# Buffalo High Yield Fund

QUARTERLY COMMENTARY

March 31, 2022

## Capital Market Overview

The U.S. high yield sector ended its streak of seven consecutive positive quarters, as inflation fears and the Russia/Ukraine conflict weighed on investor sentiment. Hawkish commentary from the Federal Reserve (the "Fed") caused significant upward pressure on Treasury yields, and commodity prices soared as the Ukraine invasion escalated. High yield bonds ended the quarter at a yield to worst of 6.31%, up 160 basis points (bps) from the beginning of the quarter and an increase of 209 bps compared to the record low of 4.22% in July 2021. The yield on the 10-year Treasury Bond rose 83 bps and produced a negative return of -6.82% during the quarter, while the S&P 500 Index posted a loss of -4.60%.

High yield funds saw cash flows of -$25.3 billion in the quarter following -$1.1 billion in outflows in the final quarter of 2021. Over the past 12 months, high yield funds experienced outflows of -$27.8 billion. Meanwhile, the $46.5 billion of high yield new issuance in the quarter was muted by the volatility of interest rates and geopolitical instability. In fact, it was the lightest quarterly new issuance since December 2018. According to JP Morgan, the middle and upper credit quality tiers (B < split BBB rated issues) accounted for 77% of the new issue activity in the quarter, led by Gaming/Lodging/Leisure (19.9%), Healthcare (14.7%), and Cable & Satellite (12.3%).

As mentioned previously, the 10-year Treasury Bond yield rose 83 bps from 1.51% at the end of December to 2.34% after the Fed pivoted to more hawkish rhetoric. Every credit rating silo produced negative returns during the quarter. According to data from JP Morgan, the heart of the high yield credit spectrum outperformed the lower and upper tiers with the split B and single B segments losing -2.91% and -3.23%, respectively. The higher credit quality silos, which tend to have higher duration (sensitivity to interest rate movements), and the lower credit quality silos were the worst performers, with BB issues declining -4.92% and CCCs returning -4.34% in the quarter. The Energy sector was the top performer during the quarter declining -1.89%, which was not surprising given the significant increase in crude oil and natural gas prices. Metals/Mining, which also saw soaring commodity prices, declined by -2.43%. The -6.28% loss in the Housing sector was the worst performing area, as investors anticipated rising interest rates potentially crimping demand.

According to data from JP Morgan, the U.S. high yield market's spread to worst for the period was 399 bps, 24 bps wider than the preceding quarter, but still 181 bps tighter than the 20-year historical average of 580 bps. As mentioned earlier, the yield to worst for the high yield market at quarter end was 6.31%, still well below the 20-year average yield to worst of 7.98%.

## Performance Commentary

The Buffalo High Yield Fund (BUFHX) produced a return of -1.70% for the quarter, a result that outperformed the ICE BofAML U.S. High Yield Index and the Lipper High Yield Bond Funds Index returns of -4.51% and -3.84%, respectively.

## Average Annualized Performance (%)

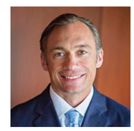
| *As of 3/31/22* | 1 YR | 3 YR | 5 YR | 10 YR | 15 YR | Since Inception |
|---|---|---|---|---|---|---|
| Investor Class - *BUFHX* | 1.97 | 6.54 | 5.25 | 5.28 | 5.90 | 6.89 |
| Institutional Class - *BUIHX*[1] | 2.12 | 6.67 | 5.39 | 5.43 | 6.06 | 7.04 |
| ICE BofAML U.S. High Yield Index | -0.29 | 4.40 | 4.56 | 5.70 | 6.41 | 6.87 |
| Lipper High Yield Bond Funds Index | 0.31 | 4.44 | 4.36 | 5.23 | 5.40 | 5.73 |
| Morningstar High Yield Bond Category | -0.39 | 3.90 | 3.87 | 4.76 | 5.27 | 5.65 |

*[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. Each Morningstar category average represents a universe of funds with similar objectives.*

## Fund Facts

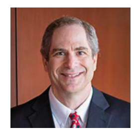
| | *Investor* | *Institutional* |
|---|---|---|
| Ticker: | BUFHX | BUIHX |
| Inception Date: | 5/19/95 | 7/1/19 |
| Expense Ratio: | 1.03% | 0.87% |
| Fund Assets: | $296.53 Million | |
| Category: | High Yield Bond | |
| Benchmark: | ICE BofAML U.S. High Yield Index | |

## Management Team



**Paul Dlugosch**, CFA

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



**Jeff Sitzmann**, CFA

Co-Manager since 2007
M.B.A. – Univ. of Chicago
B.B.A. – Univ. of Toledo

**Jeff Deardorff**, CFA

Co-Manager since 2015
B.S. – Kansas State Univ.

## Fund Composition by Asset Class

| | 3/31/21 | 6/30/21 | 9/30/21 | 12/31/21 | 3/31/22 |
|---|---|---|---|---|---|
| Straight Corporates | 62.7% | 61.5% | 65.3% | 67.8% | 68.3% |
| Convertibles | 16.3% | 17.0% | 16.1% | 7.1% | 6.3% |
| Bank Loans | 11.2% | 13.7% | 13.5% | 16.7% | 18.5% |
| Preferred Stocks | 2.2% | 2.3% | 2.2% | 2.6% | 2.7% |
| Convertible Preferreds | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% |
| Common Stocks | 0.0% | 0.0% | 0.0% | 1.3% | 0.0% |
| Cash | 7.6% | 5.5% | 2.9% | 4.5% | 4.1% |

## Approximate Rate & Contribution of Return in 1Q22

| | Contribution to Return |
|---|---|
| Straight Corporates | -1.11% |
| Convertibles | -0.34% |
| Bank Loans | -0.05% |
| Preferred Stocks | 0.00% |
| Convertible Preferreds | 0.00% |
| Common Stocks | 0.02% |
| TOTAL | **-1.48%** |

## ↑ Top Contributors

The three top contributors during the quarter were Athabasca Oil 9.75% corporate bonds, Talos Production 12% corporate bonds, and Penn Virginia 9.25% corporate bonds. All three issuers are energy exploration and production (E&P) companies, albeit from three different regions of North America. Athabasca is a Canadian operation, Penn Virginia (now known as Ranger Oil) primarily operates in the Permian basin of Texas, and Talos is an offshore producer in the Gulf of Mexico. All three benefited from the spike in crude oil and natural gas prices during the quarter.

## ↓ Top Detractors

The TreeHouse 4.0% corporate bonds, JoAnn Stores bank debt, and the Etsy 0.25% convertible bonds were the worst performers during the quarter. TreeHouse's announcement that it would not put itself up for sale, combined with investor concerns regarding the company's ability to pass along increasing input costs, and the longer duration of this particular bond issue weighed it down. JoAnn Stores bank debt declined like many retailers, as investors worried about continued supply chain issues and rising input and labor costs. Etsy convertible notes were negatively-impacted, as the underlying common stock declined throughout the quarter, driven by rising interest rates which negatively impacts valuation multiples of high growth stocks.

## Outlook

We are paying particular attention to the Federal Reserve's balancing act between taming inflation while attempting to avoid a recession. Continued supply chain disruptions and the geopolitical uncertainty caused by the tragic conflict in Ukraine are also areas to watch. We are managing the Fund cautiously yet actively, focusing on high-quality issuers with defensive business models and manageable credit metrics. We will continue to deploy cash in opportunities that we believe offer the most appealing risk/reward tradeoff with a bias toward shorter durations and less levered credits. Additionally, we believe bank loans offer a more defensive position as they provide senior positioning in the capital structure and less interest rate sensitivity due to their floating rate structures. Finally, we continue to look for opportunities in convertible bonds and preferred stocks. We ended the quarter with 138 positions, down slightly from the previous quarter's level of 142 (excluding cash).

### 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:

Christopher Crawford
ccrawford@buffalofunds.com
(913) 647-2321

Scott Johnson
sjohnson@buffalofunds.com
(913) 754-1537

*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 carefully before investing.*

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

As of 12/31/22 the Buffalo High Yield Fund top 10 holdings were Northern Oil & Gas (8.125%, 3/1/28) 3.01%, DirecTV Financing (1 Month LIBOR + 5.000%, 8/2/27) 2.66%, MPLX (6.875%, 8/15/23) 2.34%, Penn Virginia Escrow (9.250%, 8/15/26) 2.07%, Consol Energy (11.000%, 11/15/25) 2.06%, Matador Resources (5.875%, 9/15/26) 1.88%, Energy Transfer (7.125%, perpetual preferred) 1.69%, PetIQ (3 Month LIBOR + 4.250%, 4/7/28) 1.65%, Magnite (6 Month LIBOR + 5.000%, 4/3/28) 1.48%, Talos Production (12.000%, 1/15/26) 1.43%. 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 10-year Treasury bond is a debt obligation issued by the United States government that matures in 10 years. A basis point (bps) is one hundredth of one percent (0.01%). Yield is the income return on an investment. This refers 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. Yield to worst is the lowest potential yield that can be received on a bond without the issuer actually defaulting. Spread to worst measures the difference from the worst performing security to the best, and can be seen as a measure of dispersion of returns within a given market or between markets. Duration is a commonly used measure of the potential volatility of the price of a debt security, or the aggregate market value of a portfolio of debt securities, prior to maturity. Securities with a longer duration generally have more volatile prices than securities of comparable quality with a shorter duration. A coupon or coupon payment is the annual interest rate paid on a bond, expressed as a percentage of the face value and paid from issue date until maturity. JP Morgan Domestic High Yield Index is designed to mirror the investable universe of the U.S. dollar domestic high yield corporate debt market. 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 ICE BofAML U.S. High Yield Index is an unmanaged index comprised of over 1,200 high yield bonds representative of high yield bond markets as a whole. The Lipper High Yield Bond Funds Index is a widely recognized index of the 30 largest mutual funds that invest primarily in high yield bonds. One cannot invest directly in an index. The LIBOR (London InterBank Offered Rate) is a benchmark interest rate at which major global banks lend to one another in the international interbank market for short-term loans. A Standard & Poor's Rating of B means an obligor is more vulnerable the obligors rated 'BB', but the obligor currently has the capacity to meet its financial commitments. A Standard and Poor's Rating of BB means an obligor is less vulnerable in the near term than other lower-rated obligors. A Standard and Poor's Rating of CCC means an obligor is currently vulnerable, and is dependent upon favorable business, financial, and economic conditions to meet its financial commitments. The highest rating is AAA and the lowest rating is D. A Standard & Poor's Rating of BBB– or higher represents investment grade securities. In limited situations when the rating agency has not issued a formal rating, the Advisor will classify the security as nonrated.

**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.