

# Buffalo Small Cap Fund

QUARTERLY  
COMMENTARY

March 31, 2024

## Capital Market Overview

Equity markets continued to move higher in the first quarter of the year as the S&P 500 Index gained 10.56% and closed at an all-time high. The stock market has been quite strong despite dramatic changes in expectations about the timing and size of interest rate cuts since the start of the year. Back in January the market was expecting an interest rate cut in March and perhaps six cuts in total for 2024. However, because of continuing economic strength and stickier inflation, that outlook has now shifted to a June or July rate cut start and maybe only two or three 0.25% cuts for the year. The yield of the 10-year U.S. Treasury note rose to 4.20% at quarter-end, an increase from 3.88% to start the year. The shift in interest rate expectations weighed on bonds during the period and the Bloomberg Aggregate Bond Index declined 0.80%.

Recapping broad-based index results, the Russell 3000 Index gained 10.02% during the period. Growth stocks outperformed value stocks as the Russell 3000 Growth Index advanced 11.23% compared to a gain of 8.62% for the Russell 3000 Value Index. Relative performance improved going up in market capitalization (size) during the quarter as large caps advanced more than small caps. Larger cap stocks produced a return of 10.30%, as measured by the Russell 1000 Index, compared to the smaller cap Russell 2000 Index return of 5.18%. The smaller market cap Russell Microcap Index followed with an advance of 4.68% in the quarter.

## Performance Commentary

The Buffalo Small Cap Fund produced a return of 4.32% for the quarter, a result that trailed the Russell 2000 Growth Index return of 7.58%. The index, made up of over 1,050 constituents, had a unique development in the quarter in that two holdings became some of the largest weightings in the history of the benchmark, and also put-up outsized returns. Super Micro Computer and MicroStrategy are seen as beneficiaries of artificial intelligence (AI) investments and a play on bitcoin, respectively. The fund did not hold either company. Super Micro Computer has a \$60 billion market capitalization and falls outside the spirit of running a small cap portfolio while MicroStrategy is a speculative play on the price of bitcoin and does not have a fundamental story behind it. These two companies contributed approximately 360 basis points of performance to the index in the quarter.

## Average Annualized Performance (%)

As of 3/31/24	1 YR	3 YR	5 YR	10 YR	15 YR	Since Inception
<b>Investor Class - BUFSX</b>	3.88	-8.76	9.22	8.34	12.35	11.12
<b>Institutional Class - BUISX<sup>1</sup></b>	4.07	-8.63	9.37	8.49	12.51	11.29
Russell 2000 Growth Index	20.35	-2.68	7.38	7.89	13.39	6.36
Lipper Small Cap Growth Fund Index	19.70	-0.20	9.47	9.40	13.96	7.53

<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).

We do not believe we will experience anything like this past quarter's occurrence especially as Russell moves to reconstitute their indices twice per year to eliminate the potential for what just transpired. Staying true to the spirit of what fund shareholders have entrusted us to do in managing a small cap portfolio, we will continue to own "small cap" companies. Eliminating these two companies from the index would have resulted in the fund outperforming the benchmark by approximately 50 basis points during the quarter. The fund outperformed across most sectors in the quarter with the lone, large drag coming from the Technology sector related to the index constituents mentioned above.

## Fund Facts

	Investor	Institutional
<b>Ticker:</b>	BUFSX	BUISX
<b>Inception Date:</b>	4/14/98	7/1/19
<b>Expense Ratio:</b>	0.99%	0.87%
<b>Fund Assets:</b>	\$705.85 Million	
<b>Category:</b>	Small Cap Growth	
<b>Benchmark:</b>	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 10 Holdings\*

DoubleVerify Holdings, Inc.	2.86%
Summit Materials, Inc. Class A	2.54%
PGT Innovations, Inc.	2.50%
Hamilton Lane Incorporated Class A	2.46%
Endava Plc Sponsored ADR Class A	2.27%
ICF International, Inc.	2.24%
MGP Ingredients, Inc.	2.21%
AZEK Co., Inc. Class A	2.11%
Calix, Inc.	2.05%
Shift4 Payments, Inc. Class A	2.04%
<b>Top 10 Holdings Total</b>	<b>23.26%</b>



## ↑ Top Contributors

The largest positive contributor to fund results in the quarter was **Establishment Labs**. Establishment Labs is a medical device company focused on bringing safer breast implants to the breast augmentation and reconstruction marketplaces. Following some growth challenges in their international markets in the second half of 2023, fund management added to the position on the pending product launches in China and the U.S., the two largest markets in the world for breast implants. Market sentiment rebounded in the first quarter and the stock appreciated over 90%.

## ↓ Top Detractors

The largest detractor from performance in the quarter was **Endava**, an IT Services provider focused on enabling digital transformation for its corporate clients. In an uncertain macro environment, large clients in the financial services sector have delayed project ramps with Endava while the sales conversion for new project engagements has also stalled a bit. With the valuation multiples at 10-year lows, we look for this current lull in activity to pass and the shares to regain traction in the coming quarters.

## Outlook

The employment environment remains strong while consumer sentiment is being pressured by stubborn inflation. The outlook for the Fed to cut rates has dampened materially since late 2023 as economic readings continue to run hotter than expected. Consensus is now forming around two rate cuts in calendar 2024 versus as many as six rate cuts just five months ago. While inflation is showing progress towards getting to the Fed's target of 2%, this does not take away from inflation seen across food, shelter and used vehicles amongst other categories where prices are 25+% higher than pre-Covid levels.

The previous 13 rate cut cycles dating back to 1957 have been very favorable to small cap stocks, with the median return in the first six months approximating 11%. With lowered borrowing costs and lowered discount rates applied to future cash flows, small cap stocks will see immediate benefits from rate cuts. Regardless of the Fed actions, valuation levels of small caps relative to large caps remain at historically attractive levels. Additionally, the performance gap between small cap stocks and large cap stocks remains wide relative to historical levels, and we believe this performance gap will compress over time.

We continue to seek high quality companies that meet our criteria including strong management teams, consistent free cash flow generation, scalable business models, and sustainable competitive advantages. We believe that such companies are well-positioned to weather economic headwinds and deliver sustainable returns, and this approach allows the portfolio to perform well over full market cycles while being mindful of risk. During the fourth quarter we added three new investment ideas to the fund and exited three positions. At the end of the quarter, the fund held 72 securities. Thank you for your continued trust and interest in the fund. ▲

## 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.**

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 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 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. Free cash flow is a measure of the cash produced by the firm in a given period on behalf of equity holders. The true measure of the value of a firm's equity is considered to be the present value of all free cash flows. The Magnificent Seven is a term used to describe the technology-oriented, highly influential companies of Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla.

**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 12/31/23. Fund holdings and sector allocations are subject to change and are not recommendations to buy or sell any securities.

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

