Heartland Advisors Opportunistic Value Equity Strategy

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Heartland Opportunistic Value Equity Commentary | Heartland Advisors

 Heartland Opportunistic Value Equity Strategy 2Q26 Portfolio Manager Commentary 6/30/2026 Opportunistic Value Equity Strategy Executive Summary

While second-quarter indices pointed to a broadening market, abnormally strong performance was concentrated in a narrow band of technology infrastructure and semiconductor stocks. The strategy returned 12.32%, trailing the Russell 3000(R) Value Index's 14.02%. Strong stock picking across nine of eleven sectors was offset by negative selection and a disciplined underweight position in the Technology sector. There remain compelling opportunities for long-term investors across market caps, sectors, and business models, despite our acknowledgment of a speculative market environment. Second Quarter Market Discussion

Normally, when gauging market breadth, we compare equal-weighted and cap-weighted returns and evaluate small-cap performance relative to large caps. By the latter measure, the U.S. equity market might appear to be broadening: the Russell 2000(R) Index rose 21.49% in the second quarter, versus a 15.20% gain for the S&P 500.

But this is no ordinary market. Over the past three months, investors have focused on a narrow group within the Technology sector: "picks and shovels" equipment suppliers tied to the artificial intelligence (AI) infrastructure boom. For much of the quarter, this theme transcended benchmarks, styles, and market caps. In the Russell 3000(R) Value Index, for example, the Technology sector rose more than 80%, making it the only sector to outperform the Index. Within Technology, the semiconductor industry, whose products are essential to data centers, rose more than 135%, with many constituents up more than 200%. Meanwhile, software companies, which have become viewed as victims of AI disruption, fell 1%, with some down more than 20%.

The bull case for AI is predicated on the technology creating a productivity boom, which has taken place following past technological revolutions including the printing press, internal combustion engine, railroad, semiconductor, and internet. Realizing the promises of tomorrow requires a multi-year infrastructure buildout, measured in trillions of dollars, that is currently benefiting dozens of companies across multiple sectors. As the chart below shows, Tech investment spending has accounted for the vast majority of U.S. GDP growth in Q1 2026 and Q4 2025, despite consumer spending historically being the key driver of economic growth.

Source: @2026 The Leuthold Group via the U.S. Bureau of Economic Analysis. Quarterly data from 3/31/2021 to 3/31/2026. This chart compares contributions to real U.S. GDP growth from the broader economy (GDP excluding technology) and from technology investment. Past performance does not guarantee future results.

The question is whether this forecasted spending pace is sustainable. While recent earnings are strong, future expectations are high: consensus next-12-month S&P 500 earnings per share is projected to grow 30% year-over-year. If realized, this earnings growth would mark the third-fastest pace over the past quarter-century, and the fastest for an economy not emerging from a recession.

Still, aggregate corporate earnings may be flattered, since the companies receiving this spending are recording profits today as they ship products while the companies funding the buildout can treat them as capital investments and depreciate the costs over several years, a timing difference that can boost reported profits in the near term. Moreover, this spending boom is increasingly being funded by the debt and equity capital markets. If the capital markets tighten, today's winners could re-rate quickly and the economy could suffer a hangover.

Then there's the question of the job market. The AI boom has been predicted on the technology producing productivity gains significant enough to disrupt the labor market. But the bear case also hinges on jobs-or, more precisely, it centers on the financial strength of consumers, which depends heavily on employment. But if white-collar workers begin losing their jobs to AI, what would that mean? What if the process has already begun but is being masked by the positive impact of the AI infrastructure buildout?

No one can predict exactly how this will play out. This is why we believe it is important to focus on a range of possible outcomes. For us, part of that process involves setting four price targets for every business we analyze, assuming a variety of different scenarios-good and bad. Having a range of forecasts allows us to assess whether market movements are being driven by fundamentals, sentiment, or both. Thinking carefully about what could go wrong is not an exercise in pessimism. It is part of our discipline as long-term value investors. It helps us avoid overpaying when enthusiasm is high and act decisively when volatility creates opportunity.

Attribution Analysis

During the quarter, our Strategy returned 12.32%, versus 14.02% for the Russell 3000(R) Value Index. While security selection was positive in nine out of eleven sectors, led by Communications, Materials, and Industrials, negative selection within the Technology sector offset these benefits.

However, three of our top five contributors in the quarter were large technology equipment makers whose products are in demand due to the data center buildout. Our sector holdings were up 40% over the past three months, representing the top performing group in our portfolio. Even so, those gains were only about half of the benchmark's return for the sector.

Our Strategy was also underweight Technology relative to the benchmark because we reduced exposure as holdings hit or exceeded their price targets. This underweight position and not owning the most speculative companies in the industry, helps explain our underperformance.

Portfolio Activity

A significant contributor to second-quarter performance was Texas Instruments (TXN) , which joined the AI infrastructure narrative, though it still underperformed the Tech sector.

Texas Instruments is the world's largest analog semiconductor manufacturer, selling low-cost chips to a variety of end markets, including the auto industry, communications equipment manufacturers, and other industrial customers. TXN's sales have recently been turbocharged by the AI infrastructure boom, as its chips support critical data center functions such as electrical power regulation and management. Its chips are also used in AI-driven devices, vehicles, and industrial equipment. Texas Instruments' data center power management revenues are up more than 90% year over year. Even if abnormally strong data center growth continues for years-and we expect it to-the industry will remain a relatively small share of total revenue through 2030.

Although the stock rose more than 70% through late June, which is extremely rare for a company of TXN's size and maturity, we believe there are several operational inflections that could continue to drive TXN's improved relative performance versus its analog semiconductor peers and the broader Technology sector; most importantly, the company has passed peak capital expenditures as part of a multi-year fabrication-capacity buildout. As a result, higher fab utilization should drive attractive incremental profits and cash flow that can be returned to shareholders. After its recent rally, the business is now trading between our price target and intrinsic value. However, it is far less aggressively valued than many of its peers. During the quarter, we trimmed other Technology holdings that traded closer to our estimate of intrinsic value.

While TXN was one of our top contributors last quarter, the biggest detractor to our Strategy's performance was MarketAxess Holdings (MKTX) , a position we initiated in the first quarter and built in the second quarter. MKTX operates the largest U.S. corporate bond e-trading platform. It sits in a market blind spot-neither championed as an AI winner nor penalized by the AI disruption narrative-offering a high-quality, attractively valued profile with self-help-driven margin expansion potential. However, current macro conditions are a headwind. Heavy primary bond issuance volume, much of it financing the AI boom, alongside tighter credit spreads, has temporarily diverted trading volume away from MKTX's core secondary market.

Why do we remain confident in MKTX? First, the company is exiting a heavy investment cycle that historically pressured margins, setting up strong operating leverage as the pace of spending plateaus and volumes improve. Second, industry trading data indicates market share gains across a key U.S. credit trading protocol where the company investments have been focused. Third, MKTX holds distinct scale advantages in developed international and emerging markets, where electronic trading penetration is still low by comparison to the U.S. Valuation is also highly compelling: the stock trades at 8.8X consensus 2026 Enterprise Value/EBITDA versus a domestic peer median of 14.0X. Despite its superior profit margins and balance sheet, MarketAxess yields over 8% on a FCF/EV basis and is well-positioned for a multi-year profit growth cycle.

A new portfolio addition last quarter was MSA Safety (MSA) , which designs and manufactures firefighting equipment, gas detectors, and industrial safety equipment.

MSA's fundamentals have been choppy in recent years against a backdrop that has favored AI infrastructure exposure over more mature industrial equipment makers. Last year, MSA's Fire Service segment sales were negatively impacted by the timing of Federal Assistance to Firefighters Grants (AFG) and the government shutdown that took place in the fourth quarter of 2025.

Management has been slow to raise prices in a volatile inflationary backdrop as it prefers to push permanent pricing actions through the company's distribution channel. As a result, 2025 sales rose less than 4% while operating profit margin fell 0.8%. However, we expect MSA's profit margin to expand in the coming years driven by its two highest-margin products: portable gas detectors and firefighter self-contained breathing apparatus (SCBA).

Portable gas detectors are transitioning from a lumpy product sales business model to a subscription service that produces better customer lifetime revenue and profit margins. The customer realizes benefits in the form of better safety performance and lower maintenance costs. The tradeoff for MSA is that subscription-based accounting rules require the company to recognize revenue ratably over the multi-year contract life, rather than upfront as an equipment sale. Consequently, MSA is sacrificing some immediate revenue and profit today for superior economics over time. As for SCBAs, AFG funding is predicted to revert to a normal cadence this year, and we expect a replacement cycle to boost sales through the end of this decade.

Still, the stock is trading at a 20% discount to its large-cap sector peers on enterprise value to EBITDA, despite enjoying superior margins, a better return on invested capital, a stronger balance sheet, and less cyclicality.

Outlook

Today, we are cautious about valuations across major equity indices, the herding mentality of speculators, and thematic allocation of capital across both debt and equity markets. It's impossible to ignore the echoes of prior capital market bubbles, yet we recognize that timing the end of a bubble is impossible. At the same time, we continue to find compelling opportunities across market caps, sectors, and business models. Many of these, including MarketAxess and MSA Safety, are "AI agnostic"-good businesses that aren't exciting enough in today's market to garner investors' attention. Rather than speculate on how long the AI infrastructure buildout will last, we remain committed to using our 10 Principles of Value Investing(TM) to guide us toward businesses with both compelling upside and potential downside protection.

We are grateful for your continued trust and confidence. Email Signup

Contact Us Please wait while we gather your results. Portfolio Management Team Troy McGlone Vice President and Portfolio Manager Colin McWey Vice President and Portfolio Manager View Strategy Materials Composite Returns* 6/30/2026 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)** 10.37 11.41 11.35 15.55 24.50 17.22 12.69 Opportunistic Value Equity Composite (Net of Bundled Fees) 8.39 9.58 9.80 13.99 22.81 16.43 12.32 Russell 3000(R) Value 8.38 11.48 10.97 17.80 27.75 16.53 14.02 Source: FactSet Research Systems Inc., Russell Investment Group, and Heartland Advisors, Inc. *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. Opportunistic Value Equity Strategy Quick Links

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