Buffalo High Yield Fund

QUARTERLY
COMMENTARY

December 31, 2022

Capital Market Overview

The U.S. high yield sector recorded its first positive quarter after three consecutive losing quarters as investors became more optimistic that the previous aggressive Federal Reserve (the "Fed") actions were taming inflation more quickly than expected. Softer than expected economic data in October and November gave investors hope that the Fed could slow its pace of tightening. In addition, the high yield sector saw strong retail inflows, but very little new issuance, which drove demand for outstanding issues and lifted prices. December reversed course, albeit much more muted, driven by outflows and commentary from Fed officials that was more hawkish than many expected. The JP Morgan Domestic High Yield Index ended the quarter at a yield to worst of 9.23%, down 63 basis points (bps) from the beginning of the quarter, but well above the record low of 4.22% in July 2021. The 10-year Treasury yield rose 6 bps to 3.88% and produced a positive return of 0.56% during the quarter while the S&P 500 Index posted a gain of 7.56%.

High yield funds snapped a streak of quarterly cash outflows that began in the 1st quarter of 2021, posting $7.3 billion of inflows in the 4th quarter. For calendar year 2022, high yield fund outflows were a record -$47 billion, compared to -$13.2 billion of outflows in 2021. Not surprisingly, high yield new issuance remained muted during the quarter with only $16.6 billion, which was the lightest volume since the March 2009 quarter and compares to the quarterly average of $117 billion over the last two years. According to JP Morgan, the Energy sector saw the largest issuance accounting for 19%, followed by Gaming/Lodging/Leisure (14.7%), and Transportation (12.7%).

As mentioned previously, the 10-year Treasury bond yield only rose 6bps from 3.82% to 3.88%, compounding the 80bps increase in the 3rd quarter. According to data from JP Morgan, the -0.94% loss for the CCC credit tier was the only negative return amongst the credit quality silos and underperformed the rest of the credit spectrum, with split BB-rated bonds performing the best (+4.81%) for the quarter. Returns by industrial sector in the U.S. high yield universe were nearly all positive during the 4th quarter. According to data from JP Morgan, the Metals/Mining sector was the best performer with a positive 7.94% return, and Broadcasting was the only sector to deliver negative returns of -0.23%.

According to data from JP Morgan, the U.S. high yield market's spread to worst for the period was 511bps, 63bps tighter than the 3rd quarter and 55bps tighter than the 20-year historical average of 566 bps. The yield to worst for the high yield market at quarter end was 9.23%, above the 20-year average of 7.84%, and well above the 4.71% yield at the end of the December 2021 quarter.

Performance Commentary

The Buffalo High Yield Fund (BUFHX) produced a return of 3.98% for the quarter, a result that was almost in-line with the ICE BofA US High Yield Index which gained 4.01% and slightly ahead of the Lipper High Yield Bond Funds Index which gained 3.91%.

Average Annualized Performance (%)

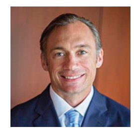
As of 12/31/22	1 YR	3 YR	5 YR	10 YR	15 YR	Since Inception
Investor Class - *BUFHX*	-5.53	2.89	3.64	4.38	5.51	6.54
Institutional Class - *BUIHX*[1]	-5.39	3.05	3.78	4.53	5.66	6.70
ICE BofA US High Yield Index	-11.17	-0.21	2.13	3.95	5.93	6.39
Lipper High Yield Bond Funds Index	-10.28	-0.15	1.99	3.59	4.95	5.31
Morningstar High Yield Bond Category	-10.09	-0.21	1.74	3.20	4.80	5.23

[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.

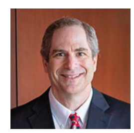
Fund Facts

	Investor	*Institutional*
Ticker:	BUFHX	BUIHX
Inception Date:	5/19/95	7/1/19
Expense Ratio:	1.02%	0.87%
Fund Assets:	$288.36 Million	
Category:	High Yield Bond	
Benchmark:	ICE BofA 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

	12/31/21	3/31/22	6/30/22	9/30/22	12/31/22
Straight Corporates	67.8%	68.3%	69.4%	69.6%	68.4%
Convertibles	7.1%	6.3%	4.6%	4.3%	3.4%
Bank Loans	16.7%	18.5%	18.9%	19.1%	19.1%
Preferred Stocks	2.6%	2.7%	2.9%	2.5%	2.2%
Convertible Preferreds	0.0%	0.0%	0.0%	0.0%	0.0%
Common Stocks	1.3%	0.0%	0.0%	0.0%	0.0%
Cash	4.5%	4.1%	4.1%	4.6%	6.9%

Approximate Rate & Contribution of Return in 4Q22

	Contribution to Return
Straight Corporates	3.20%
Convertibles	0.18%
Bank Loans	0.73%
Preferred Stocks	0.06%
Convertible Preferreds	N/A
Common Stocks	N/A
TOTAL	**3.98%**

↑ Top Contributors

During the quarter, the Fund's three top contributors were the **DirecTV** term loan, the **Ranger Oil** 9.25% '26 corporate bonds, and the **Tutor Perini** 6.875% '25 corporate bonds. As with most leveraged loans, the DirecTV term loan held up well during the quarter due to its higher quality and higher floating rate coupon. Ranger Oil bonds performed well due to its reported strong free cash flows driven by higher oil prices. Tutor Perini, which is a major commercial construction company, benefited from strong cash collections on previously disputed contracts as well as announcing several new major contracts during the quarter.

↓ Top Detractors

The **Mastec** 6.625% '29 corporate bonds, **Lions Gate** 5.50% '29 corporate bonds, and the **Stride Inc.** 1.125% '27 convertible bonds were the worst performers during the quarter. Mastec declined in early October after completing the acquisition of Infrastructure & Energy Alternatives. Lions Gate reported disappointing earnings during the quarter, and questions around the spin-off of Starz network weighed on the bonds. Stride convertible notes declined in conjunction with the underlying common stock after reporting weaker than expected results in late October.

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Outlook

We are focused first and foremost on the Federal Reserve's balancing act between taming inflation while avoiding a recession, economic weakness globally, continued supply chain disruptions, and the geopolitical uncertainty caused by the ongoing conflict in Ukraine. We are managing the Fund cautiously yet actively, focusing on higher-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, while we continue to look for opportunities in convertible bonds and preferred stocks, the increased level of bond yields for traditional bonds/loans in conjunction with the increased volatility of the underlying equities makes these types of securities less appealing to us at this time. We ended the quarter with 128 positions, down from the previous quarter's total of 131.

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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