

Buffalo Early Stage Growth Fund

QUARTERLY
COMMENTARY

December 31, 2024

Capital Market Commentary

In the final quarter of 2024 investors processed hawkish comments from the Federal Reserve signaling fewer interest rate cuts in 2025. Bond prices fell and yields rose as the outlook for sustained inflation increased, making rate cuts less certain. The yield on the 10-year Treasury note increased from 3.75% at the beginning of October to 4.57% by the end of the quarter. The Treasury yield curve steepened (normalized) and ten-year Treasury notes have a higher yield than three-month Treasury bills for the first time since October 2022.

The broad equity market, as measured by the S&P 500, managed to advance 2.41% in the period, and there was a rotation back into mega cap growth stocks. Tesla, Nvidia, Amazon, Alphabet, and Apple outperformed while value stocks, as a group, declined. The Russell 3000 Growth Index gained 7.07% significantly outperforming the Russell 3000 Value Index return of -1.94%. In general, performance improved moving up in market capitalization (company size) during the period. The small cap Russell 2000 Index returned 0.33%, the Russell Midcap Index advanced 0.62% while the large cap Russell 1000 Index produced a return of 2.75%.

Performance Commentary

The Buffalo Early Stage Growth Fund posted a return of -1.89% for the quarter compared to the Russell 2000 Growth Index return of 1.70%. Small cap growth stocks once again underperformed their large cap counterparts contributing to one of the largest performance gaps in history between the Russell 2000 Growth Index and the Russell 1000 Growth in a single calendar year. For 2024, the Russell 1000 Growth Index returned 33.36% while the Russell 2000 Growth returned 15.15%. Over the past 10-years, the large cap Russell 1000 Growth Index has delivered annualized return of 16.78%, doubling the small cap Russell 2000 Growth Index return of 8.09%.

During the quarter, the market experienced a fair amount of volatility in small caps given the decisive election result that spurred some animal spirits by investors, especially in the first half of the quarter. Various inflation metrics ticked higher in the back half of the quarter prompting the Federal Reserve to communicate a reduced outlook for interest rate cuts into 2025.

Leading contributors to small cap index returns over the past quarter, and trailing 12 months, continued to include companies that we consider speculative, and trading at valuations that are not digestible for a fundamental investor. Many of these companies have heavy retail investor interest and are seeing 20% of their total shares trading on a daily basis versus a more typical 1%.

In-line with this theme, the Technology sector was a detractor from relative performance for the fund as three companies in the index related to quantum computing and AI resulted in a contribution of 1.1% of the index's 1.7% total return.

Average Annualized Performance (%)

As of 12/31/24	1 YR	3 YR	5 YR	10 YR	15 YR	Since Inception
Investor Class - BUFOX	7.52	-6.49	5.41	7.92	12.00	8.22
Institutional Class - BUIOX ¹	7.53	-6.40	5.54	8.07	12.16	8.37
Russell 2000 Growth Index	15.15	0.21	6.86	8.09	10.92	8.86

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:	BUFOX	BUIOX
Inception Date:	5/21/04	7/1/19
Expense Ratio:	1.45%	1.35%
Fund Assets:	\$69.55 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*

Willdan Group, Inc.	3.56%
Hamilton Lane, Inc.	3.52%
Shift4 Payments, Inc.	3.06%
Compass Diversified Holdings	2.87%
ICF International, Inc.	2.73%
Transcat, Inc.	2.73%
Federal Signal Corporation	2.66%
HealthStream, Inc.	2.61%
Halozyne Therapeutics, Inc.	2.61%
Varonis Systems, Inc.	2.55%
Top 10 Holdings Total	28.91%



Industrials was one of the worst performing sectors for the portfolio during the period as the potential for sustained, higher interest rates impacted sentiment and the outlook for construction-oriented businesses. Additionally, the U.S. Presidential election caused a pause in decision making by a lot of industrial clients for their September reporting periods.

Healthcare was the largest positive contributor by sector as the fund was underweight the worst performing benchmark sector in the quarter. Additionally, the portfolio's healthcare holdings generated better returns than the index's healthcare holdings.

↑ Top Contributor

The largest individual contributor to performance for the quarter was **Playa Hotels & Resorts**. Playa owns and manages 24 all-inclusive resorts in Mexico and the Caribbean. The company has reduced its outstanding debt and bought back over 20% of its shares over the last several years while effectively managing the ever-changing travel environment impacted by hurricanes, travel warnings, and other obstacles. Late in the quarter, the company announced it was in negotiations to be acquired by Hyatt Hotels, which contributed to the stock's return of 63% in the quarter.

↓ Top Detractor

One of the top detractors in the quarter was **Option Care Health**. Option Care is the largest home infusion care provider in the U.S. with coverage across all 50 states. Home infusion therapy is cost advantageous for insurance companies and preferred by patients. During the quarter, the company announced that a pharmaceutical partner that produces a drug that is key to Option Care's revenue and earnings was significantly reducing economics with Option Care ahead of the drug going generic. This development produced uncertainty for the company and clouded forward-year earnings estimates. We believe this was a unique instance given the significance of this one drug to the company. For 2025, the remaining business is expected to grow in the high teens as the company continues to grow despite this one-time event.

Outlook

The interest rate cuts in the latter part of calendar 2024 have failed to flow through to consumer and commercial borrowers. U.S. 10-year Treasury yields moved considerably higher due to inflation readings inflecting higher since October. As it stands today, the rate cutting cycle initiated by the Fed is expected to be on pause for most of 2025. We have noted before that rate cutting cycles have historically been most favorable to small caps versus with the rationale being lower borrowing costs and lower discount rates applied to future cash flows are most impactful to smaller companies compared to their large cap peers.

With a more tepid outlook for rate cuts slowing this catalyst, one offset is the domestic consumer and the domestic economy that continues to show stability. The favorable backdrop in the U.S. is more impactful to small caps given they typically have much less exposure to foreign countries (both in operations and in end market consumption) than large caps. Fundamentally, with a more stable interest rate outlook, management teams are more likely to move forward on budgetary decisions which should positively impact smaller companies.

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 small cap 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 fund had 58 holdings at the end of the quarter, which includes four new holdings that were added in the period.

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. A yield curve is a line that plots the yields, or interest rates, of bonds that have equal credit quality but different maturity dates.

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 9/30/24. 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.

