Quarterly Market Review

Third Quarter 2020

This commentary was prepared on October 15, 2020, and reflects our view of events at that time. Please visit our website, homesteadfunds.com, for the latest perspectives.

Summary

- Despite continued spread in new COVID-19 infections, the economy recovered as regions reopened to varied degree around the country. However, the pandemic remains a threat to public health and a barrier to resuming normal activity levels. Persistently high unemployment continued into the fall.
- Even against a challenging backdrop, U.S. stock markets continued their rally for a second quarter. Company earnings trended slightly better than feared, and massive stimulus efforts from the federal government and the Federal Reserve had a positive impact. We also saw reassuring markers that global growth improved in the period.
- Bond markets posted modest gains as well. U.S. Treasury rates remained at historic lows, with little change in the quarter. Fed policymakers indicated that near-zero rates are likely to be in place for a number of years.

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Amid Support, Rally Continues

In the third quarter, stock markets continued to rebound from the pandemic-induced lows of March. Most broad categories of stocks finished the period with gains. In fact, the S&P 500 Index reached a new record high in early September before retreating modestly. Bonds also delivered positive returns for the quarter.

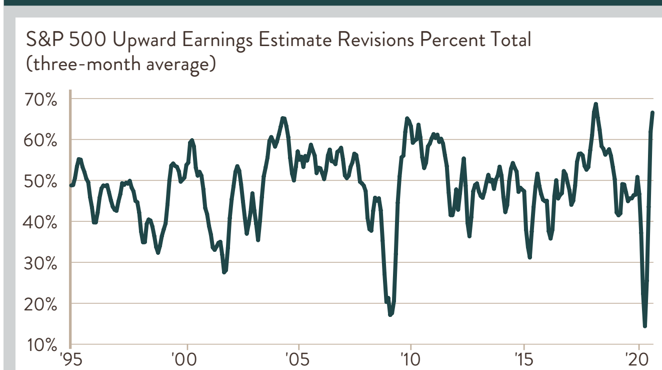
The U.S. economy enjoyed a significant bounce-back as many businesses reopened and Americans resumed some activities, though COVID-19 infections continued to spread across the country. Still, the picture remains decidedly mixed. In addition to the impact on public health, the pandemic continues to pose major challenges for the many unemployed Americans and for particular industries. In our view, three key factors drove investment values higher, despite the challenging backdrop.

1: The Business Environment Was Better Than Feared

One key theme we saw through the quarter was that things were slightly better than feared. For instance, by quarter-end, Wall Street analysts were forecasting that third-quarter earnings for S&P 500 companies would decline 21% compared with the same period in 2019 – but that was better than their forecasts at mid-summer. Back then, analysts were projecting a 25.2% decline.[1]

As the quarter unfolded, Wall Street analysts revised upward their earnings forecasts, a sign that business activity could be better than initially feared.

Earnings Looking Better Than Feared



Source: Strategas

[1]FactSet

2: Stimulus Softened the Impact

Another major factor driving stocks higher was the evidence that stimulus packages, though imperfectly administered, did soften the impact on many of the most vulnerable Americans and companies.

The CARES Act, a fiscal package passed by Congress, bolstered unemployment payments through July, a major benefit for the 57-million-plus Americans who have filed for unemployment insurance since the pandemic began.[2] Direct one-time stimulus payments to U.S. households also supported consumer spending. Meanwhile, the Payment Protection Program (PPP), a federal loan program to help businesses pay employees through the crisis, issued $525 billion in loans to more than five million business owners.[3] By our analysis, these fiscal packages were quite effective in keeping the worst-case scenario at bay.

The fiscal stimulus was only half of the picture, though. The Federal Reserve (Fed) moved swiftly in March to slash interest rates, open up direct lending to banks and corporations, and expand its bond-buying to keep markets liquid. These efforts have also been effective. We have seen public companies, even those in struggling sectors, able to issue new debt in the public markets. This crucial source of capital has allowed companies to extend their debt timelines or even lower interest costs.

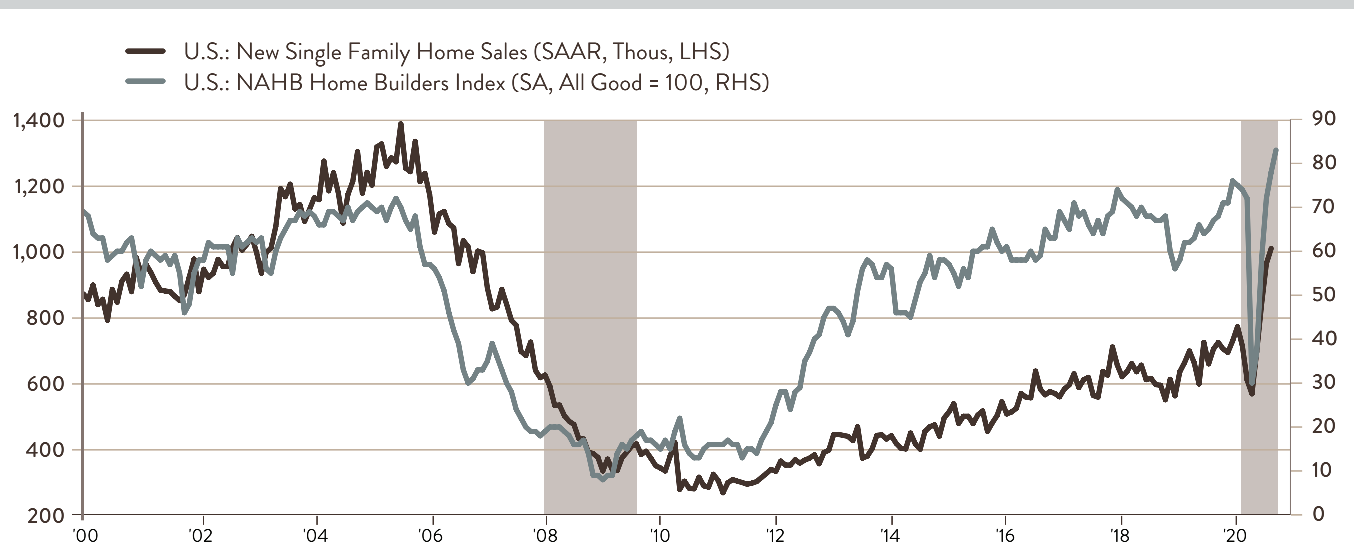
The housing sector has also benefited from lower interest rates. Despite persistently high unemployment around the country, the housing market has surged. Sales of previously occupied homes climbed in the summer months, reaching an annual rate of 6 million homes in August, a level last seen in 2006. New home sales also rocketed up, with 43% more demand compared with a year ago.[4]

3: Global Growth Resumed

The third factor supporting markets was the resumption of global growth more broadly. Because it never really got the first wave of infections under control, the U.S. remained more shut down than most other developed nations during the summer. In August, the U.S. was the only rich nation to make the top 10 list of countries with the highest daily infection counts.[5] In some regions around the globe, life was nearly back to normal.

This return to growth is visible in global manufacturing data. The global purchasing managers' index (PMI), a measure of supply chain activity in manufacturing, was the strongest component of economic activity in recent months, a byproduct of revived trade in manufactured goods. Meanwhile, retail inventories have been depleted.[6] If demand picks up in future quarters, growth could be boosted as retailers replenish their inventories.

Housing Boom Amid Low Mortgage Rates, More Time at Home



Source: Strategas

[2] Department of Labor, as reported in USA Today, September 24, 2020; "More Than 824,000 Americans File for Unemployment as Recovery Remains Sluggish"
[3] The New York Times; October 9, 2020, "Small Business Loans Will Be Forgiven, but Don't Ask How"
[4] ABC News; October 1, 2020, "U.S. Housing Roars Back Despite Recession, High Unemployment"
[5] Axios; August 16, 2020, "The U.S. Is Far Behind Other Rich Countries in Coronavirus Response"
[6] Jefferies U.S. Economic Data, September 30, 2020, "Get Ready for the Biggest Restocking Cycle On Record"

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More Uncertainty to Come

While the last two quarters have been positive for markets, a number of weighty issues loom. The pandemic remains a health threat both in the U.S. and globally, though prospects for a vaccine appear promising. Still, even a successful vaccine would take considerable time to be approved, manufactured and distributed, suggesting that the pandemic will figure into daily life for some time to come.

Meanwhile, the question of additional fiscal stimulus was a major issue at the end of the third quarter. With the expiration of most benefits in the CARES relief package, a second stimulus package is likely to become a matter of urgent concern if a second wave of infections materializes. The upcoming presidential election is also a source of uncertainty. While we view politics as a minor factor in the longer-term trajectory of markets, the possibility of an unresolved election could drive market volatility.

Bonds

Bonds had another quarter of modestly positive returns. U.S. Treasury rates ticked almost imperceptibly downward, remaining at historical lows. The Fed's bond-buying and direct lending facilities continued to bolster liquidity. Over the period, new issuance of bonds was robust, with companies even in struggling sectors, such as airlines, able to refinance or extend debt obligations.

Thanks to the massive Fed stimulus efforts enacted when the pandemic set in, bond markets have largely returned to normal liquidity levels after some periods of distress back in March. Lending markets have been functioning smoothly, with emergency programs in place to allow banks and even corporations to borrow directly from the Fed if needed. Fed policymakers also suggested in recent statements that it would be years before interest rates are expected to rise, with forecasts suggesting that near-zero rates could continue until 2023.

In this environment, Treasury rates remained nearly unchanged, falling slightly across maturity dates. Credit spreads, which are the difference in yield between Treasuries and non-government bonds, continued to tick downward.

Against this backdrop, the Homestead Short-Term Government Securities Fund (HOSGX) returned 0.46% in the third quarter, outperforming its benchmark, the ICE BofAML 1-5 Year Treasury Index, which rose 0.13%. Our holdings in U.S. agency-backed issues contributed to performance. Agency-backed issues, which are close in credit quality to U.S. Treasuries, underperformed Treasuries in the March downturn but have since outperformed as liquidity conditions returned to normal.

The Homestead Short-Term Bond Fund (HOSBX) rose 0.40% in the quarter, in line with its benchmark, the ICE BofAML 1-5 Year Corporate/Government Bond Index, which returned 0.42%. Our corporate bond holdings in the industrials and financials sectors boosted performance. Compared with the benchmark, the fund has fewer holdings in the lower credit-quality tiers, which detracted modestly from returns.

The Homestead Intermediate Bond Fund (HOIBX) returned 0.75% in the third quarter, outperforming its benchmark, the Bloomberg Barclays Aggregate Bond Index, which rose 0.62%. The fund's positions in corporate bonds in the industrials and financials sectors helped relative performance. This effect was moderated by underperformance in some of our utilities and mortgage-backed securities.

Stocks

U.S. stocks extended their rebound in the third quarter. Large-cap benchmarks continued to lead performance, followed by small-cap stocks. Growth-style benchmarks outperformed value-style benchmarks. The more economically sensitive sectors performed best, including consumer discretionary, industrials and materials stocks. Energy sector names lagged.

Stocks continued their rally for a second consecutive quarter, recovering substantially from pandemic-driven losses in February and March. The S&P 500 even reached a new record high in September. Smaller companies, which tend to be more dependent on the domestic economy, have not seen quite as much recovery in earnings as their larger counterparts. Still, the most recent data suggests that the pace of earnings declines has slowed, reflecting the improved economic environment.

The Homestead Value Fund (HOLVX) gained 5.97% in the third quarter, outperforming its benchmark, the Russell 1000 Value Index, which rose 5.59%. Stock selection in the information technology sector boosted fund performance. An underweight allocation in energy stocks, which lagged in the period, also boosted returns. Conversely, stock choices in the financials sector detracted from performance. Stock selection and an underweight allocation in the consumer discretionary sector also hindered performance.

Compared with the index, the fund holds a significant overweight in health care and information technology 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.

The Small-Company Stock Fund (HSCSX) rose 8.29% in the quarter, outperforming its benchmark, the Russell 2000 Index, which gained 4.93%. Stock choices in the health care sector helped fund performance, as did stock selection within the information technology sector. On the other hand, an underweight allocation and stock picks in the consumer discretionary sector, as well as stock choices in the industrials sector, detracted from performance.

Relative to its benchmark, the Small-Company Stock Fund continues to be notably underweight in the consumer discretionary and utilities sectors. The portfolio's most significant overweight continues to be in the information technology sector. It is also overweight in the health care 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 9/30/2020

	Q3	Average Annual 1-yr	3-yr	5-yr	10-yr	Since inception
Bond Funds						
> *Short-Term Government Securities Fund* **(HOSGX)**	0.46%	4.23%	2.76%	1.85%	1.42%	3.13%
ICE BofA ML 1-5 Year U.S. Treasury Index	0.13%	4.60%	3.18%	2.19%	1.72%	3.93%
Expense ratio 0.85% (gross) 0.75% (net) (12/31/19)*						
> *Short-Term Bond Fund* **(HOSBX)**	0.40%	4.77%	3.39%	2.70%	2.39%	4.25%
ICE BofA ML 1-5 Year Corp./Gov. Index	0.42%	4.82%	3.47%	2.60%	2.14%	4.47%
Expense ratio 0.79% (12/31/19)						
> *Intermediate Bond Fund* **(HOIBX)****	0.75%	7.19%	NA	NA	NA	8.39%
Bloomberg Barclays U.S. Agg Index	0.62%	6.98%	5.24%	4.18%	3.64%	8.84%
Expense ratio 2.49% (gross) 0.80% (net) (12/31/19)*						
Equity Funds						
> *Value Fund* **(HOVLX)**	5.97%	3.37%	6.58%	10.74%	11.42%	9.86%
Russell 1000 Value Index***	5.59%	-5.03%	2.63%	7.66%	9.95%	NA
S&P 500 Value Index	4.79%	-2.68%	4.18%	8.84%	10.35%	NA
Expense ratio 0.66% (12/31/19)						
> *Small-Company Stock Fund* **(HSCSX)**	8.29%	6.06%	-1.97%	3.98%	9.00%	7.96%
Russell 2000 Index	4.93%	0.39%	1.77%	8.00%	9.85%	6.79%
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.

***The fund's benchmark was changed to the Russell 1000 Value Index on January 1, 2020.

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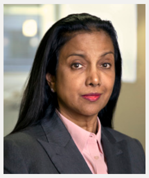
Equity Fund Management



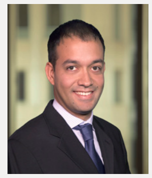
Prabha Carpenter, CFA®
Senior Equity Portfolio Manager

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

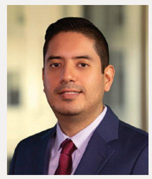
Jim co-manages RE Advisers' large- and small-cap value strategies. He received a BA in English from Colby College and an MBA from the Olin Graduate School of Business at Babson College. Jim holds the Chartered Financial Analyst designation.

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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