Buffalo High Yield Fund

QUARTERLY
COMMENTARY

June 30, 2021

Capital Market Overview

The U.S. high yield market continued its positive return streak in the quarter, posting its fifth consecutive positive quarter, after suffering a significant correction in the March 2020 quarter driven by the COVID-19 outbreak and plunging crude oil prices. In fact, high yield bond yields posted record lows in June, hitting 4.30% as investors seemed willing to believe the Federal Reserves' claim that inflation will prove transitory. The 10-year Treasury Bond returned 3.26% during the quarter while the S&P 500 Index posted a return of 8.55%.

Despite the positive returns, high yield funds experienced a cash outflow of $3.2 billion in the 2nd quarter. Meanwhile, high yield issuers brought the third-highest quarterly volume of new issuance on record with $140.5 billion, which followed the $158.6 billion issued in the preceding quarter. According to JP Morgan, split BBB and BB-rated issues accounted for the bulk of activity (42%), and new issuance was tilted heavily toward Energy (11.4%), Health Care (9.7%), and Services (9.5%).

During the quarter, the 10-year Treasury Bond's yield fell 27 basis points (bps) from 1.74% to 1.47%, reversing a third of the 82 bps increase in the 1st quarter. Every sector in the U.S. high yield universe and every credit rating silo produced positive returns during the period. According to data from JP Morgan, the higher and lower quality ends of the high yield credit spectrum outperformed the split BB/B rated credits, with the lower split B/CCC segment performing the best at 3.90% and 3.31%, respectively. The split BB segment was the laggard with a smaller gain of 2.46%.

According to data from JP Morgan, the U.S. high yield market's spread to worst for the period was 370 bps, 36 bps tighter than the preceding quarter and 225 bps tighter than its 20-year historical average of 595 bps. The yield to worst for the high yield market at quarter end was at an all-time record low of 4.30%, well below the 20-year average of 8.24%, and below the yield of 4.72% at the end of the prior quarter.

Performance Commentary

The Buffalo High Yield Fund (BUFHX) produced a return of 2.52% for the quarter but slightly trailed the ICE BofA U.S. High Yield Index and the Lipper High Yield Bond Funds Index, which both gained 2.77% during the quarter.

Average Annualized Performance (%)

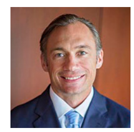
As of 6/30/21	1 YR	3 YR	5 YR	10 YR	15 YR	Since Inception
Investor Class - *BUFHX*	18.44	7.77	6.62	5.87	6.46	7.11
Institutional Class - *BUIHX*[1]	18.58	7.90	6.76	6.02	6.61	7.27
ICE BofAML U.S. High Yield Index	15.62	7.15	7.30	6.50	7.39	7.19
Lipper High Yield Bond Funds Index	16.68	6.66	6.92	5.89	6.28	6.00
Morningstar High Yield Bond Category	14.69	6.16	6.21	5.48	6.17	5.93

[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.

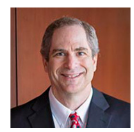
Fund Facts

	Investor	*Institutional*
Ticker:	BUFHX	BUIHX
Inception Date:	5/19/95	7/1/19
Expense Ratio:	1.03%	0.89%
Fund Assets:	$293.91 Million	
Category:	High Yield Bond	
Benchmark:	ICE BofAML U.S. High Yield Index	

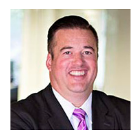
Management Team



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.

BUFFALO FUNDS

Fund Composition by Asset Class

	6/30/20	9/30/20	12/31/20	3/31/21	6/30/21
Straight Corporates	55.4%	60.6%	61.0%	62.7%	61.5%
Convertibles	20.1%	17.6%	14.7%	16.3%	17.0%
Bank Loans	16.6%	16.3%	17.2%	11.2%	13.7%
Preferred Stocks	1.7%	1.5%	1.2%	2.2%	2.3%
Convertible Preferreds	0.0%	0.0%	0.0%	0.0%	0.0%
Common Stocks	0.6%	0.4%	0.1%	0.0%	0.0%
Cash	5.6%	3.6%	5.8%	7.6%	5.5%

Approximate Rate & Contribution of Return in 2Q21

	Contribution to Return
Straight Corporates	1.80%
Convertibles	0.69%
Bank Loans	0.16%
Preferred Stocks	0.11%
Convertible Preferreds	0.00%
Common Stocks	0.00%
TOTAL	**2.52%**

↑ Top Contributors

During the period, only 12 out of 148 issues in the Buffalo High Yield Fund produced negative returns. The top three contributors were Nuance Communications 1.5% convertible bonds, Northern Oil & Gas 8.125% corporate bonds, and Mitek Systems 0.75% convertible bonds. In early April, Microsoft announced the acquisition of Nuance for a 23% premium, driving the strong performance in Nuance convertible bonds. The Northern Oil & Gas bonds, along with the Energy sector as a whole, improved on the back of the 24% rally in West Texas Intermediate crude oil during the quarter, as the COVID-19 vaccinations roll-out increased travel demand. Mitek Systems convertible bonds performed well after beating quarterly expectations and the announced acquisition of ID R&D, a provider of biometric identity fraud software, in early June.

↓ Top Detractors

The Southwest Airlines 1.25% convertible bonds, Air Transport Services 1.125% convertible bonds, and the Lumentum 0.50% convertible bonds were the worst performers during the quarter. Southwest Airlines convertible bonds were the top performer in the preceding quarter, and gave some of that back near the end of this quarter, after the CEO announced he would be stepping down in 2022. Despite Amazon exercising warrants to increase its stake in Air Transport Services to 20% early in the quarter, the convertible bonds declined in conjunction with the common stock, after the company reported that Department of Defense traffic through its Omni Air division was lighter than analysts expected. Lumentum convertible bonds were negatively-impacted after several peer Apple suppliers missed estimates and Lumentum then posted its own disappointing quarterly results.

Outlook

We are monitoring the ongoing recovery from the COVID-19 pandemic and the Federal Reserve's responses to emerging inflation, which will hopefully return to normal later this year and into 2022. The potential for new regulatory changes to various industries from the Biden administration is another area of focus. We are managing the portfolio cautiously yet actively, maintaining our ongoing bias for high-quality issuers with defensive business models and manageable credit metrics. We ended the quarter with 148 positions, up slightly from the previous quarter's level of 143 (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 and less interest rate sensitivity due to their floating rate structures. 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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