Homestead Funds

# Quarterly Market Review

First Quarter 2023


## Summary

- It was another positive quarter for bonds and a mostly positive quarter for stocks. Though the sudden failure of Silicon Valley Bank and Signature Bank was a shock to markets, policymakers swiftly contained the fallout. Market sentiment was generally solid as inflation continued to retreat, a sign that the Federal Reserve's (Fed's) rate-hike campaign is having the intended effect.
- Economists continue to expect a recession in the coming months. Employment remains at high levels, though layoffs have begun to spread from tech companies to other professional service sectors. Company earnings showed signs of further softening. Analysts are forecasting that first-quarter earnings will post a year-over-year decline.
- Bonds delivered positive returns. The Fed hiked short-term rates by 25 basis points in March, but interest rates declined modestly for longer-dated rates, boosting bond prices. The yield curve remains inverted, reflecting the outlook for a recession.


## Signs Point to a Coming Recession

It was a risk-on quarter for stocks and bonds, despite the episodic turmoil of a panic in regional banks arising from the downfall of Silicon Valley Bank in March. Stocks and bonds largely posted gains for the period. The Fed implemented one additional rate hike of 25 basis points, bringing its target overnight interest rate up to a range of 4.75% to 5% in its continued fight against inflation.

### Fed economists are anticipating a mild recession

The likelihood of a recession continued to climb.[1] Some argue that a recession is essentially unavoidable in the fight to contain inflation and keep it from perpetuating what economists call a "wage-price spiral," a scenario where inflation expectations lead to ongoing wage hikes that perpetuates further inflation.

Most of the "recession predictors" are flashing red. The yield curve, which shows the market interest rate across short-maturity bonds and long-maturity bonds, remains inverted. Consumer confidence has shown year-over-year declines since the fall of 2021, while housing starts peaked in the spring of 2022. The Leading Economic Index, a measure of "leading" indicators that predict upcoming economic environments, posted 11 consecutive monthly declines as of February 2023.[2]

Still, the labor market is unusually strong, and that could delay or diminish a recession's impact. The unemployment rate in March was 3.5%, a level that has held for over a year. A softening profit environment has prompted layoffs in certain sectors. Tech companies began substantial layoffs in late 2022, and other professional-service sectors,

This commentary was prepared on April 17, 2023, and reflects our view of events at that time. Please visit our website, homesteadfunds.com, for the latest perspectives.

[1] The Conference Board; Probability of US Recession Remains Elevated; March 5, 2023.

[2] The Conference Board; LEI for the U.S. Continued to Decline in February; March 17, 2023.

including the financial sector, have started to follow suit. Still, the labor market is at such a strong starting point that Fed policymakers continue to have room to increase interest rates.

### Rate hikes at work (with a few casualties)

Inflation is indeed retreating in response to the Fed's rate hikes. The March CPI reading showed overall inflation at a year-over-year pace of 5%, down from a peak of 9.1% in June 2022. Though price pressures are pulling back, inflation remains a key concern for households and businesses.

Rate hikes contributed indirectly to the sudden failure of Silicon Valley Bank and Signature Banks. With substantial bond holdings on their balance sheets, the banks both suffered bond losses.[3] Silicon Valley Bank also struggled with dwindling deposits from its highly concentrated tech sector clients; the combination of bond losses and a shrinking deposit base led to mild undercapitalization. A panic among depositors aggravated the problem and prompted falling confidence across all regional banks. Policymakers quickly expanded the coverage of depositor insurance through the FDIC, which stemmed the outflow of deposits and restored confidence.

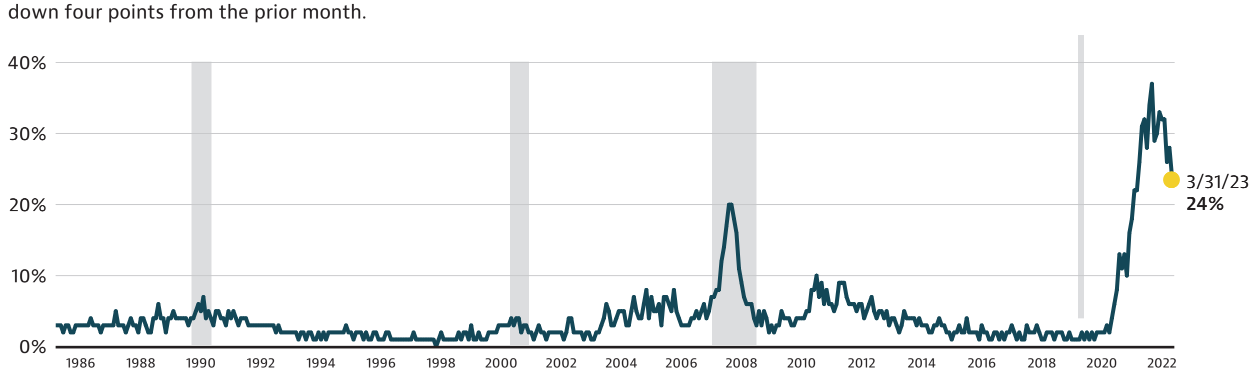
## These Conditions are Thought to Indicate a Coming Recession

| | Inverted yield curve | Unemployment | Consumer confidence | Housing starts | Leading Economic Index® |
|---|---|---|---|---|---|
| Recession warning sign | Ten-year yields been below have 2-year yields since July 5, 2022. | In March 2023, unemployment was 3.5%. In January 2023 unemployment was 3.4%, the lowest monthly reading in three years. | Year-over-year change in consumer sentiment levels has been negative since about September 2021. | Housing starts peaked in April 2022 and in February 2023 were down 22% from the peak. | Currently down 3.6% from August 2022 to February 2023. In the previous six months it declined 3.0%. |
| Current status<br>● Recession threshold met<br>● Recession threshold not met | ● (met) | ● (not met) | ● (met) | ● (met) | ● (met) |

Sources: U.S. Department of The Treasury; Federal Reserve Bank of St. Louis; PR Newswire

## Prices Remain a Top Issue for Small Businesses

In March 2023, 24% percent of small-business owners reported inflation as their single most important business problem, down four points from the prior month.




Source: Strategas; Business Surveys, National Federation of Independent Business, Small Business Economic Trends, Single Most Important Problem, Inflation

[3] The New York Times; *Why Did Silicon Valley Bank Collapse?* Andrew Ross Sorkin, Ravi Mattu, Bernhard Warner, Sarah Kessler, Michael J. de la Merced, Lauren Hirsch and Ephrat Livni; March 11, 2023.

## Bonds

**Bond returns were generally positive in the first quarter. Interest rates were mixed, with the shortest-term rates continuing to rise as the Fed hiked its target overnight rate again by 0.25%. With inflation moving steadily downward and the prospect of recession climbing higher, the outlook for further rate hikes is uncertain. The Fed has said it anticipates one more rate hike this year and does not plan to cut rates in the near future.[4] However, the markets continued to predict rate cuts before 2023 finishes.[5]**

The other component of bond yields, the credit spread, experienced a big swing in the quarter as the bank run episodes originating with Silicon Valley Bank unfolded. Credit spreads measure the difference in yield between corporate bonds and similar-duration Treasuries. Spreads widened sharply in the week of the Silicon Valley Bank failure but calmed as policymakers restored confidence to depositors. At the end of the quarter, spreads had retraced about half of their movement. Spreads, like rates, have an inverse movement with bond prices. When spreads get higher, corporate bond prices go lower and vice versa.

*Stocks and bonds largely posted gains for the period. The Fed implemented one additional rate hike of 25 basis points, bringing its target overnight interest rate up to a range of 4.75% to 5% in its continued fight against inflation.*

The yield curve remained inverted for the whole quarter, meaning that the yield on short-term Treasuries was higher than the yield on long-term Treasuries.

### Performance Attribution for Our Bond Funds

Against this backdrop, the Homestead Short-Term Government Securities Fund (HOSGX) returned 1.96% in the first quarter, outperforming its benchmark, the ICE BofA 1-5 Year Treasury Index, which returned 1.82%. The fund's overweight to agencies boosted performance in the period, as did yield curve positioning in Treasuries.

The Homestead Short-Term Bond Fund (HOSBX) returned 2.18% in the quarter, outperforming its benchmark, the ICE BofA 1-5 Year Corporate/Government Bond Index, which returned 1.79%. The fund's positioning in Treasuries boosted returns, as did holdings in credit sectors such as industrials and financials.

The Homestead Intermediate Bond Fund (HOIBX) returned 3.43% in the first quarter, outperforming its benchmark, the Bloomberg US Aggregate Bond Index, which rose 2.96%. The fund's yield curve positioning in Treasuries boosted relative performance. Holdings in industrials and financials were also additive. Conversely, an underweight in mortgage-backed securities detracted from performance. The portfolio team has been actively adding to mortgage- backed securities positions as an area of opportunity in recent quarters.

## Stocks

**Stocks largely rose again in the first quarter, though performance was mixed across different categories. Growth stocks outperformed value stocks, and large caps outperformed small caps. Thus, large-cap growth was the top-performing category, while small-cap value was the lowest performer. Performance was also mixed on a sector basis, with some sectors delivering positive returns and others posting losses. Information technology, communication services, consumer discretionary, materials and industrials sectors generally fared best. The financials, energy and health care sectors lagged in the period.**

[4] CNBC; *The Fed forecasts just one more rate hike this year;* Yun Li; March 22, 2023.

[5] CNBC; BlackRock warns that investors are making a mistake by betting on the Fed to cut rates; Jeff Cox, March 28, 2023.

Earnings started to reflect some of the softening in the economy. Analysts continued to pare back their earnings expectations over the quarter. The consensus forecasts for S&P 500 Index companies see earnings down -6.6% on a year-over-year basis, though revenues are expected to climb 1.9%.

### Performance Attribution for Our Stock Funds

The Homestead Value Fund (HOVLX) declined -1.21% in the first quarter, trailing its benchmark, the Russell 1000 Value Index, which returned 1.01%. In the period, the fund's stock choices and overweight exposure in health care holdings detracted from relative performance, as did stock selection in the industrials sector. Conversely, the fund's lack of exposure to utilities stocks boosted performance, as did stock selection in the communication services sector.

Compared with the index, the fund holds significant overweights in industrials, health care and materials 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) returned 4.94% in the first quarter, outpacing its benchmark, the Russell 2000 Index, which returned 2.74%. In the period, stock selection and overweight exposure in the industrials sector boosted returns. Positioning in the information technology sector was also additive. Conversely, stock choices in the real estate and consumer discretionary sectors detracted from performance.

Relative to its benchmark, the Small-Company Stock Fund is notably underweight in the consumer staples, health care and utilities sectors. The portfolio's most significant overweights are in the industrials and materials sectors. 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.

### Performance Attribution for Our Balanced Fund

The Rural America Growth & Income Fund (HRRLX) returned 1.80% in the first quarter, trailing its custom benchmark, a 60%/40% blend of the Russell 3000 Index and the Bloomberg Intermediate U.S. Government/Credit Bond Index, which returned 5.24% for the same period.

The fund's stock holdings underperformed their bench-mark. Stock selection and underweight exposure in the information technology sector detracted from relative returns. Stock choices in the consumer discretionary sector also weighed on performance. Conversely, stock choices in the health care sector and a lack of exposure in utilities stocks both boosted the fund's returns.

The fund's bond allocation outperformed its benchmark. The fund's yield curve positioning and underweight in Treasuries aided performance, as did exposure to agency bonds. Conversely, holdings in financials and industrials bonds detracted from performance. Compared with its bond benchmark, the fund holds overweights in corporate bonds and agency-issued bonds. It is underweight in U.S. Treasury holdings.

*Growth stocks outperformed value stocks, and large caps outperformed small caps. Thus, large-cap growth was the top-performing category, while small-cap value was the lowest performer.*

## Total Returns as of 3/31/2023

| | Q1 | Average Annual 1-yr | 3-yr | 5-yr | 10-yr | Since fund's inception |
|---|---|---|---|---|---|---|
| **Bond Funds** | | | | | | |
| Short-Term Government Securities Fund (HOSGX) | 1.96% | -0.64% | -1.09% | 0.73% | 0.59% | 2.68% |
| ICE BofA 1-5 Year U.S. Treasury Index | 1.82% | -0.38% | -1.41% | 1.10% | 0.87% | 3.40% |
| Expense ratio 0.80% (gross) 0.75% (net) (12/31/22)* | | | | | | |
| Short-Term Bond Fund (HOSBX) | 2.18% | -0.40% | -0.27% | 1.18% | 1.19% | 3.77% |
| ICE BofA 1-5 Year Corp./Gov. Index | 1.79% | -0.38% | -0.73% | 1.32% | 1.16% | 3.96% |
| Expense ratio 0.76% (12/31/22) | | | | | | |
| Intermediate Bond Fund (HOIBX)** | 3.43% | -4.78% | -1.96% | NA | NA | 0.20% |
| Bloomberg U.S. Aggregate Index | 2.96% | -4.78% | -2.77% | 0.91% | 1.36% | 0.02% |
| Expense ratio 0.87% (gross) 0.80% (net) (12/31/22)* | | | | | | |
| **Balanced Fund** | | | | | | |
| Rural America Growth & Income Fund (HRRLX)*** | 1.80% | -7.48% | N/A | NA | NA | -4.59% |
| Blended Index**** | 5.24% | -5.47% | N/A | NA | NA | -1.84% |
| Expense ratio 2.85% (gross) 1.00% (net) (12/31/22)* | | | | | | |
| **Equity Funds** | | | | | | |
| Value Fund (HOVLX) | -1.21% | -3.65% | 18.20% | 8.99% | 10.54% | 10.06% |
| Russell 1000 Value Index | 1.01% | -5.91% | 17.93% | 7.50% | 9.13% | 9.53% |
| Expense ratio 0.62% (12/31/22) | | | | | | |
| Small-Company Stock Fund (HSCSX) | 4.94% | -6.49% | 18.81% | 3.47% | 6.82% | 8.22% |
| Russell 2000 Index | 2.74% | -11.61% | 17.51% | 4.71% | 8.04% | 6.98% |
| Expense ratio 1.05% (12/31/22) | | | | | | |

*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. The net expense ratio is the expense ratio minus the portion of expenses waived or reimbursed.

*Homestead Advisers has contractually agreed, through at least April 30, 2024, to limit the fund's operating expenses to an amount not to exceed 0.75% (Short-Term Government Securities Fund), 0.80% (Intermediate Bond Fund) or 1.00% (Rural America Growth & Income Fund)of the Fund's average daily net assets. Operating expenses exclude interest; taxes; brokerage commissions; other expenditures that are capitalized in accordance with generally accepted accounting principles; other extraordinary expenses not incurred in the ordinary course of the Fund's business; and acquired fund fees and expenses such as the fees and expenses associated with an investment in (i) an investment company or (ii) any company that would be an investment company under Section 3(a) of the Investment Company Act of 1940, as amended (the "1940 Act"), but for the exceptions to that definition provided for in Sections 3(c)(1) and 3(c)(7) of the 1940 Act. This waiver agreement will terminate immediately upon termination of the Fund's Management Agreement and may be terminated by the Fund upon 60 days' notice.

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

***The inception date of this fund is May 1, 2021.

****The Fund's Blended Index is a 60%/40% blend of the Russell 3000 Index and the Bloomberg Intermediate U.S. Government/Credit Bond Index.

## Equity Fund Management

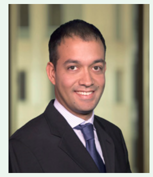
### Mark Iong, CFA®
**Equity Portfolio Manager**

Mark co-manages Rural America Growth & Income Fund and Homestead Advisers' large-cap strategies. Mark is a graduate of Cornell University, where he received a BS in operations research and information engineering. He holds the Chartered Financial Analyst designation.

### Jim Polk, CFA®
**Head of Equity Investments**

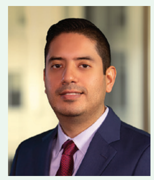
Jim co-manages Homestead Advisers' equity strategies. He is a graduate of Colby College, where he received a Bachelor of Arts degree in English. He received his MBA from the Olin Graduate School of Business at Babson College. Jim holds the Chartered Financial Analyst designation.

## Bond Fund Management



### Mauricio Agudelo, CFA®
**Head of Fixed-Income Investments**

Mauricio co-manages Homestead 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 Homestead Advisers' fixed-income strategies. 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.

Prepared: April 17, 2023

This material represents an assessment of the market and economic environment at a specific point in time and is not intended to be a forecast of future events, or a guarantee of future results. Forward-looking statements are subject to certain risks and uncertainties. Actual results, performance or achievements may differ materially from those expressed or implied. Information is based on data gathered from what we believe are reliable sources. It is not guaranteed as to accuracy, does not purport to be complete and is not intended to be used as a primary basis for investment decisions. It should also not be construed as advice meeting the particular investment needs of any investor.

Neither asset allocation nor diversification guarantee a profit or protect against a loss in a declining market. They are methods used to help manage investment risk.

The standard definition of a recession offered by the National Bureau of Economic Research (NBER) is two consecutive quarters of declining economic growth.

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. The market price of equity securities may go up or down, sometimes rapidly or unpredictably. Equity securities may decline in value due to factors affecting the issuer or equity securities markets generally.

Loans are subject to risks involving the enforceability of security interests and loan transactions, inadequate collateral, liabilities relating to collateral securing obligations, and the liquidity of the loans.

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 over any period of time and may shift in and out of favor with investors generally, sometimes rapidly, depending on changes in market, economic, and other factors. Investments in value securities may be subject to risks that (1) the issuer's potential business prospects will not be realized; (2) their potential values will never be recognized by the market; and (3) their value was appropriately priced when acquired and they do not perform as anticipated.

Securities of small and medium-sized companies tend to be riskier than those of larger companies. Compared to large companies, small and medium-sized companies may face greater business risks because they lack the management depth or experience, financial resources, product diversification or competitive strengths of larger companies, and they may be more adversely affected by poor economic conditions. There may be less publicly available information about smaller companies than larger companies. In addition, these companies may have been recently organized and may have little or no track record of success.

Index Definitions: The **ICE BofA 1-5 Year U.S. Treasury Index** measures the performance of short-term U.S. Treasury securities. The **ICE BofA 1-5 Year Corp./Gov. Index** measures the performance of U.S. government and investment-grade corporate debt. The **Bloomberg U.S. Aggregate Index** is a broad-based benchmark that measures the investment-grade, U.S. dollar-denominated, fixed-rate taxable bond market. The **Blended Index** is composed of the Russell 3000 and the Bloomberg Intermediate U.S. Government/Credit Bond Index in a static 60/40 allocation. The Russell 3000 is a market capitalization-weighted benchmark index made up of the 3000 largest U.S. stocks, which represent about 98% of the U.S. equity market. The Bloomberg Intermediate U.S. Government/Credit Bond Index is a broad-based flagship benchmark that measures the non-securitized component of the U.S. Aggregate Index with less than 10 years to maturity. Indices are unmanaged and investors cannot invest directly in an index. 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. The **Consumer Confidence Index** is an indication of future developments of households' consumption and saving, based upon answers regarding their expected financial situation, their sentiment about the general economic situation, unemployment and capability of savings.

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 1-800-258-3030 or visit homesteadfunds.com.*

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