

Buffalo Small Cap Fund

QUARTERLY
COMMENTARY

December 31, 2020

Capital Market Overview

Equity markets extended their rally in the 4th quarter, with the S&P 500 Index returning 12.15%. This capped the end to a historic year in which the S&P advanced 18.40% despite the world suffering through a global pandemic. The biggest news in the quarter was the U.S. Food and Drug Administration's (FDA) approval of two separate vaccines, following very encouraging clinical results. This helped investors look beyond worsening COVID-19 trends and provided hope that an end to the pandemic could be in sight.

The Russell 3000 Index increased 14.68% in the quarter. Value stocks led the advance, as the Russell 3000 Value Index advanced 17.21% compared to the Russell 3000 Growth Index return of 12.41% during the period. Relative performance was inversely correlated by market cap in the quarter (i.e., small caps outperformed big caps). The Russell 1000 Index delivered a return of 13.69% compared to the Russell Mid Cap Index return of 19.91%. Smaller market cap indexes surged even more as the Russell 2000 Index returned 31.37% and the Russell Micro Cap Index returned 31.39%. Cyclically-sensitive sectors such as Energy, Financials, Industrials, and Materials performed best in the quarter. The more defensive areas like Telecom Services, Consumer Staples, Utilities, and Healthcare lagged. All sectors produced positive absolute results.

Performance Commentary

The Buffalo Small Cap Fund (BUF SX) generated a return of 31.36% during the quarter, outperforming the Morningstar U.S. Small Growth Index, which increased 28.12% during same time period. Strong stock selection in Consumer Discretionary, Health Care, and Information Technology were the biggest contributors to outperformance relative to the Index. Meanwhile, negative stock selection in the Financial sector served as a slight offset to performance.

During the quarter, small cap stocks reversed the trend of the first three quarters of 2020, and outperformed large cap stocks by a wide margin. Small cap value stocks also reversed the trend of underperformance in the first three quarters of 2020, and outperformed small cap growth stocks during the period. For the calendar year of 2020, the Fund returned 66.36% and outperformed the Index return of 43.52%.

Average Annualized Performance (%)

As of 12/31/20	1 YR	3 YR	5 YR	10 YR	15 YR	Since Inception
Investor Class - BUF SX	66.36	30.25	24.43	15.94	12.18	13.88
Institutional Class - BUISX ¹	66.60	30.44	24.61	16.11	12.35	14.05
Morningstar U.S. Small Growth Index	43.52	19.98	18.57	14.44	11.23	7.70
Lipper Small Cap Growth Fund Index	37.36	19.91	18.41	13.89	10.47	8.45

¹For 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:	BUF SX	BUISX
Inception Date:	4/14/98	7/1/19
Expense Ratio:	1.02%	0.87%
Fund Assets:	\$955.84 Million	
Category:	Small Cap Growth	
Benchmark:	Morningstar U.S. Small Growth Index	

Management Team



Jamie Cuellar, CFA

Co-Manager since 2015
M.B.A. – Southern Methodist
B.B.A. – Univ. of San Diego



Bob Male, CFA

Manager since Inception
M.B.A. – Southern Methodist
B.S. – University of Kansas



Alex Hancock, CFA

Co-Manager since 2017
B.A. – Dartmouth College



↑ Top Contributors

CareDx was the top contributing stock for the Fund, posting a return of nearly 91% during the quarter. The company is a leader in testing and monitoring solutions for post-transplant patients. In spite of COVID-19 headwinds, the company generated strong growth in product and testing services in 2020. The company has also made large strategic investments that could help to set it up for meaningful growth in 2021 and beyond.

Upwork was another top stock during the period, returning around 98%. The company serves as a platform to match freelance workers with companies needing specialized work or temporary workers. A new management team installed in 2020 has adjusted the company's business model to accelerate demand. The proliferation of "work from home" has also been a driver of demand for the company's platform.

↓ Top Detractors

Palomar was the largest detracting position in the Fund during the quarter. The company is a provider of insurance services and has been a strong performer since its April 2019 initial offering. In October, its share price declined upon preannouncing above-expected policy losses due to hurricane damage on the Gulf Coast. Since that time, the company has taken steps to lower its wind exposure in the Gulf Coast region. By our analysis, the company has a very strong growth outlook into 2021, and we remain optimistic about its long-term fundamental prospects.

Outlook

Looking forward into 2021, we believe many factors point to cautious optimism for small cap growth stocks and the overall market, but perhaps with elevated volatility. Although the January special elections in Georgia have tipped control of the Senate (and, by extension, both houses of Congress) to Democrats, the Democratic majorities are slim, and far narrower than many investors feared leading up to the November election. Given this narrow majority, it will likely be difficult for the Congress to pass sweeping legislation (tax, regulatory, etc.) that would be viewed as negatives for many companies in the small cap universe. Some sectors such as alternative energy and infrastructure could be poised for improved growth in 2021 given the newly elected leadership in the Senate and White House. Control of Congress by the Democrats already appears to be driving some investor flows into small cap companies due to the likelihood of increased stimulus spending, which will likely be beneficial to small caps as they are viewed as more cyclical. We also believe that the "big tech" stocks, which make up an outsized portion of the broad market indexes, could receive more regulatory scrutiny by Democrat-led Congress in coming quarters. This could benefit small cap growth if investors reallocate away from "big tech" into small caps, or if it creates opportunities for market share gain for smaller competitors.

While the initial state-by-state rollout of the vaccines appears sluggish, we think it is likely that much of the vulnerable population in the U.S. can be vaccinated by the end of June. We believe there is large pent-up demand for travel, events, and consumer spending, and many companies in these sectors will see strong earnings growth this year. The jobless rate stands at 6.7%, far below the April 2020 peak of nearly 15%. The state of the U.S. economy will depend, in part, on success in treating the COVID-19 pandemic, but it seems that the U.S. economy will continue to heal and many small cap companies will continue to benefit from continued improvement in consumer confidence. At the same time, U.S. stock markets indexes are near all-time highs, and many stocks are trading at elevated valuations relative to historical averages. We do not expect significant multiple expansion in small caps from current levels, and high valuations could expose stock prices to heightened volatility as 2021 unfolds.

Within the framework above, we are optimistic about the prospects for our small cap growth investments in 2021. We continue to manage the portfolio actively and will allocate capital to opportunities we believe have the best risk/reward tradeoffs. As always, we will reduce or sell positions that have traded above a market cap that we believe is no longer reflective of a small cap company or where valuations appear to be excessive. One of the things we are doing is looking to invest in high-quality companies whose organic growth has been pressured in the near-term by the pandemic-driven slowdown, but still possess strong business models and balance sheets. We believe many of these businesses are using the downturn as an opportunity to operate more efficiently, gain market share, and find new opportunities for growth once the economy returns to a post-COVID "normal". Many of these have traded up since positive vaccine data was announced but still appear to be poised for strong performance in 2021.

Our time-tested strategy of investing in premier companies, which could benefit from long-term trends and also trade at attractive valuations, in our opinion, remains the cornerstone of our work, and we appreciate your continued confidence in our efforts. ▀

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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The Fund's investment objectives, risks, charges, and expenses must be considered carefully before investing. The summary and statutory prospectuses contain this and other important information about the investment company and can be obtained by calling (800) 49-BUFFALO or visiting buffalofunds.com. Read carefully before investing.

Earnings growth is not representative of the Fund's future performance.

As of 9/30/20 Buffalo Small Cap Fund top 10 equity holdings were Natera 3.70%, Bandwidth 2.94%, CareDx 2.52%, Penn National Gaming 2.50%, Kornit Digital 2.30%, Ligand Pharmaceuticals 2.06%, Palomar Holdings 1.97%, Air Transport Services Group 1.95%, ICF Intl 1.85%, Lovesac 1.84%. Top 10 holdings for the quarter are not disclosed until 60 days after quarter end.

The opinions expressed are those of the Portfolio Managers and are subject to change, are not guaranteed, and should not be considered recommendations to buy or sell any security. Fund holdings and sector allocations are subject to change and are not recommendations to buy or sell any security.

The S&P 500 Index is a capitalization weighted index of 500 large capitalization stocks which is designed to measure broad domestic securities markets. The Russell 3000 Index measures the performance of the 3,000 largest publicly held companies incorporated in the U.S. based on market capitalization. The Russell 3000 Value Index is based on the Russell 3000 Index, of companies with lower price-to-book ratios and lower expected growth rates which measures how U.S. stocks in the equity value segment perform. The Russell 3000 Growth Index is a market-capitalization weighted index that measures the performance of those Russell 3000 Index companies with higher price-to-book ratios and higher forecasted growth rates. The Russell 1000 Index is a subset of the Russell 3000 Index and measures the performance of the 1,000 largest publicly-held companies incorporated in the U.S. based on market capitalization. The Russell Midcap Index measures performance of the 800 smallest companies in the Russell 1000 Index. The Russell 2000 Index is an unmanaged index that consists of the smallest 2,000 securities in the Russell 3000 Index, representing approximately 10% of the Russell 3000 total market capitalization. The Russell Micro Cap Index measures the performance of 2,000 small cap and micro cap companies. The Morningstar U.S. Small Growth Index measures the performance of U.S. small-cap stocks that are expected to grow at a faster pace than the rest of the market as measured by forward earnings, historical earnings, book value, cash flow and sales. The Lipper Small Cap Growth Fund Index is an unmanaged, equally weighted performance index of the 30 largest qualifying mutual funds (based on net assets) in the Lipper Small-Cap classification. One cannot invest directly in an index.

Mutual fund investing involves risk. Principal loss is possible. The Fund invests in smaller companies, which involves additional risks such as limited liquidity and greater volatility than larger companies. Investments in foreign securities involve greater volatility and political, economic and currency risks and differences in accounting methods. This risk is greater in emerging markets.

Kornitzer Capital Management is the advisor to the Buffalo Funds, which are distributed by Quasar Distributors, LLC.

