

# Buffalo Small Cap Fund

QUARTERLY  
COMMENTARY

September 30, 2023

## Performance Commentary

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.

The Buffalo Small Cap Fund generated a return of -9.78% in the third quarter, trailing the Russell 2000 Growth Index return of -7.32%. Weak stock selection within the Healthcare sector was the primary driver of our underperformance in the period. This was partially offset by relatively strong stock selection within the Consumer Discretionary sector.

## Average Annualized Performance (%)

As of 9/30/23	1 YR	3 YR	5 YR	10 YR	15 YR	Since Inception
Investor Class - BUFSX	-2.82	-1.93	4.89	7.43	9.91	10.84
Institutional Class - BUISX <sup>1</sup>	-2.73	-1.81	5.04	7.59	10.08	11.00
Russell 2000 Growth Index	9.59	1.09	1.55	6.72	8.82	5.68
Lipper Small Cap Growth Fund Index	10.81	2.27	4.20	8.09	9.75	6.88

<sup>1</sup>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](http://buffalofunds.com).

## ↑ Top Contributors

The fund's largest contributors to performance for the quarter were **Ollie's Bargain Outlet Holdings** and **Castle Biosciences**. Ollie's, a closeout retailer of brand-name merchandise, had a strong quarter on a surge in bargain hunting behavior as consumers trade-down in a more challenging macro-economic environment. The company has also benefitted from merchandise deal-flow coming from excess inventory held at big box retailers that has driven consumer traffic to their stores. Castle Biosciences, a provider of diagnostic tests for skin cancer, regained momentum in the quarter following some positive developments on reimbursement by Medicare for the company's tests involving risk stratification of melanoma and squamous cell carcinoma.

## Fund Facts

	Investor	Institutional
Ticker:	BUFSX	BUISX
Inception Date:	4/14/98	7/1/19
Expense Ratio:	0.99%	0.87%
Fund Assets:	\$720.76 Million	
Category:	Small Cap Growth	
Benchmark:	Russell 2000 Growth Index	

## Management



### Bob Male, CFA

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



### Craig Richard, CFA

Manager since 2023  
M.B.A. – University of Kansas  
B.S. – Kansas State  
University



## ↓ Top Detractors

Large detractors in the quarter included **Treace Medical Concepts, Inc.** and **Inspire Medical Systems**. Treace designs, manufactures, and markets orthopedic medical devices for the foot and ankle. Treace's share price action in the quarter reflected current investor sentiment souring on longer duration stories that are currently unprofitable. Additionally, weight loss drugs, being front and center recently, with their potential to reduce the need for foot and ankle procedures longer-term also weighed on the stock. Meanwhile, Inspire was negatively impacted by the same factors impacting Treace's shares. Inspire manufactures an implantable device that helps those patients with moderate to severe sleep apnea. It is highly effective for those patients who want a surgical solution to replace CPAP machines/masks where nightly compliance has historically been below 50%. The market became concerned with the potential for weight loss drugs to reduce the patient population suffering from sleep apnea given the potential benefits of weight loss. We continue to believe that Inspire, which is currently addressing just 5-6% of the total potential patient population each year, continues to have a long runway even with higher adoption rates of weight loss drugs.

## Outlook

In the third quarter, the stock market faced declines, primarily attributed to the Federal Reserve's decision to raise interest rates in response to persistent inflationary pressures. These rate hikes contributed to market volatility and raised questions about the trajectory of future rate adjustments. While we anticipate that the Federal Reserve is nearing the end of its tightening cycle, it is important to approach the current economic landscape with caution. We are closely monitoring emerging indicators of economic vulnerability including the recent decline in consumer confidence and the observable slowdown in the housing market. While the employment environment remains strong, persistent inflation has caused excess household savings and money supply to decline.

Amid these challenges, we remain very positive on the outlook for small cap stocks and believe the performance gap that has developed between small and large caps will compress. We are strategically taking advantage of opportunities in the market as small cap valuations remain attractive relative to historical levels and the other traditional market cap ranges (mid-cap and large-cap). This creates an environment ripe for investment in companies that demonstrate durable growth with scalable business models. Furthermore, we gravitate toward companies with strong balance sheets, distinctive product cycles, pricing power and the opportunity to expand market share. We believe that such companies are well-positioned to weather economic headwinds and deliver sustainable returns. As we navigate these dynamic times, we thank you for your continued support. ▲

## 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](http://buffalofunds.com). Read carefully before investing.*

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

As of 6/30/23 the Buffalo Small Cap Fund top 10 equity holdings were DoubleVerify Holdings 2.56%, Summit Materials (A) 2.12%, ICF International 2.03%, Establishment Labs 2.03%, MGP Ingredients 2.02%, Inspire Medical Systems 2.01%, PGT Innovations 1.93%, Treace Medical Concepts 1.93%, Calix 1.86%, Halozyme Therapeutics 1.82%. Top 10 holdings for the quarter are not disclosed until 60 days after quarter end.

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 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 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 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 Midcap Index measures performance of the 800 smallest companies in the Russell 1000 Index. The Lipper Small Cap Growth Fund Index is an unmanaged, equally weighted performance index of the 30 largest qualifying mutual funds (based on net assets) in the Lipper Small-Cap classification. One cannot invest directly in an index. A basis point (bps) is one hundredth of a percentage point (0.01%). A drawdown is a peak-to-trough decline during a specific period for an investment, trading account, or fund. 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.

**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.**

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

