Buffalo Large Cap Fund

QUARTERLY COMMENTARY

December 31, 2019

Capital Market Overview

The combination of a U.S. Federal Reserve (Fed) interest rate cut, an improving economic outlook, and easing trade tensions, sent equity markets sharply higher in the 4th quarter. The S&P 500 Index advanced 9.10% during the period, which brought the full-year (2019) gain to 31.49%. The Fed cut interest rates three times in 2019, erasing the brief yield curve inversion and assuaging fears of a recession. The economy continued to add new jobs at a strong pace and unemployment declined to 3.5%. Consumer spending remained healthy, and there is optimism for better business investment following the announced "phase one" trade deal with China.

Similar to the S&P 500 Index, the broad-based Russell 3000 Index returned 9.04% during the quarter. Growth outperformed value, as the Russell 3000 Growth Index returned 10.62% compared to a return of 7.41% for the Russell 3000 Value Index. Smaller companies outperformed larger companies, as one would expect in a "risk-on" period. The Russell Microcap Index surged 13.45% and the Russell 2000 Index advanced 9.94%. Large company benchmarks such as the Russell 1000 Index advanced 9.04% while the Russell Midcap Index produced a return of 7.06%. Technology and Health Care were the best performing sectors in the quarter, while more defensive areas of the market lagged such as Real Estate and Utilities. Higher long-term interest rates weighed on high-quality bond proxies – the safe haven 10-year U.S. Treasury Bond produced a return of -1.74% during the quarter.

Performance Commentary

The Buffalo Large Cap Fund produced a return of 8.27% during the quarter, under-performing the Morningstar U.S. Large Growth Index, which gained 10.14%. Although the Fund produced strong absolute performance during the period, stock selection in Financials and Consumer Discretionary were the primary detractors to relative performance, which was offset, in part, by relative strength in Consumer Staples and Real Estate.

Average Annualized Performance (%)

As of 12/31/19	1 YR	3 YR	5 YR	10 YR	15 YR	Since Inception
Investor Class - *BUFEX*	31.77	17.41	13.14	13.38	9.33	9.98
Institutional Class - *BUIEX*[1]	31.98	17.59	13.31	13.55	9.50	10.15
Morningstar U.S. Large Growth Index	33.81	21.79	14.64	15.04	10.01	-
Lipper Large Cap Growth Index	33.39	20.52	13.20	13.66	9.28	8.67

[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.

The Fund ended the quarter with 54 holdings (excluding cash) representing 53 companies, up from 52 holdings representing 51 companies at the end of the previous quarter. The cash position ended the period at about 7% of Fund assets. We initiated three new positions in the Fund, and eliminated one holding during the quarter.

Fund Facts

	Investor	*Institutional*
Ticker:	BUFEX	BUIEX
Inception Date:	5/19/95	7/1/19
Expense Ratio:	0.94%	0.79%
Fund Assets:	$89.88 Million	
Category:	Large Cap Growth	
Benchmark:	Morningstar U.S. Large Growth Index	

Management Team

Alex Hancock, CFA

Manager since 2018
B.A. – Dartmouth College

↑ Top Contributors

Apple was the top-contributing investment for the Fund during the quarter, returning 31%. In spite of exposure to the trade war with China, Apple was a consistent strong performer throughout the year. Sources of this strength included high-margin services growth leading to favorable revenue mix, a positive outlook for new products including wearables and next generation iPhones, and signs that the U.S. is likely to deescalate the trade war with China and reach a "phase one" trade agreement in the New Year.

Microsoft was also a top contributor for the Fund during quarter, returning 13%. The company has generated strong growth across all product lines including server and cloud products and office commercial products. The company appeared well-positioned to continue this steady growth in upcoming quarters.

Alphabet (parent of Google) was also among the best-performing investments for the Fund in the quarter, returning almost 10%. After seeing slowing growth earlier in 2019, the company reported strength in its core advertising business and continues to maintain a very strong competitive position.

↓ Top Detractors

CME delivered the largest drag on the Fund's results during the quarter. While the company has a strong competitive position and very appealing business model, it struggled due to light organic growth on its trading platforms. Reported trading volumes in products such as equity index futures, interest rate futures, and foreign exchange market suggest weakness in 4th quarter results relative to investor expectations.

Under Armour was also a weak performer for the Fund. The company has struggled with inventories, gross margin pressure, and disappointing revenue growth for the past several years. Recent disclosure about an accounting probe negatively-impacted the stock when management reported 3rd quarter earnings in November. Although shares have subsequently rallied, the company's path for returning to sustained growth remains unclear.

Outlook

Looking forward, we remain optimistic about the environment for large cap growth stocks but believe several factors could drive volatility ahead. A policy misstep by the Fed or from key political figures is a concern. In 2019, the Fed's pivot on monetary policy demonstrated willingness by our nation's central bank to be flexible and "data-dependent" by cutting rates three times when there were signs of slowing economic activity.

While trade dynamics seem to change on a daily basis, the rhetoric has died down considerably, and the U.S. and China appear set to ink a phase one agreement. With the presidential election less than a year away, we think it is unlikely President Trump re-escalates the trade war again before November. We believe that we are likely in the later innings of an abnormal economic cycle that has produced below-trend growth and a longer expansionary timeline compared to historical averages. Any sign that the current economic expansion is slowing or ending would likely lead to significant market volatility. We also expect the 2020 political cycle to drive volatility in some of the Fund's investments. The risk that Democrat primary voters nominate a progressive candidate could pressure many large caps, especially those with large weightings in the index such as the "FAANG" stocks due to fear of increased regulation. Furthermore, after the strong returns of 2019 driven primarily by multiple expansion, many large caps are now trading at high absolute valuations as we enter 2020. These elevated valuations could serve to enhance market volatility as these factors play out.

Within this framework, we have been managing the Fund cautiously, yet actively seeking to deploy capital into opportunities that we believe have the most favorable risk/reward tradeoffs. We will continue to focus on large cap companies with strong secular growth opportunities that can potentially benefit from long term trends, are relatively well-positioned to withstand the risk factors cited above, and also trade at attractive valuations. As always, we appreciate your continued support and confidence in our investment capabilities over the long haul.

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