Heartland Mid Cap Value Fund 1Q21 Portfolio Manager Commentary

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Executive Summary

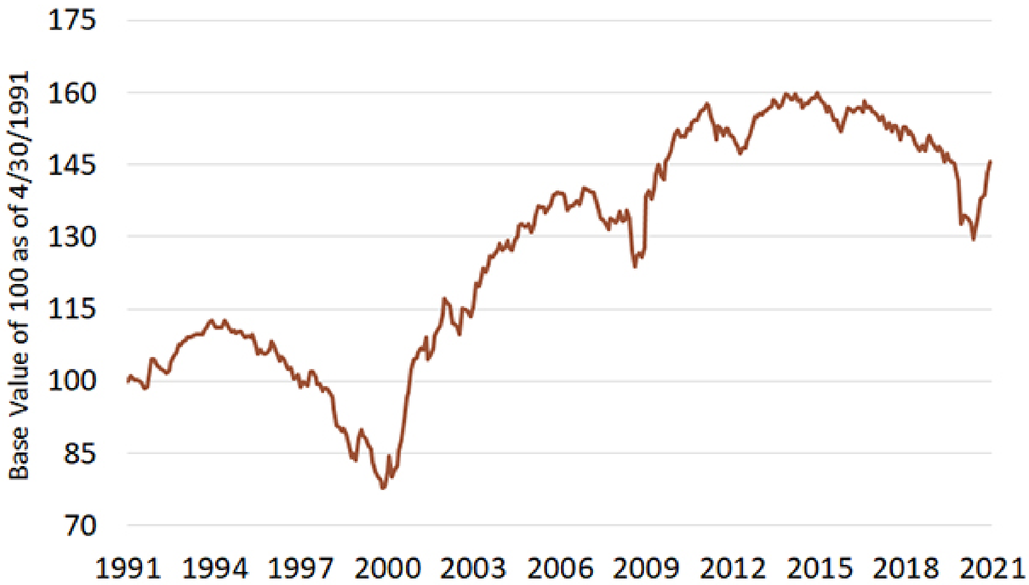
- Stock selection was strong in several sectors, and the portfolio beat its Russell Midcap® Value benchmark for the quarter.
- A sudden rise in yields for treasuries was a headwind for shares of technology companies and other growth stocks.
- The speed and strength of the rally for equities resulted in stretched valuations and may leave little room for error going forward.

First Quarter Market Discussion

A fresh flood of Federal stimulus spending and optimism that the rapid deployment of COVID-19 vaccinations would bring a return to normalcy in the economy boosted investor confidence and resulted in a surge for equities. The growing consensus that the worst of the pandemic was in the rearview mirror prompted investors to broaden their search for opportunities to include previously overlooked areas such as smaller companies and attractively valued businesses.

As shown below, during the first quarter, the equal-weighted S&P 500 index outperformed the S&P 500, a market-cap weighted index with more than 20% of the index in just five companies. The outperformance highlights a broadening of market strength, which is a welcome development for bottom-up investors.

Broad Appeal
Total Return of S&P 500 Equal Weight Index vs. Market Cap Weighted S&P 500 Index



Source: FactSet Research Systems Inc., Monthly data 3/29/1991 to 3/31/2021

The data in the chart represents the S&P 500 Equal Weighted Index less the total return relative to the S&P 500 Index. All indices are unmanaged. It is not possible to invest directly in an index.

Past performance does not guarantee future results.

As economic growth and inflation expectations moved higher, yields on the 10-year U.S. Treasury bond benchmark reached levels not seen since before the pre-pandemic days of early 2020. The sudden uptick was a headwind for shares of technology companies and other growth stocks as it caused investors to favor near-term cash flows over businesses with low or no earnings that were offering rosy forecasts for sales growth further out into the future.

Attribution Analysis

Stock selection was strong in several sectors, and the portfolio beat its Russell Midcap® Value benchmark for the quarter. Holdings in Industrials and Consumer Discretionary performed well on a relative basis while names in Energy were up double-digits but failed to keep pace with the average for those in the benchmark.

On the move. Following a muted start to the year, Industrials gained traction during the second half of the period and posted solid gains. The portfolio's holdings in the space outperformed the benchmark average and contained a top contributor, Amerco (UHAL), a leading provider of moving equipment and storage facilities under the U-Haul brand.

Amerco continues to reap the benefits of accelerating equipment rentals and rising occupancy rates at its self-storage facilities. We believe equipment rental demand surged because COVID-19 caused urban dwellers to migrate out of densely populated business districts as work environments became more flexible. Additionally, Amerco has made progress in leasing newly developed storage units and has moderated spending on the buildout of additional facilities. The efforts resulted in a 6.5% jump in occupancy rates for the most recent quarter.

We expect Amerco will continue to benefit from migration trends that began in 2020. The company's network is particularly well positioned, in our view, for one-way moves because of its comprehensive national footprint. Whether the current trend of migrating away from cities persists or people begin moving back to centralized locations, Amerco should benefit.

Financially fit. A steepening yield curve during the period was welcome news for bank stocks and helped drive double-digit gains for the Financials sector. Our holdings in the space outpaced the benchmark average;

however, we have sought opportunities beyond the banking industry. Longtime holding Reinsurance Group of America, Inc. (RGA) is an example of the type of differentiated business we find attractive in the sector.

Reinsurance Group is the largest pureplay life reinsurance company in the world. Shares of the company were up for the period as concerns over the underwriting exposure posed by mortality rates tied to COVID-19 have subsided and the company has remained profitable throughout the pandemic. Additionally, liabilities tied to a block of policies underwritten during a five-year period beginning in the late 1990s have been more manageable than anticipated.

As the shadow of COVID continues to lift, Reinsurance Group should be well positioned to make greater inroads into the market in Asia where it is already the number-two player. Additionally, the growing need for governments and businesses to offset pension liability risks could be a boon for reinsurers like RGA.

Despite its improving liability profile and strong balance sheet, Reinsurance trades at less than book value. We believe at current levels the company offers an attractive risk/reward profile.

Filling a niche. The Real Estate sector continued to add to the strong run it has enjoyed since the COVID-19 lows of early 2020. At that time, we took a stake in PS Business Parks, Inc. (PSB) based on our view that the market was being overly pessimistic about the long-term prospects for the real estate investment trust (REIT). Our actions were validated as the business has been a solid performer in the portfolio.

PS Business Parks operates in the industrial, warehouse, and “flex” (combination of industrial & office) real estate segment. Unlike competitors who often lease tens of thousands of square feet to single tenants, many of PS Business’ clients rent less than 5,000 square feet at a given location. The business also offers shorter leases—usually one to three years—than many of its peers.

The company’s differentiated approach results in fewer competitors and less pricing pressure when seeking to attract tenants. Many investors initially saw the duration of PSB’s leases as a headwind for the business as the economy shut down and prospects for the commercial real estate market were dismal. However, rent collections and commercial activity have proven more resilient than feared, and PSB’s fundamentals appear to be heading in the right direction.

Longer term, we continue to be impressed with PSB’s management team, which has demonstrated a knack for efficient use of capital all while maintaining a strong balance sheet. Management’s focus on highly efficient capital deployment is evidenced by the company’s trailing 10-year free cash flow to invested capital yield of ~9% vs. an industrial real estate investment trust (REIT) peer median of 2%. The yield is impressive in our view, given the company has grown its inventory of square footage by a 10% compounded annualized growth rate over the past two decades.

Portfolio Activity

The run up in equity prices over the past several months has narrowed the pool of attractively valued businesses. Economically sensitive areas of the market, in particular, have seen valuations stretched—but the impact of investor exuberance is evident in share prices of companies throughout the broader market. In response, we continue to focus on finding and owning companies that are poised to succeed against a variety of backdrops or those that are priced at significant discounts to peers regardless of the sector or industry. Recent addition Post Holdings, Inc. (POST) is an example of the type of business we’ve found attractive.

Post manufactures and markets food products through five business lines including a breakfast cereals unit, a food service division, refrigerated retail products, and active nutrition. Shares of the company came under pressure due to the severe impact the COVID-19 economic shutdown had on its food service segment.

Additionally, investors were wary of the company's use of debt given the uncertainty surrounding how long the economic pullback would last. The bear case against the stock, in our view, is overblown.

In recent years, Post has transformed itself into a higher-growth packaged food enterprise with a diversified portfolio that, taken as a whole, possesses superior growth and free cash flow characteristics vs. its peers. Despite this, shares sell at a meaningful discount to the peer group based on enterprise value/earnings before interest taxes depreciation and amortization, as well as our estimates of the company's intrinsic value. As the economy returns to normal, Post's food service line should rebound, and we believe investors will gain a greater appreciation of the company and its stock.

Outlook and Positioning

Surging economic optimism and a sense that the worst of COVID-19 has passed has been a welcome boost for equities. However, the speed and strength of the rise resulted in stretched valuations that leave little room for error, with signs that investors are increasingly rewarding or punishing businesses based on underlying fundamentals. The rotation has boosted attractively valued businesses and those positioned to benefit the most in the early stages of an economic return to normalcy.

In response to recent strength, we've harvested gains and redeployed capital into areas that offer a more attractive risk/reward profile. Balance sheet strength and catalysts that can result in a change in perception by investors remain a priority and are, in our view, an effective way to mitigate the impact of unforeseen macro risks. We believe this disciplined application of our process will be key to navigating the quarters ahead in a market that may become less forgiving as a result of heightened valuations and expectations.

Thank you for the opportunity to manage your capital.

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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 it's 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, 17 at Heartland.

Troy McGlone

McGlone, CFA, is Vice President and Portfolio Manager for the Opportunistic Value Equity Strategy, as well as the Mid Cap Value Fund and it's corresponding Mid Cap Value Strategy. He has 12 years of industry experience, 6 at Heartland.

View Fund Performance

Fund Returns

3/31/2021

<> Scroll over to view complete data

	Since Inception (%)	20-Year (%)	15-Year (%)	10-Year (%)	5-Year (%)	3-Year (%)	1-Year (%)	YTD* (%)	QTD* (%)
Mid Cap Value Investor Class	10.19	–	–	–	14.07	12.77	81.10	15.81	15.81
Mid Cap Value Institutional Class	10.46	–	–	–	14.36	13.04	81.55	15.83	15.83
Russell Midcap® Value	9.17	–	–	–	11.60	10.70	73.76	13.05	13.05

*Not annualized

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

The inception date for the Mid Cap Value Fund is 10/31/2014 for the investor and institutional class.

Mid Cap Value Fund Quick Links

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In the prospectus dated 5/1/2021, the Net Fund Operating Expenses for the investor and institutional classes of the Mid Cap Value Fund are 1.10% and 0.85%, respectively. The Advisor has contractually agreed to waive its management fees and/or reimburse expenses of the Fund to ensure that Net Fund Operating Expenses for the Fund do not exceed 1.10% of the Fund's average net assets for the investor class shares and 0.85% for the institutional class shares, through at least 5/1/2022, and subject thereafter to annual reapproval of the agreement by the Board of Directors. Without such waiver and/or reimbursements, the Gross Fund Operating Expenses would be 1.21% for the investor class shares and 0.96% for the institutional class shares.

Past performance does not guarantee future results. Performance represents past performance; current returns may be lower or higher. Performance information for institutional class shares of Funds that existed prior to their initial public offering is based on the performance of investor class shares. The investment return and principal value will fluctuate so that an investor's shares, when redeemed may be worth more or less than the original cost. All returns reflect reinvested dividends and capital gains distributions, but do not reflect the deduction of taxes that an investor would pay on distributions or redemptions. Subject to certain exceptions, shares of a Fund redeemed or exchanged within 10 days of purchase are subject to a 2% redemption fee. Performance does not reflect this fee, which if deducted would reduce an individual's return.

An investor should consider the Funds' investment objectives, risks, and charges and expenses carefully before investing or sending money. This and other important information may be found in the prospectus. To obtain a print prospectus, call 800-432-7856. Please read the prospectus carefully before investing.

As of 3/31/2021, Amerco, Post Holdings, Inc., PS Business Parks, Inc., and Reinsurance Group of America, Inc. represented 2.83%, 1.01%, 3.74% and 2.27% of the Mid Cap Value Fund's net assets, 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.

The Mid Cap Value Fund invests in a smaller number of stocks (generally 30 to 60) than the average mutual fund. The performance of these holdings generally will increase the volatility of the Fund's returns. The Fund also invests in mid-sized companies on a value basis. Mid-sized securities generally are more volatile and less liquid than those of larger companies.

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

The Mid Cap Value Fund seeks long-term capital appreciation and modest current income.

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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.

Book Value is the sum of all of a company's assets, minus its liabilities. Bottom-up is an investment approach that de-emphasizes the significance of economic and market cycles. This approach focuses on the analysis of individual stocks and the investor focuses his or her attention on a specific company rather than on the industry in which that company operates or on the economy as a whole. Cyclical Stocks cover Basic Materials, Capital Goods, Communications, Consumer Cyclical, Energy, Financial, Technology, and Transportation which tend to react to a variety of market conditions that can send them up or down and often relate to business cycles. Enterprise Value/Earnings Before Interest, Taxes, Depreciation, and Amortization (EV/EBITDA) Ratio is a financial indicator used to determine the value of a company and is calculated by dividing the entire economic value of the company (enterprise value) by its earnings before interest, taxes, depreciation, and amortization (EBITDA). Free Cash Flow is the amount of cash a company has after expenses, debt service, capital expenditures, and dividends. The higher the free cash flow, the stronger the company's balance sheet. Growth Rate represents the rate of growth of equity securities within the Fund's portfolio and is not meant as a prediction of the funds future performance, income earned by the Fund, or distributions made by the Fund. There can be no assurance that a company's actual earnings growth rate will be consistent with the estimate. 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. Real Estate Investment Trust (REIT) is a security that sells like a stock on the major exchanges and invests in real estate directly, either through properties or mortgages. Russell Midcap® Value Index measures the performance of those Russell Midcap® Index companies with lower price/book ratios and lower forecasted growth characteristics. All indices are unmanaged. It is not possible to invest directly in an index. 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. S&P 500 Equal Weight Index (EWI) is the equal-weight version of the widely used S&P 500. The index includes the same constituents as the capitalization weighted S&P 500, but each company in the S&P 500 EWI is allocated a fixed weight – or 0.2% of the index total at each quarterly rebalance. Yield is the income return on an investment. Yield Curve is a line that plots the interest rates, at a set point in time, of bonds having equal credit quality, but differing maturity dates. In a positive-sloping yield curve, short-term debt instruments have a lower yield than long-term debt instruments of the same credit quality. A negative, or inverted, yield curve occurs when short-term debt instruments have a higher yield than long-term debt instruments of the same credit quality.