Third Quarter 2015

***"When all the forecasts and experts agree, something else is going to happen."***
***—Bob Farrell***

The current bull market has been remarkable. Its length and steadiness are striking. So is the skittishness and investor overreaction that has reared up in response to pockets of bad news: Slowdown in China, oil's setback, and -0.5% negative growth in Canada.

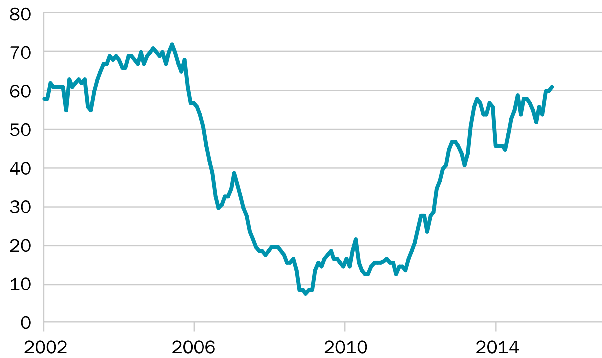
The apprehension that dominated the past few years has returned. The Chicago Board Options Exchange (CBOE) market volatility index (VIX)—also known as the fear index—shot past its previous high of 22.39, reached in mid-January, and peaked at 53 in late August. And redemptions in equity mutual funds continued their brisk pace, with $27 billion coming out in July and August alone.

The uneasiness is widespread. The AAII sentiment survey bullish percentage, which measures optimism among individual investors, sank to 27% mid-way through the quarter—a reading well below its historical average. The CBOE put/call ratio—a gauge of investor bearishness—reached 1.87x, **higher than during the 2008-2009 financial crisis**. Broad-based pessimism drove the markets into the red for the quarter.

**Half full?** In keeping with the overall tone we've seen for most of 2015, the average stock on an equal-weighted basis in the S&P 500 is down 16% for the year and down 27% for the Russell 2000® Index. To our eyes, the angst is based on an incomplete picture that points to the wrong conclusions. Here are some things being overlooked:

- Gross Domestic Product (GDP) second quarter growth was revised upward to a healthy +3.7%.
- Consumer confidence remains robust with the Consumer Confidence Index® jumping to 101.5 in August.
- Car sales are at the highest level in 10 years.
- Housing sales continue to flourish with U.S. housing starts reaching a nearly eight-year high of 1.2 million units annualized.
- Commercial construction spending rose an incredible 72% year-over-year.

**NAHB U.S. Housing Market Index**




Source: Cornerstone Macro, LP, 1/31/2002 to 8/31/2015

**U.S. Manufacturing Construction Spending**


Source: Cornerstone Macro, LP, 1/31/2002 to 7/31/2015, seasonally adjusted

Even the recent market selloff, while painful in the near-term, is to be expected in a healthy market. This summer's correction was the first since 2011. Historically, markets have had a pullback of at least 10% approximately once a year. While never pleasant, we view the widespread selling as a necessary exercise in pruning market excesses.

So what is Heartland's response to an economy that appears to be half full to us and half empty to others? To continue to apply our disciplined approach to evaluating companies on the merits of balance sheet strength, management and valuations.

While we've been steadfast in our approach, recent volatility may be reminding others of the importance of company fundamentals. During the last three months, high debt-to-capital companies have been among the worst performers. Dividend payers have held up better in the downswing, and in the volatile months of August growth names underperformed.

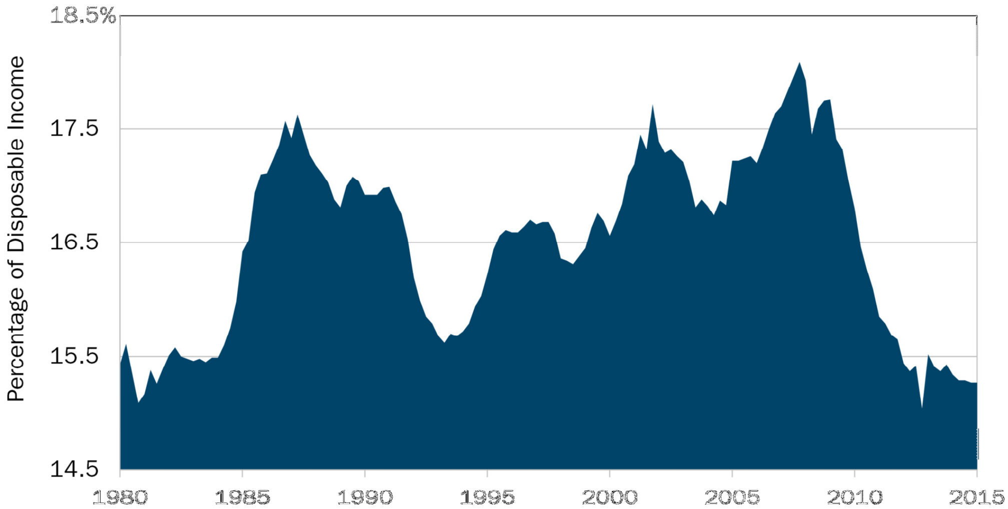
If this trend continues, it should provide a significant boost to the types of companies we favor. For example, the holdings in our domestic portfolios have an average of approximately 18% less debt-to-capital than their respective benchmarks. Our companies are also generally cheaper on both price-to-book and price-to-sales.

## Outlook

For bottom-up stock pickers, macro considerations take a back seat to the fundamentals of industries and individual names. As investors, we examine valuations first and then look for catalysts that will lead to market recognition. We are finding both elements in various areas of the market.

Consumer Discretionary is ripe with opportunities. Here's why: The economy continues to show strength and employment numbers support this view. Consumers are benefiting from a positive job market, low interest rates on loans and cheap gas. They have been cleaning up their balance sheets, and, as illustrated, have less disposable income obligated to pay off debt than at almost any time in the past 30 years.

**U.S. Consumer Financial Obligations**




Source: Evercore ISI Group and the Federal Reserve, Q1 1980 to Q1 2015

Industrials are also attractive. In our opinion, current depressed valuations and the stage of the business cycle could create significant opportunities. Since a pre-2008 peak of 19.78% of GDP, business investment has lagged and stands at 16.9%. We believe it is due for a pick up as companies retool to stay current as well as meet a steady uptick in demand.

**Where we differ.** While the consensus view may be one of skepticism, we believe the economy is solid and strong companies will be rewarded. That enthusiasm carries over to our existing holdings as well as new names we've identified. More importantly, our optimism is anchored by a steadfast belief in our approach and consistent application of our process.  This commitment allows us to identify names that we believe are sound investments regardless of broad forecasts or consensus opinions.

Thank you for the opportunity to manage your capital.

**Past performance does not guarantee future results.**

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Investing involves risk, including the potential loss of principal. There is no guarantee that any particular investment strategy will be successful.

Sector and Industry classifications as determined by Heartland Advisors may reference data from sources such as FactSet Research Systems, Inc. or the Global Industry Classification Codes (GICS) developed by Standard & Poor's and Morgan Stanley Capital International.

**Definitions:** American Association of Individual Investors (AAII: Investor Sentiment Survey: measures the percentage of individual investors who are bullish, bearish, and neutral on the stock market for the next six months by polling AAII members on a weekly basis. Only one vote per member is accepted in each weekly voting period. Chicago Board Options Exchange (CBOE) put/call ratio adds together all of the call and put options that are traded on all individual equities, as well as indices. The ratio attempts to gauge the prevailing level of bullishness or bearishness in the market. Chicago Board Options Exchange Market Volatility Index (CBOE VIX): is a popular measure of the implied volatility of S&P 500 index options. Often referred to as the fear index or the fear gauge, it represents one measure of the market's expectation of stock market volatility over the next 30 day period. Consumer Confidence Index (Conference Board) measures Americans' attitudes about current and future economic conditions. It is based on a monthly survey of 5,000 households conducted by The Conference Board and is benchmarked to a base year of 100 in 1985. Gross Domestic Product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. Price/Book Ratio: of a company is calculated by dividing the market price of its stock by the company's per-share book value. Price/Sales Ratio is the stock price divided by the sales per share for the trailing 12-month period. NAHB Housing Market Index: is based on a monthly survey of NAHB members designed to take the pulse of the single-family housing market. The survey asks respondents to rate market conditions for the sale of new homes at the present time and in the next six months as well as the traffic of prospective buyers of new homes. Total Debt/Total Capital Ratio of a stock is calculated by dividing the short- and long-term debt obligations of the company by its total capital, which is represented by the company's debt and shareholders' equity, which includes common stock, preferred stock, minority interest and net debt. Russell 2000® Index includes the 2000 firms from the Russell 3000® Index with the smallest market capitalizations. 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.



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