Buffalo Mid Cap Fund

QUARTERLY
COMMENTARY

December 31, 2022

Capital Market Overview

Capital markets rallied modestly in the 4th quarter as the S&P 500 Index gained 7.56%, the only positive quarter for 2022. Cooler inflation readings, resilient consumer spending, and better-than-expected corporate earnings buoyed markets during the first two months of the 4th quarter before pulling back in December. Much of the focus remains on the path of future interest rates, recession fears, and the economic and market impact those events may generate in 2023.

Despite the 4th quarter advance, the stock market recorded its worst calendar year since 2008, with a decline of -18.11% for the S&P 500 Index, and a loss of -32.54% for the growth-oriented and technology-heavy Nasdaq Composite Index. Large cap technology stocks and the more interest-rate sensitive assets suffered the most, while value stocks outperformed. In the end, nine of the S&P 500 Index's 11 economic sectors declined. Energy stocks were the bright spot, recording a gain of 65.72% for the sector while Utilities eked out a gain of 1.57% in 2022.

The damage wasn't isolated to the stock market as the investment-grade bond indices suffered double-digit losses for the year as well. In fact, a traditional balanced investment portfolio of 60% stocks and 40% bonds suffered the 4th worst drawdown in the past 100 years.

Recapping quarterly results, the broad-based Russell 3000 Index advanced 7.18% in the period. Value stocks significantly outperformed growth stocks to close out 2022, as the Russell 3000 Value Index returned 12.18% versus a return of just 2.31% for the Russell 3000 Growth Index. Relative performance was mixed going down in market cap size as small caps advanced less than large caps in the quarter, while mid cap stocks outperformed both large and small caps. Larger cap stocks returned 7.24%, as measured by the Russell 1000 Index, compared to the smaller cap Russell 2000 Index return of 6.23%, while the Russell Midcap Index produced a return of 9.18% in the quarter.

Performance Commentary

The Buffalo Mid Cap Fund (BUFMX) returned 6.10% for the quarter compared to a return of 6.90% for the Russell Midcap Growth Index. Strong stock selection in Industrials and Health Care was offset by some underperforming holdings in Consumer and Technology. Relative performance also suffered from our lack of exposure to the stronger performing Energy sector and an underweight position in Consumer Discretionary stocks, which rallied during the quarter. From a factor perspective, high sales growth underperformed in the quarter, and with the benefit of hindsight, we were too early in upgrading the growth profile of the Fund. While this caused a slight drag on performance during the quarter, we believe it better positions the Fund for the multi-year time horizon.

Average Annualized Performance (%)

As of 12/31/22	1 YR	3 YR	5 YR	10 YR	15 YR	Since Inception
Investor Class - *BUFMX*	-27.80	3.55	7.27	8.81	7.10	7.79
Institutional Class - *BUIMX*[1]	-27.69	3.70	7.42	8.97	7.26	7.95
Russell Midcap Growth Index	-26.72	3.85	7.64	11.41	8.61	8.70
Morningstar U.S. Mid Growth Index	-32.37	4.36	8.40	11.34	8.12	–
Lipper Mid Cap Growth Index	-29.79	2.32	6.70	10.44	7.38	7.78

[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.

Fund Facts

	Investor	Institutional
Ticker:	BUFMX	BUIMX
Inception Date:	5/19/95	7/1/19
Expense Ratio:	1.02%	0.87%
Fund Assets:	$130.67 Million	
Category:	Mid Cap Growth	
Benchmark:	Russell Midcap Growth Index	

Management Team

Josh West, CFA

Co-Manager since 2017
M.B.A. – Univ. of MO-Columbia
B.S. – Univ. of MO-Columbia

Craig Richard, CFA

Co-Manager since 2021
M.B.A. – Univ. of Kansas
B.S. – Kansas State Univ.

Doug Cartwright, CFA

Co-Manager since 2021
M.B.A. – Univ. of WI-Madison
B.S. – Baylor University

↑ Top Contributors

The top contributors to Fund performance during the period were Garter, Ametek, and ABIOMED.

Gartner, a leading research and advisory company, reported strong financial results in the 4th quarter of the fiscal year. The company's revenues and earnings exceeded analysts' expectations, driven by strong demand for its research and consulting services and a return to in-person conferences. Gartner's digital business also performed well, with continued growth in its subscription-based offerings. Additionally, the company's operating margin surprised to the upside as costs related to new hires are ramping slower than expected.

Ametek, a leading global manufacturer of electronic instruments and electromechanical devices, reported strong operating performance in the 4th quarter, highlighted by strong bookings and a record backlog. The company also raised guidance for the year and announced two bolt-on acquisitions. With valuations coming down and ample mergers and acquisition capacity, Ametek is potentially in a good position to take advantage of the market sell-off.

ABIOMED was another top contributor in the quarter, following a bid from Johnson & Johnson to acquire the company.

↓ Top Detractors

Top detractors for the quarter included Palo Alto Networks and DoubleVerify.

Security software provider, Palo Alto Networks, declined during the 4th quarter, despite posting strong results and raising guidance above Wall Street expectations. Investors seem to be concerned that the recent strength in security spending could lose steam and that growth will decelerate against tougher year-over-year comparisons.

DoubleVerify, a leading software platform for digital media measurement and analytics, was also a detractor during the quarter. Shares traded lower as investors grew increasingly concerned about advertising spending against the backdrop of a weakening consumer and tighter corporate budgets. For its part, the company reported strong quarterly results with revenues growing 26% and operating margins improving year-over-year. We recognize there are cyclical headwinds, but DoubleVerify appears well positioned to benefit from the growth in online advertising and the need for independent measurement and audience verification.

Outlook

The 4th quarter was the only quarter of 2022 where equity markets had positive returns, and market narratives continue to focus on the interest rate cycle and Federal Reserve (the "Fed") efforts to tame inflation. The 10-year Treasury yield moved up just eight basis points this quarter, putting the benchmark yield at 3.88%. That compares to a cumulative increase of 230 basis points through the first three quarters of the year. Cooler readings on inflation suggest the Fed's interest rate hikes are having their intended impact on demand, and we suspect that future rate hikes will be more modest in size.

The good news is that inflation is now moderating, even with the economy at full employment. We have seen prices peak for gasoline, ocean freight, used cars, and various commodities. Small business hiring plans are waning. Growth in home prices and rents has slowed. The U.S. dollar has also weakened. The Fed's work might not be complete, but they have done a lot and their inflation fighting appears to be working.

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The bad news is that Fed policy typically works with a lag, and we have yet to feel the full impact of the tightening cycle. Lately, Fed officials have been reiterating their desire to keep interest rates higher for longer, to make sure that inflation doesn't get a chance to reaccelerate. This raises the risk that they are behind the curve and will be overly restrictive for too long. If this plays out, it will weigh on consumer spending and economic growth, and it could lead to job losses and recession.

While it is very difficult to forecast what will happen with the economy, it is an even more futile effort to forecast what the market will do over the next year. We do know that because markets reflect future expectations, stock prices tend to bottom out before the economic data does. We also know that shares of good businesses are trading at more attractive prices than they were a year ago. We think this bodes well for future returns over a multi-year time horizon. Regardless of what happens with the economy or broader equity markets, we will strive to maximize the Fund's risk-adjusted returns by investing in attractively-valued businesses with solid growth opportunities, durable competitive advantages, scalable business models, and exceptional management teams. Thank you for your continued support.

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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