



Heartland Opportunistic Value Equity Strategy 3Q20 Portfolio Manager Commentary

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Executive Summary

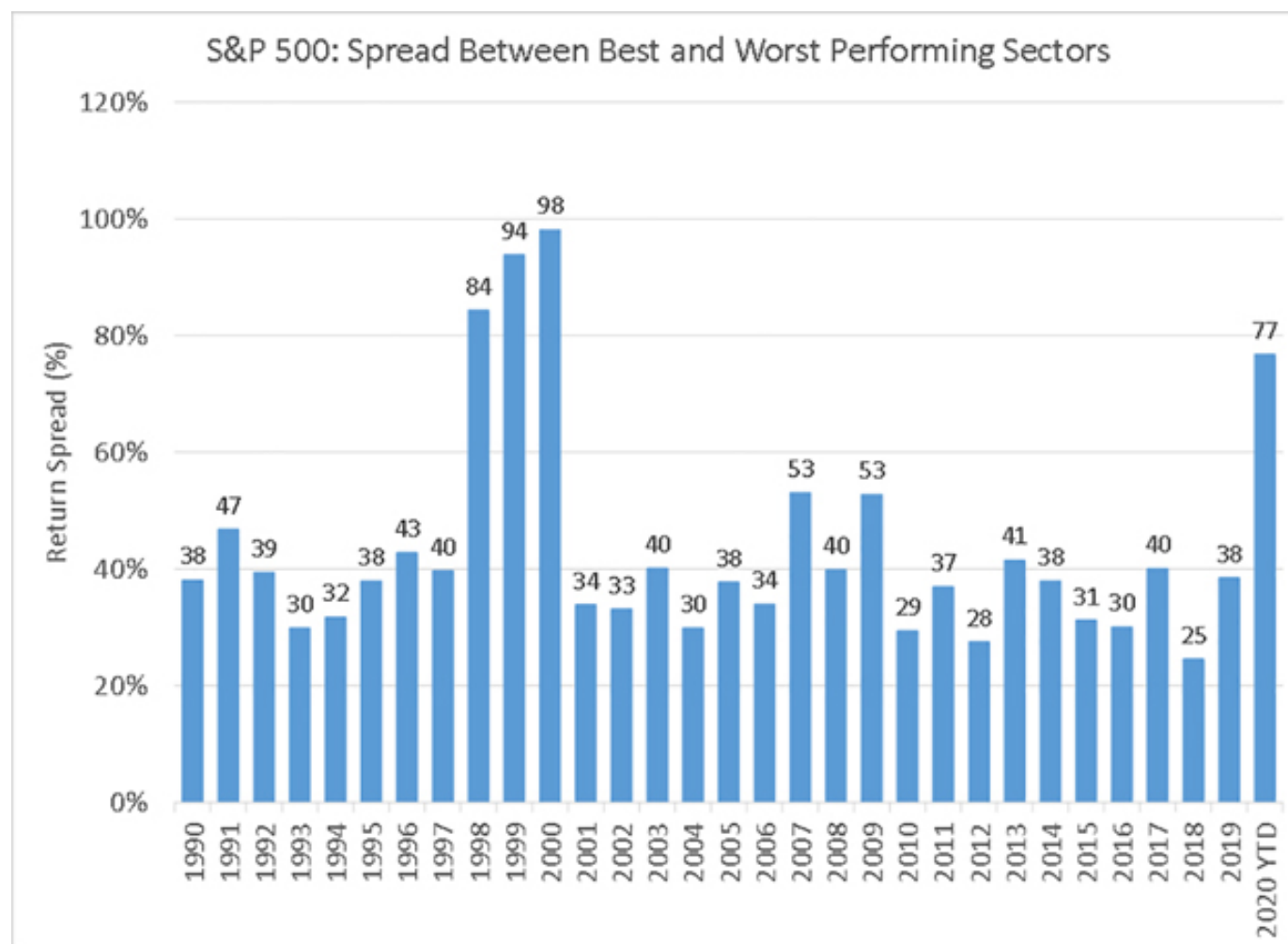
- Equities built on the strength of the previous period as investors concluded that the worst of the COVID-19 recession was over.
- Investors embraced businesses based on rosy earnings forecasts despite elevated valuations.
- The gap between top and bottom performers has reached “Dotcom-era” levels.

Third Quarter Market Discussion

Equities built on the strength of the previous period as investors concluded that the worst of the COVID-19 recession was over. The optimism was grounded in the belief that the combination of an accommodating Federal Reserve and government stimulus would propel earnings to pre-pandemic levels in the coming quarters.

Large growth companies were among the top beneficiaries, as investors seemed to continue to chase yesterday’s winners. The dynamic led to the gap between top and bottom performers reaching levels not seen since the “Dotcom” era, as shown below.

The Haves and The Have Nots



Source: Furey Research Partners, FactSet and Standard & Poor's. 1/1/1990 to 9/30/2020. This chart shows the difference in returns, as a percentage, for the best and worst performing sectors in the S&P 500. Past performance does not guarantee future results.

With the expectation that rates would remain near historically low levels for the foreseeable future, many investors embraced businesses based on rosy forecasts for earnings expansion despite elevated valuations. The dynamic was a headwind for Value investors like ourselves who are focused on owning attractively valued companies that we believe are poised to take market share if the economy stalls or should meaningfully grow earnings during a sustained economic recovery.

Attribution Analysis

Security selection in Industrials and Real Estate was strong on a relative basis but couldn't overcome weakness among Consumer Discretionary holdings and the Strategy lagged its Russell 3000® Value Index benchmark for the period. Allocation decisions moderately boosted results.

A room with a view. As stocks sold off earlier this year in response to the global pandemic, the Team acted opportunistically by adding industry-leading businesses that were trading at significant discounts relative to their intrinsic value. Hilton Worldwide Holdings Inc. (HLT) is an example of this approach.

Hilton, a global hospitality franchise and property manager with roughly one million hotel rooms under the company's operational umbrella, owns popular hotel brands including the namesake Hilton franchise, DoubleTree, Hampton Inn, and Embassy Suites. Hotel owners enter into multi-year franchise agreements with Hilton in return for access to Hilton's property management expertise, booking software, and Hilton Honors loyalty members.

Shares of the company sold off earlier this year as travel restrictions in response to COVID-19 led to a dramatic downturn in room bookings. Hilton was particularly impacted because of the company's focus on the mid and upper-price point and business travel customers. We viewed the slump in share price as an overreaction to a temporary setback for demand and initiated a position in early summer. Since then, revenue per available room night, an industry metric that measures room rate and occupancy, has improved meaningfully and shares rose double-digits this period.

Going forward, we believe Hilton should be a direct beneficiary of rising travel demand, and that the company is in the early innings of a global expansion that could serve as a catalyst for growth in the coming years.

Financially fit. The Strategy's Financials holdings were up modestly for the period and included a top performer. Shares of Berkshire Hathaway Inc. (BRK.B), a multi-business holding company run by legendary investor Warren Buffett, were up after management reported strong earnings and began aggressively repurchasing shares.

Berkshire Hathaway has been volatile this year as investors have been trading the name based on what we view as a

near-term focus. We have taken a longer view and continue to find the company's valuations attractive. Based on our estimates, shares of Berkshire are trading at a 20% discount to the S&P 500, despite the company having an exceptional balance sheet and a portfolio of market leading businesses such as Geico Insurance and BNSF Railway.

Digital divide? A handful of Information Technology (IT) names have been grabbing most of the investment headlines lately, however, as a whole, the sector has been a mixed bag from a performance standpoint. The Russell 3000® Value Index highlights the dynamic where the group ended the period mostly flat. Our holdings in the space outperformed marginally but also contained a key detractor, Cisco Systems, Inc. (CSCO).

Cisco, the world's leading computer networking provider, was down for the period after revenues from its Products and Applications business lines weakened as IT departments postponed network spending in response to COVID-19. Sales from its security line were up roughly 14% but strength in the segment wasn't large enough to offset weakness elsewhere. Impressively, they held operating margin on a 9% revenue decline.

Wall Street's reaction to the weak results were mixed. Some credited the company for executing well in the face of an unprecedented macro pressure on its clients, while others cited results as an indicator that Cisco is struggling in its transformation from a predominantly hardware-oriented business to one that generates recurring-revenue through software and services.

The challenges faced by Cisco strike us as a temporary setback to what has been ongoing progress in its transition to a model that generates recurring revenue and is less tied to the IT spending cycle.

We believe the positive strides made in previous quarters will resume. With the recent setback, shares are trading at an attractive 12x earnings, while generating a nearly 4% dividend yield and a free cash flow/enterprise yield of nearly 10%.

A bad haircut. The portfolio's holding in Consumer Discretionary were off modestly on an absolute basis and lagged the sector average for the benchmark. Most of the weakness came from our stake in a building products company and the dominant U.S. player in flooring. Shares sold off after details from a class action lawsuit filed against the company were disclosed. The lawsuit alleges that management manipulated sales figures for one of its

products through questionable accounting practices.

After digging deeper into the allegations, we chose to significantly reduce our exposure to the name and continue to monitor the situation.

Portfolio Activity

We continue to be patient and disciplined in response to ongoing volatility in the market and let our process guide our buy and sell decisions. Following a consistent approach has allowed us to make upgrades to the portfolio as well as uncover some overlooked businesses trading at discounts because they are in unloved sectors. We've recently found compelling opportunities in Health Care and have added to some of our Consumer holdings.

Outlook and Positioning

The speed and magnitude of changes in the markets caused by COVID-19 has resulted in compressed time horizons for many investors. Instead of weighing opportunities based on valuations and long-term prospects, buyers are snapping up businesses based on price momentum and blue-sky scenarios based on interest rates and inflation hovering near zero for the foreseeable future.

As equities have continued to recover, the pool of opportunity has narrowed. However, our team remains consistent in our approach of seeking financially sound businesses, trading at attractive valuations relative to conservative earnings estimates. This approach should result in a favorable risk-reward profile when viewed over a timeframe of 18 to 36 months.

Thank you for your continued trust and confidence.

Portfolio Management Team



Colin McWey

McWey, CFA, is Vice President and Portfolio Manager for the Opportunistic Value Equity Strategy, as well as the Mid Cap Value Fund and its corresponding Mid Cap Value Strategy. He has 18 years of industry experience, 11 at Heartland.



Will Nasgovitz

Nasgovitz is CEO and Portfolio Manager of the Opportunistic Value Equity Strategy, as well as the Mid Cap Value Fund, the Value Fund, and their corresponding Mid Cap Value and Small Cap Value Strategies. He also is President and Director of Heartland Funds. He has 20 years of industry experience, 16 at Heartland.

Troy McGlone

McGlone, CFA, is Vice President and Portfolio Manager of the Opportunistic Value Equity Strategy. He has 12 years of industry experience, 6 at Heartland.

Composite Returns*

9/30/2020

<> Scroll over to view complete data

	Since Inception (%)	10-Year (%)	5-Year (%)	3-Year (%)	1-Year (%)	YTD (%)	QTD (%)
Opportunistic Value Equity Composite (Net of Advisory Fees)**	8.81	7.51	6.56	0.48	-11.21	-16.19	3.54
Opportunistic Value Equity Composite (Net of Bundled Fees)	6.74	5.42	4.49	-1.46	-12.91	-17.40	3.11
Russell 3000® Value	6.44	9.75	7.43	2.11	-5.67	-12.23	5.42

Source: FactSet Research Systems Inc., Russell Investment Group, and Heartland Advisors, Inc.

*Performance data is preliminary. Yearly and quarterly returns are not annualized. The Strategy's inception date is 9/30/1999.

**Shown as supplemental information.

The US Dollar is the currency used to express performance. Returns are presented net of advisory fees and net of bundled fees and include the reinvestment of all income. The returns net of bundled fees were calculated by subtracting the highest applicable sponsor portion of the separately managed wrap account fee from the net of advisor fees return.



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†Composite return is net of advisory fees.

Past performance does not guarantee future results.

The Opportunistic Value Equity Strategy seeks to capture long-term capital appreciation by investing in companies with market capitalizations greater than \$500 million. The Strategy's flexible pursuit of value positions it as a core holding for investors.

In addition to stocks of large companies, the Opportunistic Value Equity Strategy invests in stocks of small- and mid-cap companies that are generally less liquid than large companies. The performance of these holdings generally will increase the volatility of the strategy's returns.

Value investments are subject to the risk that their intrinsic value may not be recognized by the broad market.

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As of 9/30/2019, Berkshire Hathaway, Inc, Cisco Systems, Inc., and Hilton Worldwide Holdings, Inc. represented 4.80%, 2.69%, and 1.05% of the Opportunistic Value Equity Composite, respectively.

Statements regarding securities are not recommendations to buy or sell.

Portfolio holdings are subject to change without notice. Current and future portfolio holdings are subject to risk.

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Economic predictions are based on estimates and are subject to change.

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Heartland Advisors defines market cap ranges by the following indices: micro-cap by the Russell Microcap®, small-cap by the Russell 2000®, mid-cap by the Russell Midcap®, large-cap by the Russell Top 200®.

Because of ongoing market volatility, performance may be subject to substantial short-term changes.

Dividends are not guaranteed and a company's future ability to pay dividends may be limited. A company currently paying dividends may cease paying dividends at any time.

There is no assurance that dividend-paying stocks will mitigate volatility.

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Heartland's [investing glossary](#) provides definitions for several terms used on this page.

Russell 3000® Value Index measures the performance of those Russell 3000® Index companies with lower price/book ratios and lower forecasted growth characteristics. Intrinsic Value is the actual value of a company or an asset based on an underlying perception of its true value including all aspects of the business, in terms of both tangible and intangible factors. This value may or may not be the same as the current market value. Dividend Yield is a ratio that shows how much a company pays out in dividends each year relative to its share price. Free Cash Flow Yield is calculated as the amount of cash a company has after expenses, debt service, capital expenditures, and dividends divided by either its current market price per share or enterprise value. S&P 500 Index is an index of 500 U.S. stocks chosen for market size, liquidity and industry group representation and is a widely used U.S. equity benchmark. All indices are unmanaged. It is not possible to invest directly in an index.