

The Only Investment Style You'll Ever Need?

One investment style has had a clear edge over time.

Fund Spy

By Michael Breen

Casting your net in the fishiest waters gives an edge in fishing. The same is true in investing. The ability to slice and dice data using hundreds of specialized statistics can cause us to lose sight of the fact that the underlying goal for most investors remains very straightforward: compound capital at the highest possible rate over time. Beating the overall market over time is a common goal for many funds and investors. We looked at the performance of broad investment styles over time to see if a particular style had done a better job at helping investors meet this goal. A clear pattern emerged.

Top Fishing Hole

Here's what we did. We compared the performance of all domestic-equity share classes with the Dow Jones Wilshire 5000 Index for the trailing 15-year period through Sept. 30, 2007. We chose this index because, unlike the large-cap-leaning S&P 500 Index, it covers the full market-cap spectrum. This stretch of time also represents more than a full market cycle, encompassing the last bear market from 2000 through 2002 and the fantastic bull-run from 1995 through 1999. And it contains enough funds to make meaningful comparisons. We then placed funds into value, blend, and growth groups based on their investment style. Where possible, specialty categories were placed according to style. For example, specialty technology and communications funds landed in the growth camp, while utilities and financials ended up in the value group. Some specialty categories were tough to pigeonhole, so they were not assigned a subgroup.

As the table below shows, one style stood out from the pack. And they've done so consistently, beating all other styles in nearly every decade over the past 80 years. But because of active management and fees, stock performance doesn't always translate into fund performance. In this case it does. More than 70% of value funds topped the Dow Jones Wilshire 5000 in the trailing 10- and 15-year periods. That's a much better record than domestic-equity funds in general, and growth and blend funds in particular.

Investment Style Performance

Group	Percentage of Share Classes Beating DJ Wilshire 5000 Index (10 Years)	Percentage of Share Classes Beating DJ Wilshire 5000 Index (15 Years)
All Domestic Equity Share Classes	43.8%	32.6%
Subgroups		
All Value Share Classes	71.2%	71.4%
All Growth Share Classes	41.9%	32.4%
All Blend Share Classes	46.3%	44.2%

Data through Sept. 30, 2007.

Averages Aren't Equal

The Russell 1000 Value Index has easily topped the Dow Jones Wilshire 5000 over the past 15 years, so value funds have had a leg up. But that's the point. Since value has been the superior style over time, even average value funds have beaten the market. For example, the typical large-value fund has equaled the Dow Jones Wilshire 5000 over the past 15 years. Slightly better-than-average value funds have left it in the dust. And value funds haven't just ridden a tailwind. Nearly 40% of them beat the Russell 1000 Value over the past 15 years, even though it was one of the strongest-performing domestic indexes during that time.

Avoiding Losses Pays Off

Two words explain value's long-term outperformance: downside protection. The math is simple. If a fund loses half its value, it needs to gain 100% just to get back to break-even. In the last bear market from 2000 through 2002, the Dow Jones Wilshire 5000 lost about 40% of its

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Fund spy (cont'd)

value. And excluding value funds, nearly 80% of domestic-equity funds were in the red in that downturn. In fact, many growth funds shed nearly two thirds of their value—a huge hole that would take years to dig out of. Meanwhile, more than 60% of value funds were in the black during the same stretch. Such a big head start coming out of a downturn means that value funds can still outperform over the long haul even if they lag in every bull market.

Never Goes Out of Style

Of course, the past isn't always prologue. But we feel confident about value's prospects. Because of their parsimonious ways and tendency to hold some cash, value funds have always fared better than others in market downturns. There is no reason to believe that this trend will change. So even though growth has been leading a strong market lately, value remains appealing. It may not happen tomorrow or next year, but at some point stocks will experience an extended downturn. When that happens, value's appeal will be even more readily apparent.

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Past performance does not guarantee future results. Value-based investments are subject to the risk that the broad market may not recognize their intrinsic values.

The Dow Jones Wilshire 4500 measures the performance of all small and mid-cap stocks. It is constructed using the Dow Jones Wilshire 5000 securities with the companies in the Standard & Poor's 500 Index removed. The Dow Jones Wilshire 5000 measures the performance of all U.S. equity securities with readily available price data. Over 5,000 capitalization weighted security returns are used to adjust the index. The Russell 1000 Value Index measures the performance of those Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values. The Russell 1000 Index is an unmanaged index of 1000 stocks considered representative of the large-cap market. The S&P 500 Index is the Standard & Poor's composite index of 500 stocks, a widely recognized, unmanaged index of common stock prices. All indices are unmanaged. It is not possible to invest directly in an index.

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