

Buffalo Early Stage Growth Fund

QUARTERLY
COMMENTARY

June 30, 2024

Capital Market Commentary

The broad-based equity market advanced in the second quarter (measured by the S&P 500 Index) as the economy continued to grow moderately while inflation and labor market measures eased enough throughout the period that investors became more confident of interest rate cuts. There have been big changes in expectations about the timing and size of interest rate cuts since the start of the year. In January the market was expecting perhaps as many as six rate cuts for 2024, however, that has now shifted to maybe only one or two cuts for the year, starting in September. As has been the case for some time now, however, there was a size bias in performance results during the quarter, which has particularly benefited a few mega-cap companies associated with artificial intelligence (AI). Large cap stocks continued to outperform small cap stocks and growth companies continued to outperform value companies by a wide margin.

Recapping index results, the Russell 3000 Index gained 3.22% during the period. The Russell 3000 Growth Index advanced 7.80% compared to a decline of -2.25% for the Russell 3000 Value Index. Larger cap stocks produced a return of 3.57%, as measured by the Russell 1000 Index, compared to the smaller cap Russell 2000 Index decline of -3.28%. In terms of sector leadership, Technology and Communication Services were the top performers for the quarter while a larger group of companies in the Industrials, Financials, Health Care, Consumer Discretionary, Energy, Materials and Real Estate sectors declined.

Performance Commentary

The Buffalo Early Stage Growth Fund produced a return of -3.16% for the quarter, modestly lagging the Russell 2000 Growth Index return of -2.92%. The first half of 2024 extended the elongated cycle of small caps underperforming large caps. The six-months ending June 30th represented one of the worst periods of small cap versus large cap relative performance as the Russell 2000 Growth advanced 4.44% compared to the Russell 1000 Growth up 20.70%. In fact, according to the investment bank Jefferies, the underperformance of small caps this year has been one of the worst relative stretches since 1973.

To illustrate this trend on a longer-term basis, the 10-year annualized return of the Russell 1000 Growth was 16.33% as of June 30, 2024 compared to the Russell 2000 Growth at 7.39% and the Russell Microcap Growth Index at 3.61%.

Average Annualized Performance (%)

As of 6/30/24	1 YR	3 YR	5 YR	10 YR	15 YR	Since Inception
Investor Class - BUFOX	-2.13	-10.37	5.70	7.22	13.13	8.12
Institutional Class - BUIOX ¹	-2.11	-10.27	5.83	7.37	13.29	8.28
Russell 2000 Growth Index	9.14	-4.86	6.17	7.39	11.59	8.56

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 Institutional 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.

Consumer Staples was the only major sector to produce positive absolute performance for the Russell 2000 Growth Index in the quarter. Declining expectations for interest rate cuts and some signs of moderation in the economy led to broadly lower trends for small caps.

The Fund delivered outperformance in the Industrials and Technology sectors, but that was offset by underperformance in the Consumer Staples and Consumer Discretionary sectors. The rebalancing/reconstitution of the Index in late June 2024 removed the ultra large weights that had grown significantly above "small cap" status in size.

Fund Facts

	Investor	Institutional
Ticker:	BUFOX	BUIOX
Inception Date:	5/21/04	7/1/19
Expense Ratio:	1.50%	1.35%
Fund Assets:	\$72.04 Million	
Category:	Small Cap Growth	
Benchmark:	Russell 2000 Growth Index	

Management Team



Craig Richard, CFA

Co-Manager since 2013
M.B.A. – Univ. of Kansas
B.S. – Kansas State Univ.



Doug Cartwright, CFA

Co-Manager since 2015
M.B.A. – Univ. of WI-Madison
B.S. – Baylor University

Top 10 Holdings*

Transcat, Inc.	3.23%
Compass Diversified Holdings	2.95%
Willdan Group, Inc.	2.94%
Hamilton Lane Incorporated	2.80%
Patrick Industries, Inc.	2.73%
SunOpta Inc.	2.73%
Bowman Consulting Group, Ltd.	2.68%
Kinsale Capital Group, Inc.	2.57%
Verra Mobility Corp.	2.56%
CyberArk Software Ltd.	2.41%
Top 10 Holdings Total	27.60%



↑ Top Contributors

The largest contributor to performance in the quarter for the fund was **Halozyme Therapeutics**. Halozyme offers a drug delivery platform to pharmaceutical companies that allows their drugs to be delivered subcutaneously, often in minutes, versus traditional IV infusion therapy that could take hours to be administered. The company is currently partnered with seven drugs and has a strong pipeline of new drug partners that management believes can double Halozyme's profitability metrics by 2027. The company earns a mid-single digit royalty from these partnerships. Halozyme is a holding that allows the Fund to be involved in a pharmaceutical related name that is not overly dependent on a singular product.

↓ Top Detractors

The largest detractor from performance in the quarter was **Kinsale Capital**. Kinsale is a market share disruptor in the excess and surplus insurance marketplace. The company is experiencing a slowdown in gross written premiums coming off ~40% growth in recent quarters, which was led by the company moving more aggressively into property insurance categories. Management saw attractive opportunities here with traditional carriers exiting some areas given recent heavy losses due to inflation in materials/labor on repairs and the increasing frequency of natural disasters. Premiums from property insurance policies grew to 30% of total and saw ~100% growth in 2023. The company is now rolling off that hyper-growth and is experiencing a normalization of growth. Kinsale has been owned since its initial offering in 2016 and the management team has a proven record of generating value for shareholders.

Outlook

As we enter the third quarter, we have witnessed disinflation with progress towards the Fed's stated goal of a 2% inflation target. This has led to the market expecting two rate cuts before year end starting with the mid-September meeting. While the taming of inflation is a welcome event, the level of price increases over the past four years in numerous categories (>25% in some cases) will likely continue to pressure parts of the U.S. consumer base in the near term.

That said, we believe small caps remain very well positioned to outperform their large cap counterparts after an extended period of underperformance dating back to 2014. A couple of drivers of this potential reversal in relative performance could include pending interest rate cuts. The previous 13 rate cut cycles dating back to 1957 have been very favorable to small cap performance, with the median return in the first six months after the first rate cut approximating 11%. With lowered borrowing costs and lower discount rates applied to future cash flows, small cap stocks should see immediate benefits from rate cuts.

Additionally, small caps are trading 20% below historical relative valuation multiples versus their large cap peers. We believe some revision towards the mean is due to take place if investor interest migrates back to the smaller cap segment of the market. To illustrate how quickly this can happen, softer inflation numbers on July 11th caused the Russell 2000 Growth Index to rally over 3%, beating the Russell 1000 Growth Index (large caps) by over 5% in a single trading day. We believe this performance gap will continue to compress over time.

Our job remains to find and hold attractive small cap companies that have not been fully appreciated by the market or are mispriced due to recent results or events. We believe less investor interest in our segment of the market creates an opportunity for us to uncover value over the long term. The fund typically invests at the smaller end of the small cap growth spectrum and the managers continue to seek companies with sustainable growth due to secular growth trends or innovative, disruptive products.

The Buffalo Early Stage Growth Fund is focused primarily on identifying innovation within U.S. companies with primarily North American revenue bases. With an active share of greater than 90%, a lower turnover strategy with 50-70 holdings, the Fund aims to continue to offer a distinct offering from the Index and category peers. ▀

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.

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 Nasdaq Composite Index is a market capitalization-weighted index of more than 3,700 stocks listed on the Nasdaq stock exchange. 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 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 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 3000 Growth Index is an unmanaged index comprised of those Russell 3000 companies with higher price-to-book ratios and higher forecasted growth values. The stocks in this index are also members of either the Russell 1000 Growth or the Russell 2000 Growth indices. The Russell 3000 Value Index is an unmanaged index with a market-capitalization weighted equity based on the Russell 3000 Index, which measures how U.S. stocks in the equity value segment perform. The Russell Midcap Growth Index is an unmanaged index that measures the performance of those Russell Midcap companies with higher price-to-book ratios and higher forecasted growth values. One cannot invest directly in an index. Active share is a measure of the percentage of stock holdings in a manager's portfolio that differs from the benchmark index. Alpha is a risk-adjusted measure of the so-called active return on an investment. It is the return in excess of the compensation for the risk. An alpha of 1 means the investment's return on investment over a selected period of time was 1% better than the market during that same period; an alpha of -1 means the investment underperformed the market. The Bloomberg US Aggregate Bond Index is a broad base, market capitalization-weighted bond market index representing intermediate term investment grade bonds traded in the United States. The Russell Microcap Index measures the performance of the microcap segment of the U.S. equity market. The Russell 2000 Growth Index is an unmanaged index that measures the performance of those Russell 2000 Index companies with higher price-to-book ratios and higher forecasted growth values. The Russell 1000 Growth is an unmanaged index that measures the performance of those Russell 1000 Index companies with higher price-to-book ratios and higher forecasted growth values. The price-to-earnings (P/E) ratio is a ratio for valuing a company that measures its current share price relative to its per-share earnings. Active share is a measure of the percentage of stock holdings in a manager's portfolio that differs from the benchmark index. Turnover is a measure of the fund's trading activity computed by taking the lesser of purchases or sales (excluding all securities with maturities of less than one year) and dividing by average monthly net assets. A turnover ratio of 100% or more does not necessarily suggest that all securities in the portfolio have been traded. In practical terms, the resulting percentage loosely represents the percentage of the portfolio's holdings that have changed over the past year. Benefits: A low turnover figure (20% to 30%) would indicate a buy-and-hold strategy. The Magnificent Seven is a term used to describe the technology-oriented, highly influential companies of Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla. Basis points (BPS) are one hundredth of a percentage point (0.01%). The Fund does not directly invest in Bitcoin. Bitcoin and other cryptocurrencies are a relatively new asset class and are subject to unique and substantial risks.

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.

*Top Ten Holdings for the quarter are not disclosed until 60 days after quarter end. Those listed are as of 3/31/24. Fund holdings and sector allocations are subject to change and are not recommendations to buy or sell any securities.

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

