

4th Quarter 2011

# Horizons

A quarterly newsletter for Homestead Funds' shareholders

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# Bringing Home the Gold

Small-Company Stock Fund receives high honor



We're pleased to announce that the Small-Company Stock Fund was crowned the gold winner in its category by the 2011 S&P Capital IQ U.S. Mutual Fund Excellence Awards. The awards recognize those U.S. mutual funds that have achieved the highest overall ranking on the most consistent basis for the one-year period 8/31/10 to 8/31/11.

"The Homestead Small-Company Stock Fund received the Gold Award in our Domestic Small-Cap category for its strong risk-adjusted track record, its relatively low turnover rate, and for recently owning a number of stocks that we view as undervalued," said Todd Rosenbluth, a mutual fund analyst at S&P Capital IQ, the mutual fund research provider that developed the awards program.

The Small-Company Stock Fund opened to shareholders in March 1998. It is managed by Homestead Funds President and CEO Peter Morris; Senior Equity Portfolio Manager Stuart Teach; and Equity Portfolio Manager Mark Ashton. In addition to focusing on smaller companies, the managers take a value approach by picking stocks selling at what they determine to be a discount to intrinsic value.

### A history of results

According to S&P Capital IQ data, the Fund has ranked in the top quartile of both its category and peer group in the last one, three, five and 10 years. Morris attributes the Fund's performance in part to the managers' old-fashioned screening process for potential investments.

He says the team does its own homework by *continued on page 2*

### Small-Company Stock Fund, *continued from page 1*

analyzing balance sheets, questioning management and scrutinizing product offerings.

“We like companies that we believe aren’t appreciated by the market and whose intrinsic value is not reflected in the stock price,” he says. “We start with a company that may be underperforming and we see if it’s fixable.”

As value investors, the first thing the team looks for is underperformers, Morris explains, adding that the team has had success finding potentially strong candidates for investment lately. Since the Fund typically focuses on the stock of companies that have a market capitalization of under \$2 billion at the time of purchase, names are selected from a smaller population of companies, but so far, that hasn’t posed a problem for the Fund’s managers.

### A disciplined methodology, in markets good and bad

The Fund’s risk-adjusted performance helped Homestead win gold. And that performance starts with stock picking. How do they do it?

Morris offers a glimpse into this world by way of an example—the crisis of 2008. During 2008, the team found sub-\$2 billion market-cap companies that they believed were dramatically undervalued. This is because small-caps generally experience pricing inefficiencies during volatile trading periods.

The Manitowoc Company, Inc., for instance, made acquisitions that dramatically weakened its balance sheet in 2008. But the company was able to restructure its debt and is now positioned to perform more strongly. “In this case, there was something wrong with their balance sheet, yet there was nothing wrong with the company,” says Morris.

Regardless of the market environment, however, Morris says that the team is still able to find long-term buying opportunities among nimble-yet-savvy small companies that may be mispriced either through no fault of their own or because they have a temporary problem that can be addressed.

*continued on page 3*

# Homestead Funds’ News Briefs

## Recent Press

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Here’s where our funds have been noticed recently.

*Money Magazine*, September, October and November, 2011, “Savings and Credit”

*The Wall Street Journal*, October, 2011, “Category Kings in 22 Realms”

*S&P MarketScope Advisor*, October, 2011,  
“Homestead Small-Company Stock Fund Wins Gold”

## Staff Update

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We’d like to introduce our newest client services associate, Steven Ulrich. Welcome aboard!

## Small-Company Stock Fund, *continued from page 2*

In addition, the bottom-up, value-oriented investment style the Fund's managers subscribe to also includes appraising current holdings' rivals.

"Sometimes the investment idea comes from a company we already invest in. We ask them who they admire. I think a good way to find new names for the portfolio is asking who companies respect in the business and who their suppliers are," Morris says.

### The value of experience

Morris acknowledges that there is risk inherent in investing, especially in small-capitalization stocks, which generally experience a greater degree of market volatility than stocks of larger companies, but he says that the team's experience helps separate the wheat from the chaff. Both Morris and Teach have been at Homestead since its founding in 1990, and co-manager Mark Ashton has been at the firm for 13 years.

"You have to be careful. In the beginning, our first objective is to really understand the management and how they make decisions," notes Morris, adding that the team's process is used even when markets are not experiencing a financial crisis.

"We allow companies to prove themselves. I think we are patient investors, and I think we understand the businesses we invest in."

### Keeping a tight rein on costs

In a mutual fund category in which the vast majority of portfolio holdings are replaced once a year, the

Small-Company Stock Fund turned over only two out of its 49 holdings during the year, despite periods of headline-grabbing market volatility. During the period, turnover among small-capitalization stocks averaged about 74% compared to the Small-Company Stock Fund's 4%, according to S&P Capital IQ.

Low turnover was a factor in S&P's decision to give the Fund the gold, but more important, it's an advantage for Homestead shareholders. Less frequent selling and buying limit a fund's transaction fees, while also keeping the tax liability of investors using taxable, non-retirement accounts low. (Remember to consult a tax professional for guidance specific to your situation.)

Another attractive cost factor that both S&P Capital IQ and Homestead investors can appreciate: The Fund does not have a front-end sales load and its net expense ratio is lower than its peers (based on Lipper data for period ended December 31, 2010).

Homestead Funds is a first-time winner in the awards program, which is in its second year. S&P's Rosenbluth noted that the funds honored were chosen in part for their favorable risk considerations, in light of the turbulence of broader markets over the past year. To select winners, S&P Capital IQ used a quantitative process of analyzing the risk-reward profile, cost factors, manager tenure, quality of the underlying holdings and performance. [H](#)

*Past performance is no guarantee of future results.*

*Note: Investors are advised to consider fund objectives, risks, charges and expenses before investing. The prospectus contains this and other information and should be read carefully before you invest. To obtain a prospectus, call 1-800-258-3030 or download a PDF of it from our website at [www.homesteadfunds.com](http://www.homesteadfunds.com).*

*Equity funds, in general, are subject to style risk, the risk that returns on stocks within the style category in which the*

*fund invests will trail returns of stocks representing other styles or the market overall. In addition, small-capitalization stocks have historically carried additional risks, since smaller companies generally have experienced a greater degree of market volatility than other funds that provide broader diversification.*

*The S&P Capital IQ Mutual Fund Awards is an annual awards program managed by the equity research unit of S&P Capital IQ and is based on proprietary, quantitative*

*research methodology. The awards recognize those U.S. mutual funds that have achieved the highest overall ranking on the most consistent basis during the measurement year August 31, 2010, through August 31, 2011, except for the New and Notable category. Among the factors the research process seeks to identify are consistently strong performance; high-quality holdings as measured by S&P STARS equity research, S&P Credit Ratings and S&P Quality Rankings; and favorable cost factors.*

THE ABCs OF INVESTING

# Long-Term Investing Goals



**Tanya Moat**  
Registered  
Representative

As we kick off the New Year, many of us will jot down a list of resolutions about improving our financial situations. At the top of these lists each year are long-term goals like saving for retirement and college. What are your long-term investing goals?

Far and away the most popular long-term savings goal is retirement. In fact, a poll of mutual fund investors conducted by the mutual fund trade group Investment Company Institute found that 95% of mutual fund investors said they are investing for retirement.

With medical advances, it's possible you could be in retirement for 20 or 30 years. Supporting yourself for that long will require substantial savings to supplement any Social Security and pension benefits you may expect to receive.

While many Americans invest for retirement through a tax-deferred retirement plan at work, some also maintain an IRA. IRAs give you the opportunity to save more for retirement, plus because they are independent from your employer, you are not tied to workplace rules for the accounts. That gives you more freedom to move your money and select your own investments.

Next to retirement, saving for a child's education is a top savings goal. With college costs rising far faster than the rate of inflation, it's important to start early to accumulate a sizable amount. How much you will need to save depends on the type of college and number of years your child or grandchild plans to attend. In-state tuition for a four-year program at a state university averages about \$32,000, while tuition at a private four-year college averages about four times that amount, according to research from the College Board. Many investors chose to save for college in a Coverdell ESA or an UGMA/UTMA account. Alternatively, keeping assets in the parents' names (by using a regular account or Roth IRA) could provide flexibility and, by keeping the money out of the child's name, have less of an impact on financial aid. (Read more about these account types and others in the "Helpful Tips" section

at [homesteadfunds.com](http://homesteadfunds.com), under "Find a Document.")

In addition to the long-term goals of retirement and college, many Americans are addressing short-term financial goals. Topping this list are cutting spending and paying down credit card debt. Even before saving for the long term, it is important to address these situations. It is equally important to stash away enough money to support yourself for at least six months in the event of an emergency.

Whether your New Year's resolution is to save more for retirement, open an ESA or add to a rainy-day fund, Homestead Funds can help you clarify and refine your goals and select the accounts and investments that best fit them. [H](#)

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Call 1-800-258-3030 to speak with one  
of our friendly client service associates, available weekdays  
between 8:30 a.m. and 5:00 p.m. Eastern Time.


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## CUSTOMER SERVICE TIP

# New Cost Basis Rules in Effect

On January 1, 2012, the provision of the Emergency Economic Stability Act covering the reporting of cost basis by mutual fund companies went into effect. Basis information will now be reported to you, along with the calculated short-/long-term gain or loss on the trade. The information reported to you will also be reported to the IRS.

As a reminder, cost basis is generally the price paid for your shares, adjusted for return of capital, certain corporate actions, and any sales charges or transaction fees. Cost basis is an important calculation used to determine gains and losses on any shares sold in a taxable (non-retirement) account. This information is required to prepare a tax return.

For more information, please review the frequently asked questions (FAQs) at [homesteadfunds.com](http://homesteadfunds.com). 



**Monty Bilkert**  
Registered  
Representative

## RESPONDING TO YOU

*Shareholders like you call our representatives with a lot of good questions. In this column, we share our responses to some of those questions with the thought that for every shareholder who calls to ask, there are a hundred who didn't! We encourage you to call our helpful representatives with your questions as well as to check here each quarter to see if your question is featured.*

## Dealing with Volatility


**I'm an IRA account holder with Homestead Funds and concerned about the volatility in the stock market. I'm thinking of getting out for a little while. What do you think?**

If the recent ups and downs in the stock market and lower average annual returns have you questioning your commitment to stocks in your IRA, you're not alone. These two realities have led large numbers of investors to pull their money out of stocks in the last year. If you have

stayed put but are on the fence about stocks, we'd like to recommend that you start by reviewing the long-term rates of return for stocks compared to other investments. According to Ibbotson, the financial research firm, the long-term average annual returns through 2010 are 9.9% for large-cap stocks compared to 5.3% for bonds. While it's true that you might not experience as much volatility in a short-term bond investment as you may in a stock investment, the bond investment may not help your retirement account grow enough to support your goals or sufficiently outpace inflation.

Another factor to consider is the timing of your decision. If you bail out of stocks when the price is low, you may lock in a loss. Then, if you are planning to jump back into the market, it's possible you could miss the next rebound. Trying to time the market is a risky enterprise—even the experts get it wrong at times.

Understanding that you don't control volatility, rates of return or the market's timing provides you with the clarity to focus on what you can control: your asset allocation. How much you invest in each type of investment may be the most critical decision you make that influences your return. Check your allocation to be sure it represents your goals and your tolerance for risk. If, for example, volatility keeps you awake at night, you may want to consider moving some or all of your money into investments that have historically experienced fewer ups and downs. This is particularly true if you are nearing retirement age or expect to start taking withdrawals from your account soon.

If you have a question about your IRA or would like to make a change to your account, a Homestead Funds' representative can help you. Just call 1-800-258-3030 to speak with one of our representatives. 

*Investments in fixed-income funds are subject to interest rate, credit and inflation risk. Equity funds, in general, are subject to style risk, the chance that returns on stocks within the style category within which the fund invests will trail returns of stocks representing other styles or the market overall.*

*Past performance is no guarantee of future results.*

## Fund Total Returns

For Period Ending 09/30/11

	Aggregate Year-to-Date	Average Annual 1 Year	Average Annual 5 Year	Average Annual 10 Year	Average Annual Since Inception (date)
Daily Income	0.01%	0.01%	1.64%	1.68%	3.17% (11/90)
Short-Term Govt. Securities	1.93%	1.88%	3.79%	3.08%	4.11% (5/95)
Short-Term Bond	1.55%	1.94%	4.96%	3.99%	5.07% (11/91)
Stock Index	-9.02%	0.60%	-1.72%	2.17%	-0.25% (10/99)
Value	-11.60%	-3.34%	-2.40%	4.44%	8.45% (11/90)
Growth	-10.45%	0.26%	2.89%	4.14%	-4.29% (1/01)
Small-Company Stock	-13.73%	1.17%	3.59%	9.58%	6.69% (3/98)
International Value*	-17.31%	-13.13%	-3.61%	4.48%	1.16% (1/01)

For performance data current to the most recent month-end, call Homestead Funds at 1-800-258-3030 or visit homesteadfunds.com.

## Fund Annual Operating Expenses

	Management Fees	Other Expenses	Acquired Fund Fees and Expenses	Total Annual Fund Operating Expenses	Expenses Waived by RE Advisers	Net Expense <sup>a</sup>
Daily Income	0.50%	0.19%	0.00%	0.69%	0.45% <sup>b</sup>	0.24%
Short-Term Govt. Securities	0.45%	0.30%	0.00%	0.75%	0.00%	0.75%
Short-Term Bond	0.60%	0.20%	0.00%	0.80%	0.00%	0.80%
Stock Index	0.05% <sup>d</sup>	0.58%	0.00%	0.63% <sup>e</sup>	0.01% <sup>f</sup>	0.62% <sup>g</sup>
Value	0.54%	0.19%	0.00%	0.73%	0.00%	0.73%
Growth	0.65%	0.58%	0.00%	1.23%	0.28% <sup>c</sup>	0.95%
Small-Company Stock	0.85%	0.32%	0.01%	1.18%	0.00%	1.18%
International Value	0.75%	0.27%	0.01%	1.03%	0.03% <sup>c</sup>	1.00%

## Daily Income Fund: Current Yield

Seven-Day Effective Yield as of 09/30/11

0.0100%

The total returns shown above represent past performance, which does not guarantee future results. Investment return and principal value of an investment will fluctuate. An investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be higher or lower than the performance data quoted.

Investments are subject to risk and market fluctuation. Losses could occur. Call us at 1-800-258-3030 to speak with one of our client service associates and request a prospectus. Investors are advised to consider fund objectives, risks, charges and expenses carefully before investing. The prospectus contains this and other information. Read the prospectus carefully before you invest or send money.

An investment in the Daily Income Fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although the Fund seeks to preserve the value of your investment at \$1.00 per share, it is possible to lose money by investing in this Fund. The Daily Income Fund is a money market fund.

For money market funds, the yield quotation more closely reflects the Fund's current earnings than the total return quotation.

<sup>a</sup>Net Expense shown here differs from the ratio of expenses shown in the Financial Highlights section of the prospectus because the expenses shown on this page include Acquired Fund Fees and Expenses, and amounts shown in the Financial Highlights reflect the operating expenses and do not include the Acquired Fund Fees and Expenses.

<sup>b</sup>Expenses are to be waived pursuant to an expense limitation agreement between RE Advisers Corporation ("RE Advisers") and the Fund. This contractual waiver is for a one-year period ending April 30, 2012. At that time, RE Advisers may revise, renew or discontinue the waiver. In addition, effective August 14, 2009, RE Advisers has voluntarily agreed to waive fees or reimburse expenses to the extent necessary to assist the Fund in attempting to maintain a positive yield. RE Advisers may revise, renew or discontinue this voluntary waiver at any time.

<sup>c</sup>Expenses are waived pursuant to an expense limitation agreement between RE Advisers and the Fund. The contractual waiver is for a one-year period ending April 30, 2012. At that time, RE Advisers may revise, renew or discontinue the waiver.

<sup>d</sup>The fees for the Stock Index Fund shown in this table reflect expenses of both the Stock Index Fund and the Master Portfolio.

<sup>e</sup>"Other Expenses" for the Stock Index Fund include a 0.25% administrative fee paid to RE Advisers.

<sup>f</sup>As noted in G, BlackRock Fund Advisors ("BFA") has waived expenses.

<sup>g</sup>BFA has contractually agreed to reimburse the S&P 500 Stock Master Portfolio ("Master Portfolio") for the cost of fees paid by the Master Portfolio to the Independent Trustees, counsel to the Independent Trustees and the Master Portfolio's independent registered accounting firm, through April 30, 2012. This contractual arrangement may not be terminated prior to May 1, 2012, without consent of the Board of Trustees of the Master Portfolio.

\*The performance information for the International Value Fund (formerly the International Stock Index Fund) reflects its investment experience in the State Street MSCI® EAFE® Index Portfolio from its inception through October 16, 2005, and in the Vanguard Developed Markets Index Fund from October 1, 2005, to June 9, 2006. Mercator's role as subadviser began June 12, 2006.

Distributor RE Investment Corporation. 12/11