Buffalo High Yield Fund

QUARTERLY COMMENTARY

June 30, 2020

Capital Market Overview

After suffering a massive correction in the 1st quarter, driven by the COVID-19 outbreak and plunging crude oil prices, the U.S. high yield sector delivered a substantial rally in the 2nd quarter -- the strongest since the 3rd quarter of 2009. While not fully recapturing the losses of the 1st quarter, aggressive monetary and fiscal stimulus implemented in April and May fueled the rebound in high yield bonds from the March low point. The 10-year Treasury Bond returned 0.68% during the quarter while common stocks, as measured by the S&P 500 Index, logged a return of 20.54%.

Following $16.7 billion in outflows from a flight to quality during the preceding quarter, high yield funds saw a record cash inflow of $47.3 billion in the June quarter. Recognizing the influx of capital, high yield issuers brought a record $145.5 billion in high yield new issuance, easily exceeding the previous record of $121.2 billion set in the 2nd quarter of 2014. In the first six months of 2020, new issuance volume totaled $218.4 billion, up 55% from the $140.5 billion in the first six months of 2019. According to JP Morgan, BB-rated issues accounted for the bulk of activity (58%), and tilted heavily toward sectors impacted by the virus. The heaviest volume in period came from Gaming/Leisure and Lodging ($21.6 billion, 15%), Autos ($13.3 billion, 9%), and Energy ($12.0 billion, 8%).

During the quarter, the 10-year Treasury bond yield was essentially flat at 0.66% following the 125 basis point (bps) contraction in the 1st quarter, and remains near record lows. Excluding transportation, every industry and sector in the U.S. high yield universe and every credit rating silo produced positive returns. According to data from JP Morgan, the lower quality end of the high yield credit spectrum (i.e., CCC and non-rated) performed better than the higher end of the quality spectrum. The non-rated segment produced the largest gain of 13.81% and the higher-rated split BBB segment was the worst performer, but still produced a solid 7.36% gain.

According to data from JP Morgan, the U.S. high yield market's spread to worst for the period was 722 bps, 227 bps tighter than the preceding quarter and 111 bps wider than its 20-year historical average of 611 bps. The yield to worst for the high yield market at quarter end was 7.57%, below the 20-year average of 8.64%, and below the yield of 10.00% at the end of the 1st quarter.

Performance Commentary

The Buffalo High Yield Fund (BUFHX) advanced10.00% over the quarter and outperformed the ICE BofAML U.S. High Yield Index, which gained 9.61%. The Fund also outperformed the peer group Lipper High Yield Bond Funds Index return of 9.27%.

Average Annualized Performance (%)

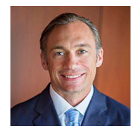
As of 6/30/20	1 YR	3 YR	5 YR	10 YR	15 YR	Since Inception
Investor Class - *BUFHX*	0.24	2.54	3.11	5.26	5.52	6.69
Institutional Class - *BUIHX*[1]	0.34	2.67	3.25	5.41	5.67	6.84
ICE BofAML U.S. High Yield Index	-1.10	2.94	4.58	6.48	6.68	6.87
Lipper High Yield Bond Funds Index	-2.70	2.17	3.48	5.82	5.52	5.60
Morningstar High Yield Bond Category	-1.89	2.04	3.38	5.49	5.50	5.61

[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

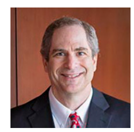
	Investor	*Institutional*
Ticker:	BUFHX	BUIHX
Inception Date:	5/19/95	7/1/19
Expense Ratio:	1.02%	0.87%
Fund Assets:	$208.63 Million	
Category:	High Yield Bond	
Benchmark:	ICE BofAML U.S. High Yield Index	

Management Team



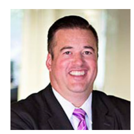
Paul Dlugosch, CFA

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.

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Fund Composition by Asset Class

	6/30/19	9/30/19	12/31/19	3/31/20	6/30/20
Straight Corporates	64.7%	65.0%	55.6%	60.1%	55.4%
Convertibles	12.1%	13.4%	17.7%	16.7%	20.1%
Bank Loans	15.2%	16.0%	16.2%	19.1%	16.6%
Preferred Stocks	0.0%	0.0%	1.1%	1.3%	1.7%
Convertible Preferreds	0.0%	0.0%	0.0%	0.0%	0.0%
Common Stocks	1.4%	1.2%	1.7%	1.0%	0.6%
Cash	6.5%	4.4%	7.6%	1.8%	5.6%
TOTAL	100.0%	100.0%	100.0%	100.0%	100.0%

Approximate Rate & Contribution of Return in 2Q20

	Unweighted Return	Contribution to Return
Straight Corporates	8.6%	5.00%
Convertibles	13.5%	2.51%
Bank Loans	10.7%	1.91%
Preferred Stocks	36.6%	0.55%
Convertible Preferreds	0.0%	0.00%
Common Stocks	32.1%	0.26%
TOTAL		**10.00%**

↑ Top Contributors

All but a handful of securities delivered positive returns during the period, with the three top contributors being **Cerence** 3.000% convertible bonds, **MPLX** 6.875% corporate bonds, and **Nuance Communications** 1.500% convertible bonds. The Fund participated in the new issuance of the Cerence 3.000% convertible bonds, which increased over 25% in their first week of trading. MPLX bonds, one of the Fund's worst performers in the preceding quarter, recovered significantly in the 2nd quarter as crude oil prices recovered and the energy sector as a whole rebounded. Nuance Communications convertible bonds rallied on the back of the common stock, which increased 51% during the quarter as investors favored the technology sector.

↓ Top Detractors

Specific securities that detracted the most from performance include **Brunswick** 7.375% corporate bonds, **Townsquare Media** 6.500% corporate bonds, and **J2 Global** 1.750% convertible bonds. Brunswick bonds were one of the Fund's best performers in the 1st quarter as higher quality issues were safe havens for investors, but the bonds experienced some selling pressure this period as capital was redirected into riskier securities that had been punished starting the year. Townsquare Media declined due to the negative economic impact of the pandemic resulting in the pull back of radio advertising. This has caused leverage to increase and may require the company to get a waiver on its revolver covenants. The company also took a non-cash impairment charge due to an accounting error. J2 Global was negatively-impacted by a hedge fund short-sell report released in June. In response, management issued a firm rebuttal addressing the assertions and pointed out multiple inaccuracies in the report.

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Outlook

Until March, the United States had been enjoying a growing economy with modest inflation that created a favorable environment for risky assets. However, by early March, the COVID-19 pandemic and plummeting crude oil prices wreaked havoc on the markets. The U.S. high yield default rate increased to a 3-year high of 3.54% in March, an increase of 91 bps from the December 2019 level, and slightly above the long-term average of 3.44%. Unfortunately, the trend continued during the 2nd quarter with the default rate increasing to 6.61%, a 10-year high. During the quarter, 47 companies defaulted on a record-breaking $82.2 billion of debt.

We are concerned first and foremost about the ongoing COVID-19 pandemic and the fallout on global economies. Previous concerns such as trade talks with China and the upcoming presidential election have become a secondary focus. We are managing the Fund cautiously yet actively, focusing on high-quality issuers with defensive business models and manageable credit metrics. We ended the quarter with 136 positions, unchanged from the previous quarter's level (excluding cash). 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. Finally, we continue to look for opportunities in convertible bonds and preferred stocks.

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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