Buffalo High Yield Fund

QUARTERLY
COMMENTARY

December 31, 2019

Capital Market Overview

After producing positive returns in the previous two quarters, the U.S. high yield sector continued to push higher in the 4th quarter, albeit to a lesser extent. The market's performance was impacted by: (i) continued modest U.S. gross domestic product (GDP) growth; (ii) a widely-anticipated interest rate cut from the U.S. Federal Reserve (the Fed); (iii) volatile movements in crude oil prices that affected the energy space; and (iv) the equity markets continuing to climb higher. The Fed's rate cut and the resulting decline in short-term interest rates (3Month LIBOR down 18bps to 1.91%) encouraged investors to buy risky assets. The safe haven 10-year Treasury bond returned -1.74% during the quarter while the S&P 500 Index produced a return of 9.07%. The 10-year Treasury bond's yield increased by 25 basis points (bps) from 1.67% to 1.92% during the period.

High yield mutual funds experienced cash inflows of about $3.6 billion during the quarter. This follows $3.8 billion in cash inflows during the prior quarter and a flat second quarter. The $78.6 billion in high yield new issuance during the quarter was up from $67.7 billion during the 3rd quarter. On a year-over-year basis, new issuance was significantly higher than the $19 billion that came to market in the 4th quarter of 2018, which happened to be the lowest quarterly issuance volume in 10 years.

The U.S. high yield universe as a whole produced positive returns in every sector and credit rating silo during the period. According to data from JP Morgan, the lower quality end of the credit spectrum (i.e., single B-rated issues and below) outperformed higher-rated issues. This comes after underperforming higher-rated issuers in the previous two quarters. The non-rated segment produced the highest return of 4.43% while the higher quality split BB-rated tranche was the worst performer at 2.22%.

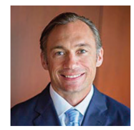
According to data from JP Morgan, the U.S. high yield market's spread to worst for the period was 424bps, which was 143bps tighter than a year ago (December 2018,) and 185bps below its 20-year historical average of 609bps. The yield to worst for the high yield market was 5.91% at quarter end, below the 20-year average of 8.76%, and below the yield of 8.23% from one year ago (December 2018).

The U.S. high yield default rate increased to 2.63% in December, up 11bps from 2.52% in the previous quarter, but still below the long-term average of 3.44%.

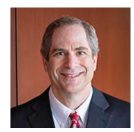
Fund Facts

	Investor	Institutional
Ticker:	BUFHX	BUIHX
Inception Date:	5/19/95	7/1/19
Expense Ratio:	1.02%	0.87%
Fund Assets:	$215.67 Million	
Category:	High Yield Bond	
Benchmark:	ICE BofAML U.S. High Yield	

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.

Performance Commentary

The Buffalo High Yield Fund produced a return of 2.90% for the quarter, which out-performed the ICE BofAML U.S. High Yield Index return of 2.61%. The Fund's result was in-line with the Lipper High Yield Bond Funds Index return of 2.93% during the period.

Average Annualized Performance (%)

As of 12/31/19	1 YR	3 YR	5 YR	10 YR	15 YR	Since Inception
Investor Class - *BUFHX*	12.32	5.18	4.78	6.11	5.69	6.99
Institutional Class - *BUIHX*[1]	12.40	5.31	4.92	6.26	5.84	7.15
ICE BofAML U.S. High Yield Index	14.41	6.32	6.13	7.50	7.11	7.23
Lipper High Yield Bond Funds Index	14.46	6.09	5.41	6.93	6.03	6.00
Morningstar High Yield Bond Category	12.48	5.16	4.78	6.26	5.50	5.95

[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 Composition by Asset Class

	12/31/18	3/31/19	6/30/19	9/30/19	12/31/19
Straight Corporates	68.1%	65.4%	64.7%	65.0%	55.6%
Convertibles	7.6%	10.1%	12.1%	13.4%	17.7%
Bank Loans	20.2%	17.2%	15.2%	16.0%	16.2%
Preferred Stocks	0.0%	0.0%	0.0%	0.0%	1.1%
Convertible Preferreds	0.6%	0.6%	0.0%	0.0%	0.0%
Common Stocks	0.8%	0.7%	1.4%	1.2%	1.7%
Cash	2.7%	6.0%	6.5%	4.4%	7.6%
TOTAL	100.0%	100.0%	100.0%	100.0%	100.0%

Approximate Rate & Contribution of Return in 4Q19

	Unweighted Return	Contribution to Return
Straight Corporates	2.2%	1.31%
Convertibles	8.4%	1.28%
Bank Loans	2.4%	0.37%
Preferred Stocks	6.4%	0.04%
Convertible Preferreds	0.0%	0.00%
Common Stocks	6.6%	0.09%
TOTAL		**2.90%**

↑ Top Contributors

Specific securities that contributed most positively to performance included **Medicines Company** 2.75% convertible bonds, **Teva Pharmaceuticals** 6.75% corporate bonds, and **Maxar Technology** bank debt. Medicines Company convertible bonds rose due to favorable study results for its new cholesterol-lowering medication along with an announcement that the company was being acquired by Novartis. Teva's bonds rallied significantly following favorable court settlements that relieved investor concern over the company's exposure to opioid litigation. Maxar Technology's term loans improved after announcing asset sales that would be used to pay down debt.

↓ Top Detractors

Securities that detracted from performance included **8x8 Inc.** 0.5% convertible bonds, **US Silica** bank debt, and **Quad Graphics** 7% corporate bonds. 8x8 Inc. convertible notes declined as the underlying common stock was negatively-impacted by a sell-off in the Technology sector in early December. US Silica bank debt declined due to a weak earnings report and declining sand prices. Quad Graphics bonds declined following disappointing earnings announcement in late October.

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Outlook

Looking ahead, a growing economy with modest inflation presents a favorable environment for risk assets; however, market participants are becoming increasingly concerned about trade wars, political uncertainty in Washington, and escalating tension in the Middle East.

Given that we are likely in the later stages of the economic cycle we find ourselves confronted with relatively-low spread and yield levels and are therefore managing the Fund cautiously, yet actively. We ended the quarter with 136 positions (excluding cash) compared to 131 positions in the previous quarter. We continue to focus on high-quality issuers with defensive business models and manageable credit metrics, and 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 compelling opportunity as they offer senior positioning in the capital structure and floating interest rates. Finally, we continue to look for opportunities in convertible bonds and preferreds.

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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