

# Horizons

A quarterly newsletter for Homestead Funds' shareholders

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# Cost Basis Mailing Sent to Taxable Account Holders



## Average cost will be default accounting method

If you're a regular reader of this newsletter, you already know that the 2008 Emergency Economic Stabilization Act included a provision that requires financial services firms like Homestead Funds to report adjusted cost basis for taxable accounts to both the IRS and taxpayers. You're also aware that the provision gives you, the shareholder, the ability to proactively select the cost basis method that you would like us to use for your accounts. And if you have a taxable account, you've received the mailing requesting your selection. So, what do you need to do now?

The choice is yours. The list below shows you the available options. You may want to consult your tax advisor to determine which method best suits your individual tax situation. If you don't make a selection, the "average cost" method will automatically be selected for you. Why *continued on page 3*

## Overview of Cost Basis Options

The cost basis options included in the mailing to taxable account holders show the array of options available to you.

### First In, First Out (FIFO)

depletes shares beginning with the earliest acquisition date

### Last In, First Out (LIFO)

depletes shares beginning with the most recent acquisition date

### High Cost (HIFO)

depletes shares beginning with the most expensive shares

### Low Cost (LOFO)

depletes shares beginning with the least expensive shares

### Loss/Gain Utilization (LGUT)

depletes shares with losses prior to shares with gains and short-term shares prior to long-term shares

### Specific Lot Identification

depletes shares according to the lots chosen by the shareholder

### Average Cost (ACST)

the purchase price of all covered shares in the account are averaged

# Homestead Funds' News Briefs

## Recent Press

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Homestead Funds were mentioned in a number of publications recently, including:

*The Wall Street Journal*, August, July and June, 2011  
"Category Kings in 16 Realms"

Louis Rukeyser's *Mutual Funds*, August 2011  
"Home, Sweet Homestead"

*Money Magazine*, August, July and June, 2011  
"Savings and Credit"

## Reduce Paperwork Clutter with E-delivery

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If you'd like less paper clutter in your home mailbox, sign up to receive shareholder documents electronically. It's quick, easy, and available at no additional cost to shareholders. It's simple to set up: Log into your Homestead Funds' account and select "Sign Up for Electronic Document Delivery" from the Portfolio Overview home page. Enter your e-mail address and select "Yes" beside "Investor Statements." While you are logged in, you can also sign up for electronic delivery of shareholder documents, such as the prospectus, semi-annual, and annual reports. Then, you will be notified via e-mail when your statement and fund documents are posted online at [homesteadfunds.com](http://homesteadfunds.com) and available for viewing.

## Semi-Annual Report in the Mail

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The Homestead Funds' semi-annual report mails to shareholders in early September. You can also view this document as well as year-to-date fund performance online at [homesteadfunds.com](http://homesteadfunds.com).

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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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## A Quick Reminder about Cost Basis

If you sell your mutual fund shares, the taxable gain or loss is the difference between the amount you receive from the sale and the cost basis of the shares you sold. When you purchase mutual fund shares, the initial cost basis is the purchase price, but you need to continue to add the cost of additional shares purchased to that basis. If you received a dividend that was reinvested back into additional shares in the fund, your basis is increased by the amount of the dividend.

*Cost Basis Mailing, continued from page 1*

this method? Homestead Funds has chosen average cost as the default because it is consistent with what we have provided in the past. Whether you're automatically moved into average cost or you select a different method, these cost basis selections will apply to shares purchased after January 1, 2012. Shares purchased after this date are considered "covered" shares. Shares purchased before this date are considered "non-covered" shares. When calculating cost basis for your account we will always deplete your non-covered shares first and provide an average cost if available. You may see this distinction between covered and non-covered shares on your tax form 1099B at tax time. [H](#)

## Staying the course in choppy markets

Homestead Funds comments on market volatility

The market's recent roller coaster ride this quarter has brought back unwelcome memories of its plunge in the fall of 2008 that triggered the worldwide recession. Amid that turmoil, Homestead Funds counseled its shareholders to try to stay as calm as possible and maintain a long-term perspective. Three years later, our recommendation to investors remains the same: Stay the course.

### How today is different than 2008

The feeling induced by the dramatic ups and downs seen this quarter may be unpleasantly familiar, but the reasons for such volatility are different. Today's major economic problems are sovereign debt, a high unemployment rate, slow growth and a soft housing market. In 2008, the problem was too much consumer and corporate debt fueled by a housing bubble.

While the debt-ceiling debate in Washington and Standard & Poor's

subsequent downgrade of U.S. debt from AAA to AA+ may have triggered the volatility, it is not the only reason for a general loss of some investor confidence. Debt problems in Europe, particularly Spain and Italy, are concerns worldwide and are also a factor in global stock markets.

With different triggers, the solutions today will also be different. Governments will need to take more decisive actions to instill more confidence in markets and businesses. One piece of encouraging news: on the heels of the stock market drop on August 8, the Federal Reserve pledged to keep interest rates near zero at least through mid-2013. Other bright spots in the economy include strong corporate profits, which are up more than 10% since 2010; oil prices below their spring-time peak; a resolution to the supply chain disruptions stemming from the Japanese earthquake and tsunami; and moderate inflation.

### Why staying the course makes sense

Market swings are enough to rattle anyone's nerves, but if you've got a well thought-out plan and your investments are properly diversified, don't make sudden moves you may regret later. Bailing out when the market is lower than your entry point forces you to lock in losses. Just as important, you could miss the chance for the prices to go up. Remember that just as market drops are unpredictable, so is its ascent. You can only capture potential gains if you remain invested. And if you make automatic investments in an account, such as an IRA or college savings account, your money can buy more shares when prices are depressed. Making regular investments over time can effectively lower the average total cost of shares purchased.\*

In all circumstances, remember that long-term investing involves riding the ups and downs, anticipating that the market may reward you for your patience in the end. [H](#)

\*Dollar cost averaging does not necessarily ensure a gain or protect against a loss.

## THE ABCS OF INVESTING

# The Dow **vs.** the S&P 500 Index



**Dennis Smith**  
Registered  
Representative

The Dow and S&P 500 are two indexes that provide investors with a useful yardstick to measure how a certain segment of a capital market is performing. You may see these two indexes used interchangeably to refer to the performance of the overall U.S. stock market. However, there are some major differences between each index's composition and its performance, particularly over the short term.

### The Dow

The Dow Jones Industrial Average (DJIA) is made up of 30 stocks of large North American companies across a range of industries, except for transportation and utilities. Editors of the Wall Street Journal, which is owned by Dow Jones & Co, pick the stocks that make up "the Dow," as it's called.

The 30 stocks chosen are considered leaders in their industry and to be bellwethers for other similar companies. The editors do not change the companies in the Dow often, but when they do it often represents a major shift in the economy. For example, decades ago the Dow contained primarily manufacturing companies, but over time the editors have replaced a number of those companies with service companies and retailers to reflect the shift toward a service economy.

Because the index uses such large frequently traded stocks, it provides a timely picture of the overall stock market. The index's average changes with lightning-quick speed throughout the day. Traders and investors around the world

watch the Dow closely and its value at the closing bell of the New York Stock Exchange at 4 p.m. eastern time is widely reported, particularly when the Dow is hovering near an easily remembered milestone, as in "the Dow just passed the 12,000 mark."

Critics of the Dow say such a small basket of stocks cannot truly represent the U.S. stock market. Also, because the Dow is a weighted index, higher-priced stocks influence the average more than lower-priced ones, which can indicate more volatility than other stock indexes show.

### The S&P 500

The Standard & Poor's 500 (S&P 500) is made up of the 500 largest companies by market capitalization from a broad range of industries. An S&P committee uses several criteria to select stocks for the index: The company must have a market capitalization of more than \$5 billion, be liquid, and represent a particular market sector.

With such a large number of companies in the index, the S&P 500 represents a far wider range of market sectors than the Dow. Another difference is that the S&P 500 weighs each of the 500 companies in the index based on its market value, regardless of its price.

Critics of the S&P say because of its market capitalization requirement, it only represents large companies. Other criticisms: The top 45 or so companies make up more than 50% of the index's value and that there is very little representation of foreign companies.

### Which index to use

Select the index that best suits your purpose. For example, a number of funds are designed to track the Standard & Poor's 500 Stock Index, including the Homestead's Stock Index Fund. So, naturally this would be the best index to use to gauge the performance of the Stock Index Fund. But, the Dow is more widely reported and can provide a timely window in the performance of U.S. stocks in general.




CUSTOMER SERVICE TIP

# Financial Literacy Resources

At Homestead Funds, we want you to understand the products you invest in. We know that if you understand your investments, you will make better-informed decisions and feel more confident in your decisions.

One resource we offer to help you become a better-informed investor is our series of educational articles, *Helpful Tips*. The articles are available on our website. Go to [homesteadfunds.com](http://homesteadfunds.com), then to the "Account Services" tab and scroll down on the left-hand menu to "Find a Document," where you will see a list of all the shareholder information we offer, including the *Helpful Tips* articles in a Flash-based program that allows you to read the brochure online in a manner similar to the way you would read a newsletter like *Horizons*.

For assistance or to receive any of those articles in the mail at no additional cost, please call 1-800-258-3030 to speak with one of our friendly client service associates. 

## RESPONDING TO YOU

*Shareholders like you call our representatives with a lot of good questions. In this column, we'll 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!*

# The Importance of Fund Distributions

## When are fund distributions made and how does this affect my account?

When a fund makes money during the year, it is required to distribute its earnings to its shareholders. It's smart to be aware of the timing of these distributions so you can make informed choices. Distributions only affect those shareholders who have a taxable account.


For all Homestead Funds, capital gains are distributed at year-end. Since fund managers are actively trading portfolio securities and fund shares are being bought and sold through year-end, final year-end distribution amounts cannot be determined until the last day. Homestead Funds' estimates the year-end distributions and makes this information available a few days before year-end to help shareholders plan for tax time. Also at year-end, the funds pass through their final distributions of dividend or interest income.



**Amy DiMauro**  
Fund Accounting

You can log into your account to view recent distributions. From the Portfolio Overview page, select a fund/account position and click "Last Dividend" from the left-hand list.

Knowing about the timing and amount of fund distributions can help you better prepare for tax time. In addition, having an estimate of the year-end distribution can help if you are considering buying shares late in the year. If a significant income or capital gains distribution is anticipated, you may want to delay your purchase until after the record date to avoid having to pay income tax on the distribution.

The day the distribution is declared, the distribution amount is deducted from fund assets and calculated as a per share amount to be passed through to shareholders. Shareholders will see the fund's share price decline by the amount of the distribution (plus or minus any share price change related to market activity). The following business day, shareholders will see their portion of the distribution posted to their account as either a cash dividend or dividend reinvestment. The record date is the date on which you must be a shareholder in order to receive a portion of the fund's distribution. 

Fund distributions	
Daily Income Fund Short-Term Government Securities Fund Short-Term Bond Fund	Income declared daily; paid monthly
Value Fund	Income declared and paid semi-annually
Stock Index Fund Small-Company Stock Fund International Value Fund Growth Fund	Income declared and paid annually
All Homestead Funds	Capital gains declared and paid annually at year-end or more, if necessary

# Fund Total Returns

For Period Ending 06/30/11

	Aggregate Year-to-Date	Average Annual 1 Year	Average Annual 5 Year	Average Annual 10 Year	Average Annual Since Inception (date)
Daily Income	0.005%	0.01%	1.87%	1.76%	3.21% (11/90)
Short-Term Govt. Securities	0.91%	1.60%	3.93%	3.22%	4.11% (5/95)
Short-Term Bond	1.57%	3.42%	5.41%	4.25%	5.14% (11/91)
Stock Index	5.80%	29.94%	2.37%	2.06%	1.04% (10/99)
Value	8.15%	29.99%	2.15%	5.58%	9.63% (11/90)
Growth	4.79%	33.87%	7.13%	1.06%	-2.94% (1/01)
Small-Company Stock	8.38%	41.35%	8.29%	10.62%	8.67% (3/98)
International Value*	4.69%	27.67%	1.99%	5.33%	3.50% (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 08/01/11

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. 9/11