Quarterly Market Review

Second Quarter 2020

Homestead Funds

This commentary was prepared on July 7, 2020 and reflects our view of events at that time. Please visit our website homesteadfunds.com for the latest perspectives.

Summary

- As the pandemic wears on, the true state of the U.S. economy remains hard to assess through the traditional economic data points. However, most signs point to a trough in economic activity in April, with some rebound over the rest of the quarter. Globally, central banks and governments have unleashed massive support for markets and economies, a force that has cushioned the blow and bolstered investments.
- U.S. stock markets recovered substantially following the February-March declines, though most categories of stocks remained below earlier peaks. Reversing first-quarter performance, energy and consumer discretionary companies led the rally while utilities stocks trailed this quarter.
- Bond markets also posted broad gains as the Federal Reserve conducted substantial bond-buying to support markets. U.S. Treasury rates saw little change in the quarter, remaining at historical lows. Bond prices for corporate and other non-government issues rallied as credit spreads retreated back toward average levels.

Massive Support Cushions the Blow

Stock and bond markets were broadly positive in the second quarter. Stocks recovered substantially from first-quarter declines, though most categories of stocks remained below February peaks as of quarter-end. Bonds also posted gains as credit spreads, the difference in yields between non-government bonds and U.S. Treasuries, retreated from crisis levels.

These market trends may seem uniquely disconnected from the economy of the second quarter, a period when the COVID-19 pandemic wore on and even gathered steam in many states. Indeed, staggering job losses rippled across the economy amid shutdowns and social distancing measures. In mid-May, Federal Reserve (Fed) chairman Jerome Powell noted that nearly 40% of U.S. households earning $40,000 or less had lost a job in March.[1] A statistical model from the Federal Reserve Bank of Atlanta estimated that real GDP growth in the second quarter fell at an annualized rate of about -35%.[2]

Massive, Coordinated Support

A number of factors explain this disconnect between the markets and the economy. One is the speed and magnitude of the support efforts from both central banks and governments, not just in the U.S. but across the globe.

IN SYNC

More than 500 support programs[3] have been announced by central banks and governments across the globe, representing a massive and synchronized response to the economic impact of the COVID-19 pandemic.

The Fed also extended direct lending programs to small businesses and major corporations.

[1]Fed Chair Jerome H. Powell; May 13, 2020 speech at the Peterson Institute for International Economics, Washington, D.C. (via webcast)
[2]GDP Now; Federal Reserve Bank of Atlanta
[3]Evercore ISI, update as of July 2, 2020

Though single data points may not tell us much, we can see an emerging pattern — one that we believe suggests April was the low point of economic activity thus far.

The Fed's support program, which was initiated even before the U.S. markets really began to register the full implications of the pandemic, included interest-rate cuts and extensive bond-buying programs that went even further than the rescue package of the financial crisis in 2008-09.[4] The Fed also extended direct lending programs to small businesses and major corporations.

The $2 trillion stimulus package from the federal government also offered substantial support to households and employers. As the quarter closed, it looked increasingly possible that an additional support package would follow later in the year.

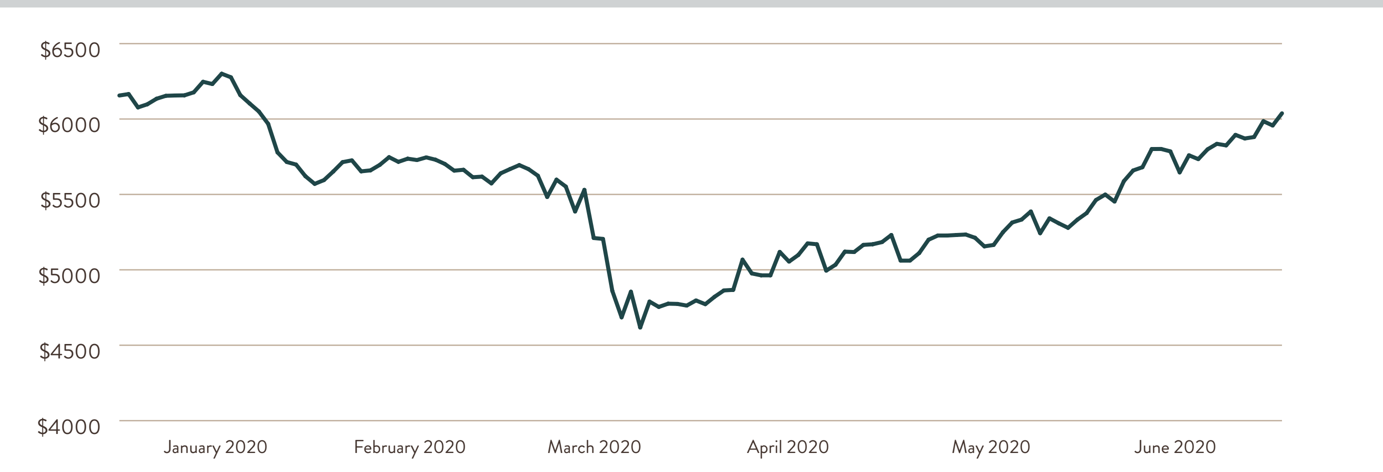
Evidence of Economic Bounce-Back

A second factor is that the economic situation is so distinct from a traditional recession that it's difficult to make conclusions from the usual markers of economic activity. What can we make of a -35% GDP growth rate if the following months could show a major reversal? Investors are generally navigating an environment where the usual data points don't reveal much about what happens next. For instance, while employment plummeted in March and April, jobs numbers came roaring back better than expected in May.[5]

Though single data points may not tell us much, we can see an emerging pattern — one that we believe suggests April was the low point of economic activity thus far. Manufacturing and service-business measures from the Institute of Supply Management, like unemployment figures, we believe suggests that the lowest point is behind us for now. Inflation readings remained positive, revealing that the prices for goods and services have not fallen — another sign of strength. The price of copper, often cited as a barometer of global demand, bottomed in March along with the stock market and rebounded through the second quarter.

"King Copper" Suggests Recovering Global Demand

Copper prices year-to-date



Source: FactSet

[4]CNBC; "The Fed is providing way more help for the markets now than it did during the financial crisis;" Published March 24, 2020
[5]The Washington Post, "Unemployment rate drops and 2.5 million jobs added, after states reopened;" Published June 6, 2020

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Unprecedented Investment in 'Return to Normal'

We believe a third factor drove major optimism for markets: the enormous global investment in vaccine and treatment options to combat COVID-19. The resources and brainpower devoted to this global problem were clearly reassuring signs, driving higher valuations not just for particular pharmaceutical stocks but also for the broader market. At the time of this publication, 27 vaccines are already in human trials.[6] While the final outcome remains to be seen, the hope of having a vaccine sometime in 2021 does appear reasonable.

Bonds

Bonds generally posted modestly positive returns for the quarter. U.S. Treasury rates remained nearly unchanged at historical lows. Substantial bond-buying programs by the Fed boosted the market for corporate and other non-government bonds, while direct lending programs to small and large businesses also eased pressure on borrowing markets.

The Fed's largest-ever support program proved effective in the second quarter. As the pandemic's impact materialized in March, some segments of the bond market seized up in anticipation of deep stresses to lending systems for banks, companies, brokerages and other market-based borrowers. Over the second quarter, the Fed conducted expansive bond-buying, flooding the system with much-needed liquidity. Direct-lending programs from the Fed also saw heavy usage, a crucial bridge to help borrowing markets resume normal function.

After plummeting in the first quarter, Treasury rates across the yield curve (from short-term bonds to 30-year maturities) remained steady. Credit spreads declined substantially from crisis-level peaks, boosting bond prices for corporate issues.

Against this backdrop, the Homestead Short-Term Government Securities Fund (HOSGX) returned 0.97% in the second quarter, outperforming its benchmark, the ICE BofAML 1-5 Year Treasury Index, which rose 0.29%. Our holdings in U.S. agency-backed issues contributed to performance. Though agency-backed issues are close in credit quality to U.S. Treasuries, this segment lagged amid first-quarter stresses and rebounded in the second quarter as liquidity improved.

The Homestead Short-Term Bond Fund (HOSBX) rose 2.84% in the quarter, outpacing its benchmark, the ICE BofAML 1-5 Year Corporate/Government Bond Index, which returned 1.84%. Our corporate bond holdings in the industrials sector boosted performance, as did an allocation to asset-backed securities. Treasury and U.S. government agency holdings detracted modestly.

The Homestead Intermediate Bond Fund (HOIBX) returned 4.02% in the second quarter, outperforming its benchmark, the Bloomberg Barclay's U.S. Aggregate Bond Index, which rose 2.90%. The fund's positions in industrial and financial bonds, as well as asset-backed securities, helped relative performance, while Treasury holdings detracted.

Stocks

U.S. stocks rebounded in the second quarter. Large-cap growth benchmarks led performance, followed by small-cap stocks and large-cap value stocks.

After plummeting in late February and March, stocks posted a recovery. Published earnings forecasts from company managements remain unusually scarce, after many companies withdrew guidance in the first quarter.

The Homestead Value Fund (HOVLX) gained 16.29% in the second quarter, trailing its benchmark, the Russell 1000 Value Index, which rose 14.29%. Stock picks and an overweight allocation in health care holdings detracted from performance. Stock selection in the consumer discretionary sector also weighed on relative returns. Conversely, the fund's stock choices and overweight allocation in the information technology sector contributed to fund performance.

Compared with the index, the fund holds a significant overweight in information technology and health care stocks. Its largest underweight allocations are in consumer staples and utilities stocks. With a bottom-up stock-picking process, our portfolio managers note that they consider diversification from a sector perspective, but that they also look at company-level factors to balance the portfolio. In the current environment, they continue to seek out high-quality stocks as they consider how economic headwinds could play out in the medium term.

[6]The New York Times, "Coronavirus Vaccine Tracker;" Updated July 27, 2020

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The Small-Company Stock Fund (HSCSX) gained 20.43% in the quarter, lagging its benchmark, the Russell 2000 Index, which gained 25.42%. Stock choices and an underweight allocation in the consumer discretionary sector weighed on the fund's relative performance this quarter. Stock selection in the information technology sector also detracted. On the other hand, stock choices in the financials sector contributed to the fund's relative performance.

Relative to its benchmark, the Small-Company Stock Fund continues to be notably underweight in utilities and in the consumer discretionary sector. The portfolio's most significant overweight continues to be in the information technology sector. As in the Value Fund, the Small-Company Stock Fund's portfolio managers assemble the portfolio with a bottom-up approach, applying a company-specific approach to diversification.

Total Returns as of 6/30/2020

		Average Annual				
	Q2	1-yr	3-yr	5-yr	10-yr	Since inception
Bond Funds						
> *Short-Term Government Securities Fund* **(HOSGX)**	0.97%	4.53%	2.75%	1.84%	1.45%	3.15%
ICE BofA ML 1-5 Year U.S. Treasury Index	0.29%	5.25%	3.23%	2.31%	1.84%	3.96%
Expense ratio 0.85% (gross) 0.75% (net) (12/31/19)*						
> *Short-Term Bond Fund* **(HOSBX)**	2.84%	5.21%	3.39%	2.64%	2.50%	4.27%
ICE BofA ML 1-5 Year Corp./Gov. Index	1.84%	5.32%	3.48%	2.64%	2.27%	4.50%
Expense ratio 0.79% (12/31/19)						
> *Intermediate Bond Fund* **(HOIBX)****	4.02%	8.52%	NA	NA	NA	9.59%
Bloomberg Barclays U.S. Agg Index	2.90%	8.74%	5.32%	4.30%	3.82%	10.25%
Expense ratio 2.49% (gross) 0.80% (net) (12/31/19)*						
Equity Funds						
> *Value Fund* **(HOVLX)**	16.29%	-2.75%	6.61%	7.50%	11.83%	9.73%
Russell 1000 Value Index	14.29%	-8.84%	1.82%	4.64%	10.41%	NA
Expense ratio 0.66% (12/31/19)						
> *Small-Company Stock Fund* **(HSCSX)**	20.43%	-6.11%	-2.73%	0.37%	9.29%	7.67%
Russell 2000 Index	25.42%	-6.63%	2.01%	4.29%	10.50%	6.64%
Expense ratio 1.05% (12/31/19)						

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. For performance data current to the most recent month-end, call 800.258.3030 or visit homesteadfunds.com.

The expense ratio shows the percentage of fund assets deducted annually to cover operating expenses. Fund expense ratios shown here do not include acquired fund fees and expenses. If applicable, these additional costs are disclosed in the prospectus.

*RE Advisers has contractually agreed, through at least May 1, 2021 to limit the funds' operating expenses to an amount not to exceed 0.75% (Short-Term Government Securities Fund) or 0.80% (Intermediate Bond Fund). This waiver agreement will terminate immediately upon termination of the fund's Management Agreement and may be terminated by the fund or RE Advisers with one year's notice.

**The inception date of this fund is May 1, 2019.

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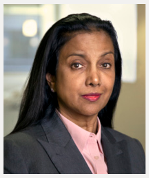
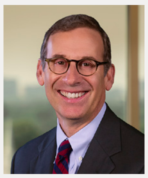
Equity Fund Management

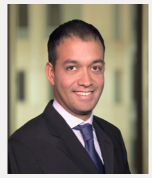


Prabha Carpenter, CFA®
Senior Equity Portfolio Manager
Prabha co-manages RE Advisers' large- and small-cap value strategies. She is a graduate of the University of Madras, where she received a BA in economics. She received her BS degree in business economics and an MBA with distinction in finance from American University. Prabha holds the Chartered Financial Analyst designation.

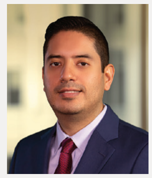


Jim Polk, CFA®
Senior Equity Portfolio Manager
Jim co-manages RE Advisers' large- and small-cap value strategies. He received a BA in English from Colby College and an MBA from the Olin Graduate School of Business at Babson College. Jim holds the Chartered Financial Analyst designation.

Bond Fund Management



Mauricio Agudelo, CFA®
Senior Fixed-Income Portfolio Manager
Mauricio manages RE Advisers' fixed-income strategies. He received a BS in finance from the University of Maryland, Robert H. Smith School of Business. He minored in business culture and language, with a concentration in Spanish. He holds the Chartered Financial Analyst designation.



Ivan Naranjo, CFA®, FRM®
Fixed-Income Portfolio Manager
Ivan co-manages RE Advisers' fixed-income strategies. He joined RE Advisers in 2018. Ivan received a BS in finance from the University of Maryland, Robert H. Smith School of Business. He holds the Chartered Financial Analyst and Financial Risk Manager designations.

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Debt securities are subject to interest rate risk, credit risk, extension risk, income risk, issuer risk and market risk. The value of U.S. government securities can decrease due to changes in interest rates or changes to the financial condition or credit rating of the U.S. government. Investments in asset-backed and mortgage-backed securities are also subject to prepayment risk as well as increased susceptibility to adverse economic developments. High-yield, lower-rated, securities involve greater risk than higher-rated securities. Equity securities generally have greater price volatility than fixed-income securities and are subject to issuer risk and market risk. Value stocks are subject to the risk that returns on stocks within the style category will trail returns of stocks representing other styles or the market overall. Securities of small and medium-sized companies tend to be riskier than those of larger companies.

Index Definitions: The **ICE BofA Merrill Lynch 1-5 Year U.S. Treasury Index** measures the performance of short-term U.S. Treasury securities. The **ICE BofA Merrill Lynch 1-5 Year Corp./Gov. Index** measures the performance of U.S. government and investment-grade corporate debt. The **Bloomberg Barclays U.S. Aggregate Bond Index** is a broad-based benchmark that measures the investment-grade, U.S. dollar-denominated, fixed-rate taxable bond market. The **Dow Jones Industrial Average** measures the stock price performance of 30 actively traded, blue chip companies. The **ISM Manufacturing Index** is an indicator of recent U.S. economic activity based on a survey of purchasing managers at manufacturing firms. The **MSCI EAFE Index** represents the performance of large- and mid-cap securities across 21 developed markets, including countries in Europe, Australasia and the Far East, excluding the U.S. and Canada. The **MSCI Emerging Markets Index** represents the performance of large- and mid-cap securities in emerging market countries, including China, South Korea, Taiwan, India and Brazil. The **Russell 1000 Index** is a subset of the Russell 3000 Index and measures the performance of the 1,000 largest companies in the Russell 3000 Index. The **Russell 2000 Index** is a subset of the Russell 3000 Index and measures the performance of the 2,000 largest companies in the Russell 3000 Index. The **Russell 1000 Growth Index** measures the performance of those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values. The **Russell 2000 Growth Index** measures the performance of those Russell 2000 companies with higher price-to-book ratios and higher forecasted growth values. 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 2000 Value Index** measures the performance of those Russell 2000 companies with lower price-to-book ratios and lower forecasted growth values. The **Standard & Poor's 500 Stock Index** is a broad-based measure of U.S. stock market performance and includes 500 widely held common stocks. The **Standard & Poor's 500 Value Index** is a subset of the S&P 500 Index and consists of those stocks in the S&P 500 Index exhibiting the strongest value characteristics. Indices are unmanaged and investors cannot invest directly in an index. Unless otherwise noted, index performance does not account for any fees, commissions or other expenses that would be incurred. Index returns do not include reinvested dividends.

Investing in mutual funds involves risk, including the possible loss of principal. Past performance does not guarantee future results.

Investors should carefully consider fund objectives, risks, charges and expenses before investing. The prospectus contains this and other information about the funds and should be read carefully before investing. To obtain a prospectus, call 800.258.3030 or download a PDF at homesteadfunds.com.

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