

# Small Cap Fund

PM Commentary as of March 31, 2018



## CAPITAL MARKET OVERVIEW

The long streak of low volatility and positive stock market returns ended in the 1st quarter of 2018. Strong gains in January were erased in February and March, leaving the S&P 500 Index down 0.76% for the quarter. Volatility as measured by the Cboe Volatility Index (VIX) was up about 80% in the 1st quarter after falling for the last three years. Investor worries about increasing interest rates, possible trade wars, and threatened government action against large technology companies, offset generally strong economic data and corporate earnings growth.

The Russell 3000 Index declined 0.64% in the quarter, and, broadly speaking, small cap companies outperformed large cap companies during the period. The Russell Microcap Index advanced 0.68% and the Russell 2000 Index finished the period nearly flat, edging down just 0.08%. Moving up the market cap spectrum, performance worsened – the Russell Mid Cap Index was down 0.46% and the larger cap Russell 1000 Index declined 0.69%. Growth outperformed value by a wide margin during the quarter as the Russell 3000 Growth Index advanced 1.48% compared to a decline of 2.82% for the Russell 3000 Value Index. Technology and Consumer Discretionary were the best performing sectors, while Consumer Staples and Energy were the worst performing.

## PORTFOLIO MANAGEMENT TEAM



**Bob Male, CFA**

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



**Jamie Cuellar, CFA**

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



**Alex Hancock, CFA**

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

## PERFORMANCE COMMENTARY

The Buffalo Small Cap Fund gained 2.32% in the 1st quarter, a result that was in-line with the Russell 2000 Growth Index return of 2.30%. The Index's return was driven mainly by Technology which gained over 10% and drove 220 basis points (bps) of the benchmark's 230 bps total return. Healthcare and Financials also advanced for the Index while most other sectors were down during the period.

The Fund managed to outperform in Technology and Telecom mainly due to solid returns from SaaS (Software as a Service) and UCaaS (Unified Communications as a Service) companies such as **Twilio**, **Zendesk**, **Hubspot**, and **8x8**. Financials also performed very well on a relative basis while Healthcare and Industrials were the largest detractors from performance. Stock selection was beneficial to returns while sector allocation was slightly negative.

Twilio was the largest contributor to performance gaining just over 60% for the quarter. The stock was somewhat controversial last year due to declining sales from a large customer in Uber as well as declining gross margins. Twilio posted a solid month in February, showing extremely high rates of revenue growth of greater than 60% outside of Uber, while gross margins were stable, which led to the stock's significant advance. Despite the move, the stock remains a relative value among high growth software companies, in our opinion, and growth should reaccelerate as the company anniversaries the declines in Uber revenue in the second half of the year.

### Average Annualized Performance (%)

As of 3/31/18	1 YR	3 YR	5 YR	10 YR	Since Inception
<b>Buffalo Small Cap Fund</b>	17.65	8.30	10.11	10.43	11.55
<b>Russell 2000 Growth Index</b>	18.63	8.77	12.90	10.95	6.23

*Expense ratio 1.02%. Inception Date 4/14/1998. 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](http://buffalofunds.com).*

Zendesk was also a solid contributor to return. The company continued to execute at a high level, with increased sales to larger accounts and continued growth in new products, while beating street estimates for revenue and billings growth. Salesforce.com's announced acquisition of Mulesoft at a premium multiple also drove additional investor interest into SaaS companies, which helped boost shares of both Zendesk and Twilio.

**Wageworks** was the largest detractor to performance for the quarter. Shares were weak as the company announced that they would not file their 2017 annual report on a timely basis and would have to restate revenues in 2016 and 2017 due to incorrect accounting for a government contract in 2016. We believe the restatement is fairly small and the company will take the appropriate steps to improve internal controls and make management changes to restore investor confidence.

## OUTLOOK

---

We believe the environment for small capitalization companies in the U.S. remains positive due to lower tax rates, reduced regulation, increased merger and acquisition activity, and good global economic growth. However, we also believe that market volatility could remain heightened throughout the year due to the increased risk of a trade war with China, uncertainty around the approaching mid-term elections, the potential for increased regulation of large technology companies, and increased investor wariness of market valuations in the midst of the elongated bull market cycle.

As always, we continue to look for ways to upgrade the portfolio and have, in fact, reduced the weightings of some of our technology holdings where we believe the upside potential is limited. We will continue to look for ways to take advantage of the volatility to improve potential performance while still maintaining our long-term focus and discipline. ◀

### 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](mailto:ccrawford@buffalofunds.com)  
(913) 647-2321

**Scott Johnson**  
[sjohnson@buffalofunds.com](mailto:sjohnson@buffalofunds.com)  
(913) 754-1537

---

*The Fund's investment objectives, risks, charges and expenses must be considered carefully before investing. The prospectus contains this and other important information about the investment company, and can be obtained by calling (800) 49-BUFFALO or visiting [buffalofunds.com](http://buffalofunds.com). Read it carefully before investing.*

As of 12/31/17 the Buffalo Small Cap Fund's top ten equity holdings were: Catalent 2.32%, Generac Holdings 2.10%, HealthEquity 2.05%, Zendesk 2.00%, MasTec 2.00%, Monolithic Power Systems 1.98%, Five9 1.94%, Bio-Techne 1.90%, Summit Materials 1.81%, WageWorks 1.80%. Top 10 holdings for the quarter are not disclosed until 60 days after quarter end. Those listed are for the previous quarter.

The opinions expressed are those of the Portfolio Manager(s) 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 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 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 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 1000 Index is a subset of the Russell 3000 Index, which 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 Chicago Board of Options Exchange Volatility (CBOE) Index measures the market expectations of near-term volatility conveyed by S&P 500 stock index option prices. The S&P 500 is a capitalization weighted index of 500 large capitalization stocks which is designed to measure broad domestic securities markets. The Russell Micro Cap Index is an unmanaged capitalization weighted index of 2,000 small cap and micro cap companies. 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. It is not possible to invest directly in an index. A basis point or bps is one hundredth of a percentage point (0.01%).

**Diversification does not assure a profit, nor does it protect against a loss in a declining market.**

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

**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. The Fund may invest in U.S. based companies with substantial interests outside of the U.S. which may involve additional risk such as greater volatility and political, economic and/or currency risks. This risk is greater in emerging markets.**

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