2021 Second Quarter

U.S. Economic Outlook
A Focus on Rural America

Homestead Funds

Prepared June 2021

In this issue, we focus on the economic impacts of the vaccine rollout (and now pause in demand) and abundant fiscal support, the two dominant forces shaping the economy and markets over the past year and in the coming months.

Economists with the Business and Technology Strategies Department of the National Rural Electric Cooperative Association (NRECA) examine issues expected to be particularly impactful for rural electric co-ops and likely to play a big role in shaping the economic health of the communities they serve. These insights are paired with a broad view of the health of the U.S. economy overall and portfolio management perspectives from RE Advisers, NRECA's money management subsidiary and the investment advisor for Homestead Funds. In comparing these different vantage points, you'll notice that an economic backdrop of uncertainty or increased volatility may present an opportunity for active money managers with a long-term view.

Created by NRECA, Homestead Funds offers a range of professionally managed strategies cooperatives and individuals can use to meet their short-, intermediate- and long-term investment needs.

Contents

We would also like to alert readers to a change in frequency. *We will be producing the report quarterly — up from twice a year — and offering an NRECA-hosted webinar to dig deeper into the issues of greatest importance to cooperatives. Go to cooperative.com for webinar information and registration.*

The State of the U.S. Economy

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The stock market has climbed generally higher so far in 2021, powered by an aggressive vaccine rollout, declining COVID-19 case numbers, a growing economy and solid earnings reports. There were several sell-offs along the way, as investors grappled with the prospect of higher inflation and possible tax hikes to fund spending related to the Biden administration's infrastructure plan, but the trend line remains positive as of this writing.

The Federal Reserve (Fed) has signaled that it will be patient in hiking interest rates or making other changes to its accommodative monetary policy, recognizing that while the economy has strengthened, a number of sectors are still weak. Fed policymakers have reassured markets that they view the recent spike in inflation as a transitory development, calming those who feared a quick and dramatic rise in rates.

As we near the end of Q2, we are seeing a surge in economic activity as stimulus measures continue to provide support and businesses reopen across the country. There are signs of higher inflation, as you'll read in this report, but we are inclined to follow the Fed's thinking that these are temporary spikes reflecting dislocations in specific markets and supply chains.

NRECA's Business and Technology Strategies Department offers insights on trends affecting operations, technology, consumer expectations and policy. The team engages directly with internal and external stakeholders and represents cooperative needs in key forums to help ensure the longevity and success of America's electric cooperatives.

We also want to share with you the news that we launched the 10th fund in the Homestead Funds series in May of this year. The Rural America Growth & Income Fund is a balanced fund (with exposure to both stocks and bonds) that seeks to invest in businesses and sectors tied to rural communities and therefore important to economic development in rural America. The fund's approach is true to our roots as investment managers for rural electric cooperatives and their employees and very much aligned with the mission of our parent organization, NRECA. We invite you to visit homesteadfunds.com for more information.

Unemployment Rate Continues to Decline

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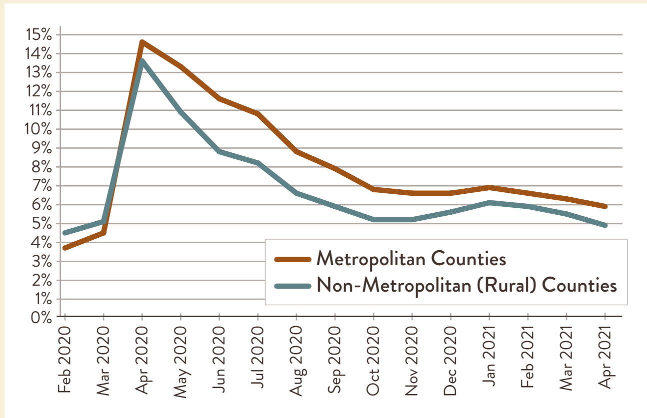
A year out from the April 2020 peak of unemployment caused by the COVID-19 pandemic and resulting recession, the national unemployment rate is still about 2% higher than pre-pandemic levels but continues to trend downward. This recovery has been felt in both metropolitan and non-metropolitan (rural) counties, with unemployment rates of 5.9% and 4.9%, respectively, which are both 8.7% lower than the 2020 peaks. While the rate of decline has slowed, this is partly due to the return of workers to the labor force.

U.S. Unemployment Rate by County Type



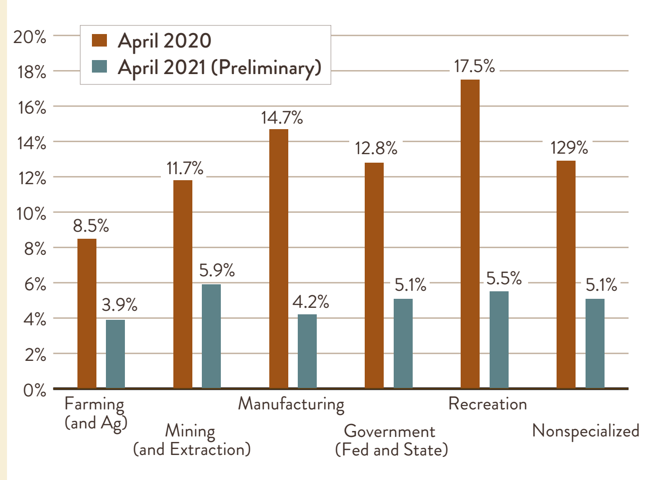
Sources: NRECA analysis of data from the U.S. Bureau of Labor Statistics and U.S. Census (April 2021 is preliminary)

From February to April 2020, the labor force shrunk by 5.1% nationally (5.4% in metropolitan counties and 3.4% in rural counties). While the labor force in April 2021 is still smaller than pre-recession levels, it is now only 2.4% below February 2020 levels in both metropolitan and rural counties.[1]

Unemployment rates have fallen significantly from their April 2020 highs across all industries. The U.S. Department of Agriculture (USDA) classifies counties by their dependence on particular economic sectors. Year over year, unemployment has fallen significantly across county types. The largest recoveries have been in counties that are dependent on recreation (-12%) and manufacturing (-10.5%), which were the sectors hit hardest early in the pandemic. At 5.9%, unemployment rates remain highest in counties primarily dependent on mining (and extraction), with government, recreation and nonspecialized counties experiencing rates higher than the 4.9% unemployment rate for all rural counties. Farming (and agriculture) counties, which were generally least impacted by the recession, still have the lowest rate at 3.9%, with manufacturing counties also below the rural county average.[2] This difference across economic sectors has been driven by the varying impacts of the virus and measures meant to contain it, which have affected consumer demand and supply chains, and proven particularly challenging to industries that rely on delivering in-person services and those associated with transportation and travel.

While April 2021 nonfarm payroll growth of 278,000 was significantly lower than the 1 million expected by economists, May numbers show an acceleration with 559,000 jobs (closer to the 671,000 economists expected) added as rising vaccination rates have helped facilitate a return to more normal operations for many types of businesses.[3,4] Though encouraging, current employment trends still suggest a longer recovery and continuing challenges in overcoming the unprecedented impacts of the pandemic. Even if job gains continue to grow at May's rate, total employment would still not reach pre-pandemic levels until July 2022.[5]

Year-Over-Year Unemployment Rate in Non-Metropolitan (Rural) Counties by Dominant Industry



Sources: NRECA analysis of data from the U.S. Bureau of Labor Statistic and USDA Economic Research Service.

The seasonal employment gap is back to normal.

As of April 2021, the seasonal gap between agricultural employment and non-agricultural employment had returned to its normal zone, with agricultural unemployment about three percentage points higher than non-agricultural unemployment. Historically, the April gap between the two labor forces has ranged from 1% to 4.5%, in a month where agricultural unemployment is easing off seasonal highs and coming close to the level of non-agricultural unemployment. This normalization of the relationship between ag and non-ag unemployment rates is to us one more indication that the pandemic's footprint is fading.

However, looking at the longer-term patterns between ag and non-ag unemployment, we noticed that the seasonal gap between the two labor forces has been slowly shrinking over time. If this broader trend holds, we believe it bodes well for rural areas. Our view is that more stability in ag employment is good for local economies and for the companies serving those areas, which could see more return for investing in rural services. These are key trends that we'll be watching as we make investment choices for the newly launched Rural America Growth & Income Fund.

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[1] Aggregate unemployment rates for rural and metropolitan counties are calculated by NRECA using county-level unemployment data from the BLS Local Area Unemployment Statistics (LAUS) Program. All rates in this report are not seasonally adjusted (i.e., not adjusted for predictable seasonal patterns) because these adjustments are not applied below the state level. Preliminary county-level data for April 2021 was the latest available as of printing.

[2] Unemployment rates by county typology are calculated by NRECA using county-level unemployment rates from BLS LAUS and county economic typologies from the U.S. Department of Agriculture's Economic Research Service. USDA's county typologies are based on 2015 data.

[3] U.S. Bureau of Labor Statistics, " Employment Situation News Release," June 4, 2021.

[4] Vox, "May's solidly meh jobs report," June 4, 2021.

[5] The Washington Post, "U.S. economy adds 559,000 jobs in May, as the recovery shows signs of strength amid headwinds," June 4, 2021.

A Divided Post-Pandemic Labor Market

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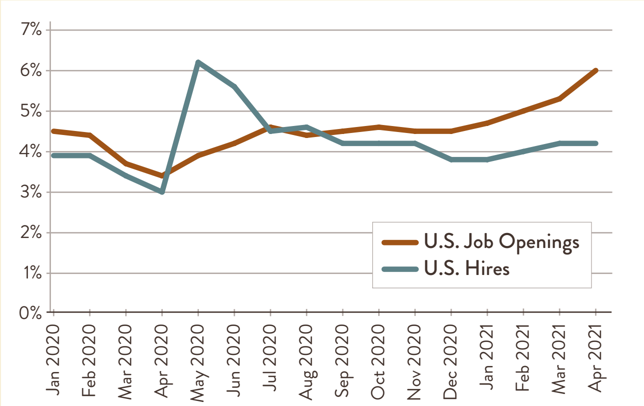
While the U.S. labor market has shown signs of recovery, with a steady increase in job openings since the pandemic, the rate of hiring has conversely slowed down.[6] Many people are continuing to opt out from the workforce as a result of the pandemic. According to data from the U.S. Bureau of Labor Statistics, the U.S. civilian labor force participation rate saw a sharp 3.1% decrease within only two months, from a rate of 63.3% in February 2020 to a low point of 60.2% in April 2020. As of May 2021, the rate has since grown to 61.6%, but it remains below the pre-pandemic levels.[7] This trend can be partially attributed to several factors exacerbated by the pandemic, including child care issues, hesitancy to work in service industry jobs and job reallocation.

As schools went remote during the COVID-19 pandemic, many parents left their jobs or reduced their work hours to provide child care. The pandemic has widened the gap in labor force participation among mothers and fathers, especially for unpartnered mothers with younger children.[8] Nearly one-third of women aged 25 to 44 who left the labor force cited child care responsibilities, compared with only about 12% of men in that age group.[9] With child care centers facing staffing shortages, many parents may continue to stay out of the labor market.[10]

Most pandemic-related job losses were seen in the service industry, where Black women, Hispanic women, and Asian Americans and Pacific Islanders (both men and women) were disproportionately impacted due to their overrepresentation in the industry.[11] Many rural Americans were affected by these job losses, as the service industry, which includes the education and health services sector and the leisure and hospitality sector, accounts for about one-fifth of all non-metro jobs.[12] Although job openings in the service industry have rebounded since the pandemic,[13] some workers are reluctant to return to those jobs because of low wages and persisting health concerns.[14] Businesses have also reported struggles in filling new openings, with some noting that the continuance of enhanced unemployment insurance may be competing with their ability to hire.[15] With these enhanced benefits due to expire in September, and several states already ending expanded unemployment, the service industry could see an uptick in hiring later in the summer.[16] Some larger companies, such as Chipotle, Walmart and Costco, are addressing their labor shortages by increasing their minimum wage to attract more workers.[17]

U.S. Nonfarm Job Openings and Hires Rates



Source: NRECA analysis of data from the U.S. Bureau of Labor Statistics, Nonfarm job openings, hires, and separations rates by region, seasonally adjusted.

The COVID-19 pandemic has also accelerated trends that have been driving job reallocation, particularly automation and e-commerce. A study by the Becker Friedman Institute for Economics at University of Chicago finds that for every 10 layoffs due to the pandemic, three new jobs were created. The study also estimates that 32%-42% of pandemic-induced layoffs could be permanent, revealing

[6] U.S. Bureau of Labor Statistics, Nonfarm job openings, hires, and separations rates by region, seasonally adjusted

[7] U.S. Bureau of Labor Statistics, Civilian labor force participation rate, seasonally adjusted.

[8] The Brookings Institution, "Mothers are being left behind in the economic recovery from COVID-19," May 6, 2021.

[9] U.S. Census Bureau, "Parents Juggle Work and Child Care During Pandemic," August 18, 2020.

[10] The Washington Post, "There's a massive child-care worker shortage and the market can't fix it," May 26, 2021.

[11] Economic Policy Institute, "Low-wage, low-hours workers were hit hardest in the COVID-19 recession," May 20, 2021.

[12] Data from the U.S. Bureau of Economic Analysis, CAEMP25N Total Full-Time and Part-Time Employment by NAICS Industry 1.

[13] U.S. Bureau of Labor Statistics, Job openings rates by industry, seasonally adjusted.

[14] The Washington Post, "'The final straw': How the pandemic pushed restaurant workers over the edge," May 24, 2021.

[15] The New York Times, "Job Growth Slowed in April, Muddling Expectations," May 7, 2021.

[16] Fox Business, "These 25 states are ending $300 unemployment benefits this summer," June 2, 2021.

[17] The Washington Post, "Chipotle raises wages amid expansion plans, as companies compete for workers," May 10, 2021.

a shift in labor needs.[18] With many service industry jobs permanently disappearing, Americans without a college degree have been disproportionately impacted. As of March 2021, almost 4 million Americans without a college degree are still unemployed from a pandemic-era job loss, while only about 200,000 Americans with a bachelor's degree or higher are still unemployed, emphasizing an educational divide.[19] This trend affects rural areas more than others, with nearly 70% of rural Americans having no college degree compared with about 57% of urban Americans without a college degree.[20]

Wage growth could help (and hurt) small businesses.

Wage growth could be a double-edged sword for workers and businesses in rural America. On the one hand, with more than half of rural Americans living in states with a minimum wage at the current federal level of $7.25 an hour, overall wage inflation or an increase in the federal minimum wage to $15 (as proposed by the Biden administration) would immediately raise the wages for 32% of nonmetro workers, according to policy research firm Center for American Progress. Proponents say this will not only benefit workers but also small businesses by injecting their local economies with consumer spending as well as lowering staff turnover and spurring better worker productivity.

On the other hand, however, some economists argue that this kind of wage inflation could devastate small businesses amid a fragile economic recovery. The shock could be even worse in rural areas where current wages are lower, pushing businesses to replace workers with automated technology or pay workers off the books with fewer employment benefits.

According to a study released by the Congressional Budget Office, a higher minimum wage could potentially cost 1.4 million American jobs over the next four years. Regardless of the intended or unintended consequences, widespread wage inflation will have implications on the profitability of companies of all sizes. Those with pricing power should be best positioned to navigate this environment.

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Supply Chain Issues Linger as Economy Recovers

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For the past few decades, many businesses have relied on just-in-time manufacturing, where companies align raw materials and components with their production times to reduce inventory costs, under the assumption that these supplies would be available when needed. Pioneered by Toyota,[21] this manufacturing principle has been used worldwide, including at many U.S. auto companies. However, the pandemic and extreme weather events of the past year have demonstrated some limitations and vulnerabilities in this manufacturing model. As the U.S. returns to normal operations, the supply chain for semiconductors (used in chip manufacturing), timber and other raw materials critical to manufacturing of finished products are seeing severe shortages and rising prices.

The current scarcity of semiconductors and chips can be traced to challenges of both supply and demand. Microchips and semiconductors can now be found in a variety of common products, such as automobiles, home appliances, batteries and solar cells, and the number of components required per product has increased over time. According to the Semiconductor Industry Association, the U.S. accounts for almost 50% of global sales of semiconductors,[22] with production in 18 states.[23] During the COVID-19 pandemic, manufacturing in all sectors slowed down as a result of stay-at-home orders, which put pressure on the supply of these critical materials. Additionally, the number of chip factories has not kept pace with the increase in demand. According to one estimate, a new chip factory costs $10 billion and requires three years to build,[24] further exacerbating the issue. The manufacturing industry is the second largest economic sector in rural America, accounting for more than 14% of rural jobs.[25] There have been reports of auto factories shutting down due to the shortage in chips for production,[26] which leads to higher consumer prices for vehicles and could create employment instability for workers in those industries. Some analysts predict that supply for these products may not catch up to demand until mid-2022.[27]

[18] Becker Friedman Institute for Economics at University of Chicago, "COVID-19 Is Also a Reallocation Shock," June 25, 2020.
[19] The Washington Post, "Many left behind in this recovery have something in common: No college degree," April 22, 2021.
[20] U.S. Department of Agriculture Economic Research Service, Rural Education, last updated April 23, 2021.
[21] University of Cambridge, "JIT Just-in-Time manufacturing."
[22] "2020 State of the Industry Report," Semiconductor Industry Association, June 2020.
[23] Semiconductor Industry Association, "Semiconductors 101 Industry Impact."
[24] Dollar, David and Don Clark, "Dollar and Sense Podcast," The Brookings Institute, May 24, 2021.
[25] "Rural-Grown, Local-Owned Manufacturing," The Aspen Institute.
[26] Ewing, Jack and Don Clark, "Lack of Tiny Parts Disrupts Auto Factories Worldwide," New York Times, January 13, 2021.
[27] "Gartner Says Global Chip Shortage Expected to Persist Until Second Quarter of 2022," Gartner, May 12, 2021.

Raw material shortages are also occurring in the housing sector. Demand and prices for timber and milled lumber have skyrocketed during the pandemic because many Americans made housing improvements, and now homebuilding is starting to ramp up as well.[28] According to the chief economist at the National Association of Home Builders, the increase in lumber price is "adding about $36,000 to the price of a typical newly built home and almost $13,000 to a typical apartment."[29] Even before the pandemic, lumber industry operations were starting to move to the Southeast, where there is an abundance of inexpensive timber, but not enough sawmills.[30]

Additionally, wood was already seeing shortages due to wildfires and the bark-eating beetle infestations in Canada. The beetle has already killed over 60% of marketable pine for British Columbia and this epidemic has still not been curbed.[31] Wood is used in a broad range of industries in rural America, including by electric cooperatives and other rural utilities. Shortages and inflated prices can increase the cost of doing business, though these impacts may only be in the short term, as analysts note that costs should return to pre-pandemic levels by the end of the year.[32]

These supply chain issues and manufacturing trends have caused the World Economic Forum to call for a "Great Reset,"[33] urging companies to reevaluate their supply chain practices and potentially move away from just-in-time manufacturing. The Great Reset argues that, where able, businesses should bring the supply chain closer to manufacturing while also stockpiling more components in case there is another severe disruption in the supply chain.

In rural communities, we see heavy adoption of computing tools and devices aimed at driving efficiencies.

Snow in Texas hurt farm smart-tech and other rural tech initiatives.

The late-winter snowstorms in Texas wreaked havoc and hardship — and even contributed to the global semiconductor supply shortage. Coming at a moment when the pandemic had already disrupted global supply chains, the Texas storms shut down semiconductor production facilities in Texas and exacerbated shortages.

For years, an interruption in the semiconductor supply chains felt like a problem just for technology companies and large consumers of computing power, but the truth is, proliferation of these semiconductor devices has spread into all aspects of our lives no matter where we are. In rural communities, we see heavy adoption of computing tools and devices aimed at driving efficiencies. Telemetry, infotainment and geo-tracking are all critical cogs in the rural economy. When semiconductor production is delayed, whether it is in Asia or in Texas, manufacturers can't produce fully operational farm equipment, wind turbines or telecommunications equipment, and the economy slows because of it.

When the pandemic hit, manufacturers that have not always been major consumers of microelectronics did what they normally would in a recession: They called their suppliers and canceled orders. The problem with this is, the semiconductor suppliers have other customers that would never cancel orders, so the suppliers gave the last of their semiconductor inventory to those customers. When manufacturers realized that demand had recovered (and in some cases expanded), there was no capacity to make the necessary chips.

The obvious question remains: When does this shortage end? The experts disagree, but the emerging consensus is that it depends which industry you're in. For some, semiconductor supply issues could be solved by the end of this month; for others, it may take until 2023.

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[28] Meyer, Robinson, "Why Dead Trees Are 'the Hottest Commodity on the Planet," (Meyer), The Atlantic, April 27, 2021.

[29] Stewart, Emily, "Lumber mania is sweeping North America," Vox, May 3, 2021.

[30] *Ibid.*

[31] *Ibid* Meyer.

[32] Conerly, Bill, "Why Lumber And Plywood Prices Are So High—And When They Will Come Down," Forbes, May 22, 2021.

[33] Schwab, Klaus, "Now is the time for a 'great reset'," World Economic Forum, June 3, 2020.

Economic Growth Sparks Inflation Concerns

NRECA

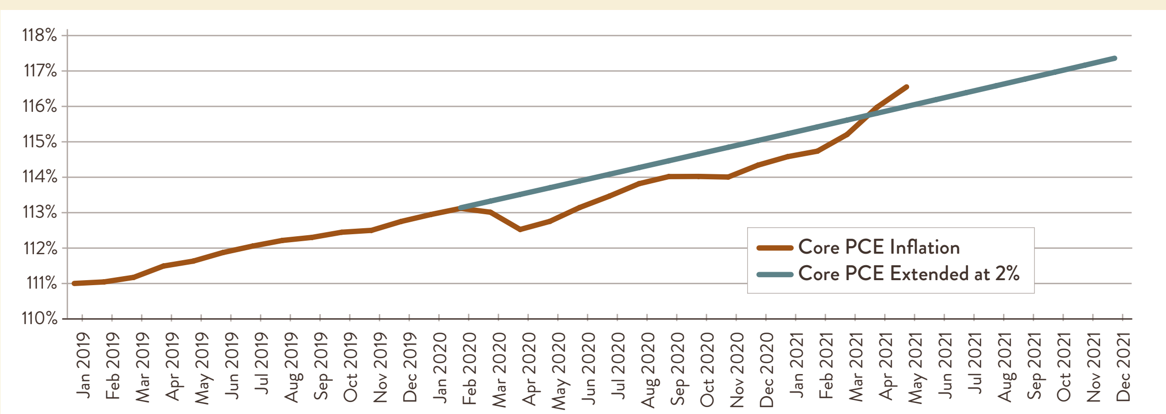
As the U.S. economy continues to reopen and recover from the COVID-19 pandemic, rapid economic growth is being accompanied by rising concerns about the potential for inflation.[34] Through May, consumer prices, reported by the U.S. Bureau of Labor Statistics, are up 5% on an annual basis,[35] and producer prices are up 6.6%.[36]

Federal Reserve Chairman Jerome Powell has described such price movements as "transitory" and predicted in March that the reopening of the economy would be accompanied by inflation through base effects.[37] Indeed, with the COVID-19 pandemic leading to widespread impacts across a broad range of sectors, annual increases in consumer prices will appear to be more extreme, as measured against a baseline when much of the economy was shut down in 2020. The Fed has also pointed out that short-term inflation does not necessarily lead to "durable" high inflation, noting that while recovering from such a unique event, different parts of the economy will move at different speeds, and as supply chains unblock at varying times, inflationary pressure is expected to occur, though only temporarily.[38]

While inflated commodity prices can put additional pressure on consumers during the recovery, they can also provide a boost for parts of the rural economy.

The Brookings Institution recently addressed this issue of short-term volatility, through an analysis of the personal consumption expenditures (PCE) price index, which is the Fed's preferred measure of inflation.[39] Looking over the longer term, to account for the historic impacts of the pandemic in 2020, Brookings found that price levels in January 2021 were still below where they would have been if prices had grown annually at the Fed's target rate of 2% since 2019. Updating this analysis with the more recent data, we see that even by April the "core" PCE (meaning it excludes food and energy prices, which are typically volatile) remained mostly in line with the Fed's 2% inflation target, though May's core PCE continued to increase above a 2% trend line.[40] This

Core Personal Consumption Expenditures (PCE) Index (2012 = 100)



Source: NRECA analysis of PCE data from the U.S. Bureau of Economic Analysis

[34] Ezrati, Milton, "For Everyone's Sake, Our Economic Experts Need to Say More About Inflation," Forbes, May 10, 2021.

[35] U.S. Bureau of Labor Statistics, Consumer Price Index for All Urban Consumers (CPI-U), 12-Month Percent Change.

[36] U.S. Bureau of Labor Statistics, Producer Price Indexes May 2021, Table A. Monthly and 12-month percent changes in selected final demand price indexes, seasonally adjusted.

[37] Cox, Jeff, "Fed Chairman Powell says economic reopening could cause inflation to pick up temporarily," CNBC, March 4, 2021.

[38] Thomson Reuters, "Fed's Quarles: Still Expects Inflation Jump Will Be Transitory," U.S. News & World Report, June 1, 2021.

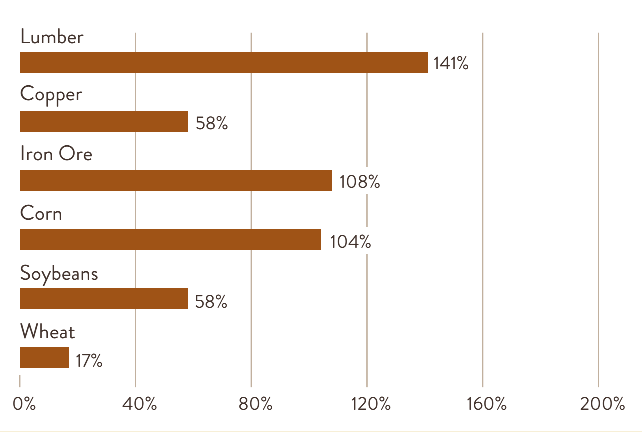
[39] Shambaugh, Jay, "Don't overreact to inflation data this spring," The Brookings Institution, April 8, 2021,

[40] NRECA analysis of data from the U.S. Bureau of Economic Analysis, Monthly Personal Consumption Expenditures Excluding Food and Energy, retrieved from FRED, Federal Reserve Bank of St. Louis.

analysis highlights that large monthly increases are less severe in the context of long-term trends and the recent volatility, though concerning, suggests that the economy may need more time to further normalize before drawing major conclusions about inflation.

Although analysis of PCE trends on a longer horizon may alleviate some concerns about economy-wide inflation, prices for a number of individual commodities currently remain elevated. Supply chain issues, combined with spiking demand, have led to inflated prices for lumber, copper and iron, reaching record highs in May. Lumber and iron are still trading at prices more than double those from a year ago.[41]

Spot Prices for Select Commodities — 1-Year Increase (As of Late June 2021)



Source: NRECA analysis of commodity prices, retrieved from Markets Insider

While inflated commodity prices can put additional pressure on consumers during the recovery, they can also provide a boost for parts of the rural economy. Prices for corn, soybeans and wheat reached levels not seen since 2013 and remain well above where they were last summer. These high prices can help drive increases in farm income and potentially benefit other rural businesses, including grain traders, equipment manufacturers and fertilizer suppliers.[42]

Commodity boom could spur investments in rural communities.

As one of the largest producers and exporters of commodities, the U.S. profits from rising commodity prices. We believe the current boom could help lead an economic revival in rural areas of the country where key commodity products such as agriculture, metals and lumber are produced. Since the second half of 2020, the market has witnessed a surge in commodity prices as a result of varying supply and demand imbalances. In agriculture, corn prices have rallied to an eight-year high thanks to rising demand from China coupled with a drought in Brazil. In industrial metals, copper and iron ore prices recently reached new record levels driven by synchronized global demand recovery as well as supply disruptions at large mines. The U.S. has 10% of the world's proven reserves of lithium, a silvery metal used for electric-car batteries, and lithium prices have soared due to tight supply. These dynamics have driven robust gains in mining stocks. Ultimately, strong commodity prices will in our view entice commodity producers to invest in maintaining and expanding the capacity of their physical assets. This trend should help stimulate a resurgence in farm and mining towns.

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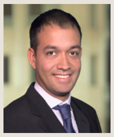
[41] NRECA analysis of historical commodity trading prices, retrieved from Markets Insider, June 2, 2021.
[42] Newman, Jesse, "Surging Grain Prices Fuel Surprise Farm Recovery," The Wall Street Journal, January 22, 2021.

Contributors



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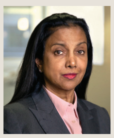

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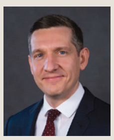

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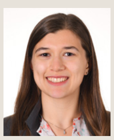

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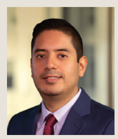

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