

# Small Cap Fund

PM Commentary as of December 31, 2017



## CAPITAL MARKET OVERVIEW

Equity markets ended 2017 on a strong note. The 4th quarter saw a continuation of trends that have influenced the market all year. Investor optimism about improving global economic growth and strong corporate earnings led to another quarter of higher stock prices and low volatility. Strong holiday sales and the passage of tax reform legislation also provided tailwinds to equity markets during the period. Volatility continued to hover near record lows, and, for the first time since 1958, the S&P 500 Index delivered positive returns in every single month of the year.

The Russell 3000 Index produced a total return of 6.34% in the 4th quarter. Growth continued to outperform value, as the Russell 3000 Growth Index advanced 7.61% and outperformed the Russell 3000 Value Index return of 5.08%. Large companies generally outperformed smaller companies during the quarter. The Russell 1000 Index returned 6.59%, the Russell Midcap Index returned 6.07%, the Russell 2000 Index returned 3.34%, and the Russell Microcap Index returned 1.80%. Consumer discretionary and technology were the best performing sectors while utilities, health care, and consumer staples underperformed in the quarter.

## 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 3.80% during the 4th quarter underperforming its benchmark, the Russell 2000 Growth Index, which gained 4.59%. The index generated strong returns across all industries, with the largest advances from consumer staples, energy, consumer discretionary, and industrials. The fund's biggest sources of relative outperformance were in technology and industrials while health care and financials were the largest detractors. For the full calendar year, the fund outperformed the index by 4.90% with a return of 27.07% compared to 22.17% for the index.

**Cavium** was the largest contributor to the fund's performance in the quarter, gaining nearly 29%. The company announced an agreement in November to be acquired by Marvell Technology at a significant premium to its share price. The merger will create a leading company in the semiconductor chip industry.

**Universal Display** was another large contributor during the quarter. The company is a leading provider of materials used in the manufacturing of OLED glass and experienced very strong demand for its products, as mobile phone makers ramp up production of phones with these displays. We believe the long-term outlook for Universal Display is strong, as the mobile phone opportunity continues to unfold and other devices such as tablets and televisions also likely shift to these displays.

**Nevro** declined by about 24% during the quarter and was the biggest detractor for the fund. The company is a leader in the market for spinal cord stimulation products, and the stock declined after giving fairly conservative revenue guidance for the 4th quarter on their 3rd quarter call. However, Nevro gave 4th quarter preliminary results early in 2018 that were much better than consensus, suggesting solid growth remains intact.

### Average Annualized Performance (%)

As of 12/31/17	1 YR	3 YR	5 YR	10 YR	Since Inception
<b>Buffalo Small Cap Fund</b>	27.07	8.85	11.68	8.37	11.57
<b>Russell 2000 Growth Index</b>	22.17	10.28	15.21	9.19	6.19

*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).*

Another investment that underperformed in the quarter was **Twilio**, which offers solutions that enable companies to communicate with their customers via voice, text message, etc. Twilio's share price has been weak as the company is losing revenue from a large customer (Uber), and investors are concerned about potential gross margin erosion. Our long-term outlook for the stock is positive given its large and growing addressable market and our belief that margin contraction concerns are overstated. The company will start to anniversary the reduction in revenue from Uber in 2018 and should return to more normalized growth.

## OUTLOOK

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We continue to be positive on the outlook for smaller capitalization companies in the U.S. The tax legislation passed by Congress at the end of 2017 should disproportionately benefit many small cap companies as their operations are often concentrated in the U.S. and many have historically paid high cash taxes. The ability for companies to repatriate foreign cash at lower tax rates likely increases the amount of merger and acquisition activity and many small companies could be acquisition candidates.

A more business-friendly regulatory environment has given companies increased confidence in making capital expenditures, hiring more employees, and increasing wages. Moreover, the U.S. economy continues to show signs of strength with relatively low unemployment, accelerating U.S. gross domestic product (GDP) growth, and positive commentary from many companies about their outlook moving in 2018.

At the same time, as equity markets trade at or near all-time highs, there is a heightened risk of a sell-off driven by factors such as a policy misstep by central banks, a crisis in a foreign region like the Middle East or North Korea, or companies reporting earnings that fall short of lofty investor expectations. We continue to focus on trimming or selling portfolio positions with limited upside potential while finding new ideas with the potential to benefit from long-term trends and trade at attractive valuations. We are also seeking to maintain a diversified portfolio by monitoring risk exposure to any single stock, business model, or sector. ◀

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### 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:

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

**Joe Pickert**  
[jpickert@buffalofunds.com](mailto:jpickert@buffalofunds.com)  
(913) 647-9875

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*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 9/30/17 the Buffalo Small Cap Fund's top ten equity holdings were: Cavium, Inc. 2.42%, Catalent, Inc. 2.26%, Five9, Inc. 2.21%, Monolithic Power Systems, Inc. 2.18%, Exact Sciences Corp. 2.11%, HubSpot, Inc. 2.06%, HealthEquity, Inc. 2.01%, Bio-Techne Corp. 1.98%, Generac Holdings, Inc. 1.95% & CyrusOne, Inc. 1.83%.

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 S&P 500 Index is a free-float capitalization-weighted index published since 1957 of the prices of 500 large-cap common stocks actively traded in the United States. 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 Russell 2000 Index is a small-cap stock market index of the smallest 2,000 stocks in the Russell 3000 Index based on market capitalization. The Russell Microcap Index is a small-cap and micro-cap stock market index of the smallest 2,000 companies in the Russell 3000E Index incorporated in the U.S. based on market capitalization. The Russell 2000 Growth Index measures the performance of those Russell 2000 Index companies with higher price-to-book ratios and higher forecasted growth values. You can not invest directly in an index.

**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.