

INVESTOR BEHAVIOR:

HOW INVESTORS' DECISIONS CAN NEGATIVELY AFFECT RETURNS

Research shows that, collectively, equity mutual fund investors' personal portfolios underperform the market in which they are invested. Some common investor behaviors likely contribute to this underperformance. While we hope your experience is different from the average, we also believe it is wise to review the potential causes of self-inflicted damage to your portfolio.

The 2011 QAIB Study

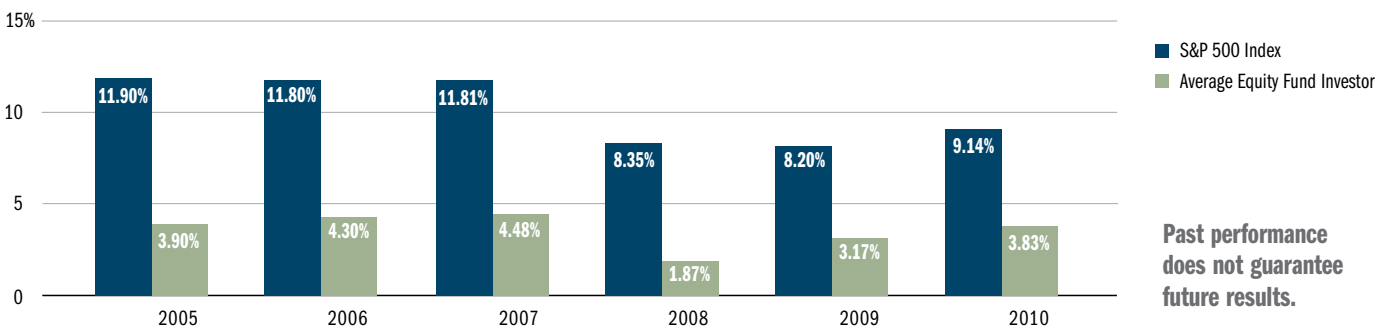
Over the long term the average equity mutual fund investor underperforms the market. This conclusion was re-confirmed for the seventeenth year in a row by DALBAR, Inc. in its study "Quantitative Analysis of Investor Behavior" (QAIB). The DALBAR study reports "Investment results are more dependent on investor behavior than on fund performance. Mutual fund investors who hold on to their investments are more successful than those who time the market." The study shows that decisions made regarding when to buy in or sell out of the market can have a significant impact on the actual results generated within an investor's portfolio.

The performance differences are stark. In 2010, the average equity fund investor underperformed the S&P 500 Index *by almost one and a half percent*. The graph below illustrates this difference, by comparing annualized returns (for the 20 year period previous to the year noted) for the average of all equity mutual fund investors, with to the S&P 500 Index.

We are proud to note that the Heartland Value Fund, with over a quarter century of results, outperformed both investors and the S&P 500 Index over the same periods.

20-Year Annualized Returns

12/31/84 - 12/31/10



Source: DALBAR, Inc. "Quantitative Analysis of Investor Behavior", March 2011, Heartland Advisors, Inc., and Standard & Poor's.



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The DALBAR Report Examines Nine Behaviors Contributing to Those Dramatically Different Results.

Investor Behavior Contributing to Fund Underperformance

- 1. Loss Aversion** Expecting high returns with low risk. Loss Aversion causes the investor to search for investments that don't exist and results in either taking no action or later discovering that the selected investment fails to meet the expectation. The effect is often selling the investment at an imprudent time.
- 2. Narrow Framing** Making decisions without considering all implications. The result is quick decision making without due consideration of potentially consequential facts.
- 3. Anchoring** Relating to familiar experiences, even when inappropriate. Anchoring is a reassuring exercise but can mislead investors unless it is used with caution. For example, investors can be misled about the stability of an investment if analogies are used to represent stability. Analogies of growth can also lead to unrealistic beliefs and expectations.
- 4. Mental Accounting** Taking undue risk in one area and avoiding rational risk in others. Used wisely, Mental Accounting can permit an investor to generate returns in one area while protecting assets in another. Imprudent use of Mental Accounting can be damaging as investors may fail to consider overall portfolio risk.
- 5. Diversification** Simplistic efforts to reduce risk can create a false sense of protection.
- 6. Herding** Copying the behavior of others even in the face of unfavorable outcomes. Investors who go along with the crowd simply because there is one, tend to avoid catastrophic errors but seldom achieve above average results.
- 7. Regret** Considering a potential error of commission to be more serious than an error of omission. Not deciding is a decision... and not deciding to take action is the same as deciding to not take action.
- 8. Media Response** Reacting to news without reasonable examination. Media sources may or may not have thorough authentication. This question of reliability raises concerns about reacting to news.
- 9. Optimism** Believing good things happen to "me" and bad things happen to "others". Optimistic investors hold on to poor investments despite ample evidence that losses are not likely to be recovered.

How You Can Help Yourself

The bad news is investors generally underperform the market. The good news is it doesn't have to be true. Again we quote from the 2011 QAIB study:

As this report has shown for the 17th time in as many years, mutual fund investors consistently underperform the relevant index. The report also shows that most of this loss in performance is due to psychological factors that translate into poor timing of their buys and sells (investor behavior).

Portfolio managers expend enormous efforts determining what investments to make, the right time to buy and the right time to sell so as to gain a few basis points of alpha, only to see retail investors give up percentage points in returns by poor timing of their buys and sells.

While this contradiction between the psychological drivers of investor behavior and prudent investing continues to create enormous lost opportunities, some investors and some advisors have been able to avoid the alpha robbing behavior. This has been achieved by a better understanding and management of the psychological factors coupled with the understanding of the investments being used. (emphasis added).

What's important here is no surprise. By utilizing a systematic, risk-appropriate, long-term approach to investing, you can help counteract the strong behavioral tendencies that destroy value. Most investors know in theory that chasing returns doesn't pay off... but it's very challenging to overcome individual predispositions and behavioral tendencies.

Additional Research¹

Researchers Geoffrey Friesen of the University of Nebraska and Travis Sapp of Iowa State University concluded that over the period 1991-2004 equity fund investors' timing decisions *reduced fund investor average returns by 1.56% annually.*²

They note that mutual fund investors can theoretically enhance returns by selecting high-performing funds, advantageously timing their fund cash flows, or both. But the authors showed that even investors who do select stronger-performing funds have their gains *largely offset by poor timing decisions.*

The authors further concluded that the ability to select good funds and the ability to time cash flows well are not necessarily related. In fact, they state that *"investors who select the best performing funds also exhibit the worst timing performance of all."*

There are several relatively simple things you can do to help prevent falling into these traps.

- 1) Before making a decision to buy or sell a position, always ask yourself whether this decision is based on an objective review of facts. If not, you may be falling prey to one of the nine negative behaviors.
- 2) For those still contributing to their investment strategies, dollar cost averaging is a proven technique that, when faithfully exercised, helps to ensure you are buying more when the market is priced low, and less when the market is priced high.
- 3) Select funds that you believe have a discipline that will outperform, especially when they also have lower volatility than the broader market. Having confidence in your manager, and seeing less volatility of results than the market may make it easier for you to stay the course throughout market cycles, thus potentially breaking the emotional tendency to sell low and buy high.

The volatile and difficult markets of the past decade (plus) have made many investors nervous and jumpy. During this same period Heartland has been working diligently to create wealth for our shareholders in all our Funds, through our time tested discipline. We feel they offer the exceptional results that may just make it easier for an investor to stay the course, thus bettering their chances of avoiding the traps of counter-productive proclivities. Following is a table showing the Funds' results.

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appreciate the
opportunity to
talk with
investors.**

Average Annual Total Returns as of December 31, 2011 – Investor Class Shares

	Since Inception	Twenty-Five Years	Ten Years	Five Years	Three Years	One Year	Quarter-To-Date*
Select Value Fund (HRSVX)	9.57%	—	7.04%	1.73%	15.07%	-6.68%	10.11%
Russell 3000 Value Index	6.90	—	4.08	-2.58	11.62	-0.10	13.33
S&P 500 Index	5.91	—	2.92	-0.25	14.11	2.11	11.82
Value Plus Fund (HRVIX)	10.72%	—	10.15%	5.74%	15.40%	-5.37%	16.32%
Russell 2000 Value Index	9.07	—	6.40	-1.87	12.36	-5.50	15.97
S&P 500 Index	7.72	—	2.92	-0.25	14.11	2.11	11.82
Value Fund (HRTVX)	12.37%	11.42%	7.17%	-1.40%	17.71%	-6.92%	10.87%
Russell 2000 Value Index	10.85	10.22	6.40	-1.87	12.36	-5.50	15.97
S&P 500 Index	10.45	9.28	2.92	-0.25	14.11	2.11	11.82

Source: FactSet Research Systems, Inc. and Standard & Poor's.

*Not Annualized

The inception dates for the Select Value, Value Plus and Value Funds Investor Class Shares are 10/11/96, 10/26/93 and 12/28/84, respectively.

In the prospectus dated 5/1/11, the gross expense ratios for the Heartland Select Value, Value Plus and Value Funds Investor Class shares are 1.23%, 1.17% and 1.14%, respectively. Through 11/30/01, the Advisor voluntarily waived a portion of the Select Value Fund's expenses. Without such waivers total returns would have been lower.

Past performance does not guarantee future results. Performance represents past performance; current returns may be lower or higher. 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. To obtain performance through the most recent month end, call 800-432-7856 or visit www.heartlandfunds.com. 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.

The value of The Fund's investments will vary from day to day in response to the activities of individual companies and general market and economic conditions, which may cause loss of principal.

The Heartland Funds are offered in Investor Class and Institutional Class shares. See our prospectus for more information.

The S&P provides an indication of broad market performance but is not a benchmark of the Funds.

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In addition to stocks of large companies, the Funds invest in small and mid-sized companies that are generally less liquid than large companies. The Select Value Fund and the Value Plus Fund invests in a smaller number of stocks (40 to 60 and 40 to 70, respectively) than the average mutual fund. The performance of these holdings generally will increase the volatility of the Fund's returns. **Value investments are subject to the risk that their intrinsic value may not be recognized by the broad market.**

Definitions

DALBAR is an independent, Boston-based financial research firm. The full "Quantitative Analysis of Investor Behavior 2011", can be found at www.dalbar.com.

Alpha is an annual measure of a portfolio's return in excess of the market return, both adjusted for risk. It is a measure of the manager's contribution to performance due to security selection. A positive annual Alpha indicates that the portfolio outperformed the market on a risk-adjusted basis, and a negative annual Alpha indicates the portfolio did worse than the market.

Average Investor refers to the universe of all mutual fund investors whose actions and financial results are restated to represent a single investor. This approach allows the entire universe of mutual fund investors to be used as the statistical sample, ensuring ultimate reliability.

[Average] Investor Return (Performance) QAIB calculates investor returns as the change in assets, after excluding sales, redemptions, and exchanges. This method of calculation captures realized and unrealized capital gains, dividends, interest, trading costs, sales charges, fees, expenses and any other costs. After calculating investor returns in dollar terms (above) two percentages are calculated:

- Total investor return rate for the period
- Annualized investor return rate

Total return rate is determined by calculating the investor return dollars as a percentage of the net of the sales, redemptions and exchanges for the period.

Annualized return rate is calculated as the uniform rate that can be compounded annually for the period under consideration to produce the investor return dollars.

Basis Point is the relationship between percentage changes and basis points can be summarized as follows: 1% change = 100 basis points, and 0.01% = 1 basis point.

Dollar Cost Averaging does not assure a profit and does not protect against a loss in a declining market. The strategy involves a continuous investment in securities regardless of fluctuating prices. Investors should consider their financial ability to continue purchases through periods of low price levels

Russell 3000 Value Index measures the performance of those Russell 3000 Index companies with lower price-to-book ratios and lower forecasted growth values.

Russell 2000 Value Index measures the performance of those Russell 2000 companies with lower price-to-book ratios and lower forecasted growth values.

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 mentioned are unmanaged. It is not possible to invest directly in an index.

¹ "Mutual Fund Flows and Investor Returns: An Empirical Examination of Fund Investor Timing Ability", Geoff Friesen and Travis Sapp, 2007.

² Using cash flow data at the individual fund level for 7,125 equity mutual funds, Friesen and Sapp, (2007).

Source: DALBAR, Inc. "Quantitative Analysis of Investor Behavior", March 2011, used with permission.

An investor should consider the Fund's investment objectives, risks, and charges and expenses carefully before investing or sending money. This and other important information can be found in the Fund's prospectus. To obtain a prospectus, please call 1-800-432-7856 or visit www.heartlandfunds.com. Please read the prospectus carefully before investing.

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