible bonds which declined about -7% during the 4th quarter. Nuance announced plans to simplify its operating businesses by divesting its non-core imaging business (10% revenue), spinning off its automotive business, and concentrating on its core digital assistants market. Additionally, the company is currently in the process of transitioning its revenue model to subscriptions from licenses, which will likely limit sales growth in 2019. Subsequently, company management guided down revenue growth and profit margin expectations for the year.

Within Energy, the primary detractor from performance was **Forum Energy Technology**. Forum had historically been focused on generating free cash flow, but, in recent quarters, working capital increases have negatively impacted the company's ability to produce free cash flow. Additionally, the macro environment negatively impacted their business as oil prices declined significantly during the quarter. Within Health Care, **Medicines Company** was the biggest detractor, due to lowered expectations for the PCSK9 class of drugs and questions surrounding upcoming cash needs to fund additional clinical trials for key potential drugs.

Overall, the top three detractors from the equity portion of the Fund's portfolio performance were **Schlumberger**, **HollyFrontier**, and **Hess**. The largest relative detractors to the fixed income return were Medicines Company 2.500% convertible bonds, Forum Energy 6.250% senior notes, and Nuance Communications 1.500% convertible notes.

Outlook

As we begin the New Year, significant uncertainty about the direction of the stock market exists due to concerns about slowing global growth, the outcome of the U.S. trade dispute with China, a deceleration in corporate earnings, and the potential for continued interest rate hikes. Amidst this uncertainty, we continue to be diligent in our process of seeking income-producing securities trading at reasonable valuations by our analysis.

Given that we believe the U.S. is in the later stages of the current economic cycle, we continue to find ourselves confronted with relatively low spread and yield levels with the non-investment grade fixed income asset class that we prefer over the long haul. This backdrop has resulted in a bond allocation that is close to the low end of our expected range in terms of the Fund's overall asset mix of stocks, bonds, and cash. Within the fixed income portion of the portfolio we continue to focus on high-quality, non-investment grade issuers with defensive business models and manageable credit metrics. As always, we appreciate your support and confidence in our investment process over the 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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The Fund's investment objectives, risks, charges and expenses must be considered carefully before investing. The summary and statutory prospectuses contain 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.

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

As of 9/30/18 the Buffalo Flexible Income Fund top 10 holdings were Boeing 4.77%, Microsoft 4.07%, Intel 3.30%, Exxon Mobil 3.03%, HollyFrontier 2.97%, Verizon Communications 2.85%, AT&T 2.81%, Royal Dutch Shell 2.79%, ConocoPhillips 2.76%, Johnson & Johnson 2.75%. Top 10 holdings for the quarter are not disclosed until 60 days after quarter end.

The opinions expressed are those of the Portfolio Managers 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 capitalization weighted index of 500 large capitalization stocks which is designed to measure broad domestic securities markets. 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 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 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 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 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. The Morningstar U.S. Large Cap Index measures the performance of the U.S. equity market targeting the top 70% of stocks by market capitalization. The ICE BofAML High Yield Index is an unmanaged index comprised of over 1,200 high yield bonds representative of high yield bond markets as a whole. It includes zero-coupon bonds and payment-in-kind (PIK) bonds. The Lipper Mixed-Asset Target Allocation Moderate Funds Index is an unmanaged index considered representative of mixed-asset target allocation moderate funds tracked by Lipper, which would combine the 30 biggest funds, based on asset size, that belong to this asset category. One cannot invest directly in an index. Free 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. Spread is the difference between the bid and the ask price of a security or asset. Yield is the income return on an investment, referring 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. Investment grade is a rating that indicates a municipal or corporate bond has a relatively low risk of default.

Mutual Fund investing involves risk. Principal loss is possible. Investment by the Fund in lower-rated and non-rated securities presents a greater risk of loss to principal and interest than higher-rated securities. Investments in debt securities typically decrease in value when interest rates rise. This risk is usually greater for longer-term debt securities. Investments in foreign securities include additional risk such as greater volatility, and political, economic, and currency risks, as well as difference in accounting methods.

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

