Buffalo Large Cap Fund

QUARTERLY COMMENTARY

September 30, 2023

Capital Market Review

Capital markets pulled back in the third quarter of 2023 as the S&P 500 Index declined 3.27% and the Barclay's Aggregate Bond Index fell 3.23%. Rising bond yields and expectations that the Federal Reserve will maintain interest rates "higher for longer" weighed on investors sentiment. Inflation is trending down; however, it remains above the Fed's target of 2% leading to the central bank's hawkish tilt. Until recently, markets had been forecasting numerous interest rate cuts in 2024, a scenario that now looks unlikely. The yield of the U.S. Treasury 10-year note finished the period at 4.57%, up from 3.9% to start the year. Performance results among eight of the ten economic sectors were negative during the period, but energy rallied over 12% as the price of oil surged 27% during the third quarter. Overall, economic growth appears to be slowing, but most economists are not calling for a recession in the near term.

Recapping broad-based index results, the Russell 3000 Index dropped 3.25%. Relative performance deteriorated going down in market capitalization (size) as small caps declined more than large caps in the quarter. Larger cap stocks produced a return of -3.15%, as measured by the Russell 1000 Index, compared to the smaller cap Russell 2000 Index return of -5.13%. The even smaller market cap Russell Microcap Index pulled back by -7.93% in the quarter.

Average Annualized Performance (%)

As of 9/30/23	1 YR	3 YR	5 YR	10 YR	15 YR	Since Inception
Investor Class - *BUFEX*	26.77	6.94	10.18	12.6	12.3	9.98
Institutional Class - *BUIEX*[1]	26.94	7.08	10.34	12.76	12.46	10.14
Russell 1000 Growth Index	27.72	7.97	12.42	14.48	13.67	10.13
S&P 500 Index	21.62	10.15	9.92	11.91	11.28	–
Morningstar Large Growth Category	23.15	4.18	8.58	11.22	10.90	8.73

[1]For 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. Each Morningstar category average represents a universe of funds with similar objectives.

Third Quarter 2023 Key Takeaways

Mega cap tech or adaptively known as the "Magnificent 7", continued to anchor overall growth equity returns but with more dispersion among the Mag 7 themselves. Accordingly, breadth remains remarkably narrow across the various large cap indices. We feel like the ongoing narrow market breadth leaves investors in a zone of either being leading indicator of further market declines or alternatively, positioned for other large cap sectors and companies to better catch-up with the Magnificent 7 heading into 2024. Over the course of the next two to three months, we believe we will have better clarity about which alternative is more likely.

We continue to see growing concerns around the health of the U.S. Consumer. Consumer confidence has continued to slip and fall below expectations as higher interest rates and elevated gasoline prices take their toll on pocketbooks. Moreover, student loan repayments commenced October 1st adding an additional layer of concern about household's propensity to spend. Partially offsetting these factors is that employment remains strong across the U.S.

Weight loss drugs (GLP-1's such as Wegovy and Monjaro) created a profound investment narrative during the quarter that has negatively impacted various medical device, consumer discretionary and consumer staple stocks. The narrative implies structural changes to food and drink consumption and less need for medical procedures such in areas such as cardiovascular disease and orthopedics. We refer to this as the "great exaggeration" and see selective opportunities to take the other side of this theme

Fund Facts

	Investor	*Institutional*
Ticker:	BUFEX	BUIEX
Inception Date:	5/19/95	7/1/19
Expense Ratio:	0.95%	0.80%
Fund Assets:	$99.62 Million	
Category:	Large Cap Growth	
Benchmark:	Russell 1000 Growth Index	

Management Team

Ken Laudan

Manager since 2021
B.S. – Kansas State Univ.

BUFFALO FUNDS

with company shares that have been overly penalized with GLP-1's being viewed as a significant risk factor from a portion of the population losing 5% to 7% (mean percentage) of their body weight.

Artificial Intelligence also remains a key driver of investor interest and it remains strongly intact. The key question, in our opinion, is how much of the near-term growth is now priced into the key AI beneficiary stocks. We've continued to have overweight exposure, generally to a handful of these companies where the risk/reward upside is likely to hold-up over the next six to nine months. Notwithstanding the remarkably long-term secular outlook of this big macro trend, we do believe there will likely be a digestion point sometime in late 2024 or 2025 where the aggregate AI investment, on a rate of change basis, will decelerate or possibly be negative on a year-on-year basis. The growth outlook of AI investment over the next 10 plus years remains unambiguously positive, however.

Performance Commentary

For the third quarter, the Buffalo Large Cap Fund produced a return of -3.44% versus a decline of 3.13% for the Russell 1000 Large Cap Growth Index and a -3.27% return for the S&P 500 Index. The portfolio was somewhat negatively impacted by declines in two medical device companies and two quick serve restaurants whose share price declines were directly related to investors heighted concerns regarding potential implications from increased uptake of weight loss drugs.

On a year-to-date basis, the Buffalo Large Cap Fund has delivered a return of 23.65% though September 30th versus a gain of 24.34% for the Russell 1000 Growth Index. The S&P 500 Index is up 13.07% year-to-date through the end of September. We remind investors that we remain under-indexed to the Russell 1000 Growth to high growth, high volatility stocks such as Tesla, which is up +103% year to date. Owing to U.S. Securities and Exchange Commission (SEC) regulations regarding diversified investment funds, we remain capped on our position weighting to Alphabet (GOOGL), and Apple (AAPL), which have advanced +48.3% and 38.2% year-to-date, respectively.

↑ Top Contributors

Top absolute contributors to the fund's return for the quarter were Alphabet, Nvidia, and Eli Lilly.

Alphabet, the parent company of Google, has the world's largest search engine at 84% share and generates nearly $225 billion of advertising related revenue annually. The strong outperformance in the quarter and year-to-date reflects the company's early leadership in developing generative AI search and infrastructure technology, specifically tensor processing units (TPU's) which is the compute technology that gives AI the context of various user questions so it can better come up with more predictive and accurate answers. While Alphabet lost the initial thrust to generative AI to Microsoft (Open AI's Chat GPT) the company has subsequently started to take back the early leadership position with their launch of Bard AI search tool. Shares have rebounded strongly (up 48.3%) over the last two quarters as revenue and earnings per share have beaten expectations and as investors have started to view Alphabet as an AI beneficiary, not casualty.

Nvidia is the leader in accelerated compute (e.g AI/ML) and is a critical enabler for deploying AI across several vertical industries. The company's next generation datacenter graphics processing unit, the H100 continues to scale as generative AI becomes a mainstream tool used by consumers in optimizing their internet search results. Enterprises are also accelerating their generative AI product roadmaps looking to achieve higher levels of productivity and further leveraging their own proprietary data to guide improved product fit and service levels. After advancing 90% in the first quarter, Nvidia shares have appreciated another 70% since then on the back of another large jump in sequential revenue growth guidance.

Eli Lilly possesses the fastest revenue and earnings growth in the large cap pharmaceutical category with projected revenue growth in the low to mid double-digits and 20% plus earnings per share growth over the next three years. Lilly is an early leader in the launch of GLP-1's for both Type-2 diabetes and weight loss and is the clear number two player behind the global GLP-1 leader Novo Nordisk (NVO). Shares have responded positively to the uptake and investor attention to this class of weight loss drugs with a gain of 15% in the quarter on top of prior share price expansion of 31% coming into the most recent quarter.

Top Detractors

The top absolute detractors from the fund's performance for the Quarter were Apple, Microsoft, Amazon.

Apple's shares declined 11.6% in the quarter on concerns about its large reliance on China for its supply chain for iPhones, as well as trepidation about the uptake of the iPhone-15 in China and worldwide. We also believe that coming into the quarter shares were richly valued, trading at 31x forward EPS, for a sub-10% revenue growth company. Apple is still the dominant leader in IT consumer space with its leading iPhone share and brand value along with its growing consumer services business via its app-store. We would stress the company is in the middle of a lawsuit with the U.S. Department of Justice (DoJ) regarding the traffic fees or traffic acquisition cost (TACs) it receives from Google for being the preferred search engine that powers Safari on all the iPhones sold by Apple. If the DoJ is successful in its anti-competitive suit against Apple, we estimate, it would impact global revenues by 4% in a worst-case scenario. We would expect Apple to appeal any loss in this decision.

Finally, Apple also has some minor level of exposure to European regulator efforts to reduce the fees/commissions paid by web developers to be offered on the App Store and a potential requirement to carry other app stores such as the Microsoft App store. This will take awhile to play out and we're also aware that Apple may be able to offset any reduction in fees or App store utilization by re-categorizing fees from commissions to an "IP Fee" structure to appear within the the Apple App Store.

Microsoft's shares underperformed in the most recent quarter, declining 11.4% as the company guided revenues a bit below Wall Street's estimates for the upcoming quarter. Management also expects flat operating margins for their new fiscal year related to investments in AI within their gross margin cost structure. The company remains well-positioned to be one of the top one or two intermediate to long term generative AI beneficiaries. The company is now launching their gen AI feature with Office 365 (O365 cloud version) to the over 200 million monthly active users at a price point of $30 per user per month. This launch will be watched with some interest by the investment community to get a sense for what sort of initial interest will be shown by enterprises in engaging with AI tools.

Outlook

Looking ahead we believe that we are at an important inflection point in assessing the global and U.S economic health. After strong equity market performance largely driven by the big gains in the mega cap tech related companies, we now turn our attention to signs of a soft or hard landing for the U.S. and global economies heading into year-end.

We believe, the next two to three months is a key period that will help determine if the economic backdrop of higher rates for longer persists, which could very likely lead to a recession, or if inflation begins to durably decelerate to the 2.0% to 2.5% level without being triggered by an economic credit event or an escalation or expansion in geo-political hot spots.

Without taking a strong binary bet on either of these unknowns, our large cap growth portfolio remains positioned with a bar-bell approach...being invested in the key secular growth companies within tech but also being over-weight defensive areas that have delivered mixed performance YTD but offer what we feel are interesting and attractive risk/reward opportunities.

As always, we appreciate your continued confidence in our investment strategy and approach. It's one that has historically demonstrated a track record of consistent outperformance through various market challenges and opportunities.

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
(913) 647-2321

Scott Johnson
sjohnson@buffalofunds.com
(913) 754-1537

Buffalo Large Cap Fund

QUARTERLY COMMENTARY

September 30, 2023