Homestead Funds

Our Perspectives: **Six Reasons Why Investing in the U.S. Can Be A Ballast in Times of Volatility**

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Mark is responsible for shaping the strategic vision and directing the business activities of the fund company and its related money management entity, Homestead Advisers. He oversees portfolio management, operations, client services, marketing and sales. Prior to joining Homestead Advisers in 2018, he was the CEO of Dreyfus Corporation, a subsidiary of BNY Mellon Investment Management.

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This commentary was prepared on May 5, 2022, and reflects our view of events at that time. Please visit our website, homesteadfunds.com, for the latest perspectives.

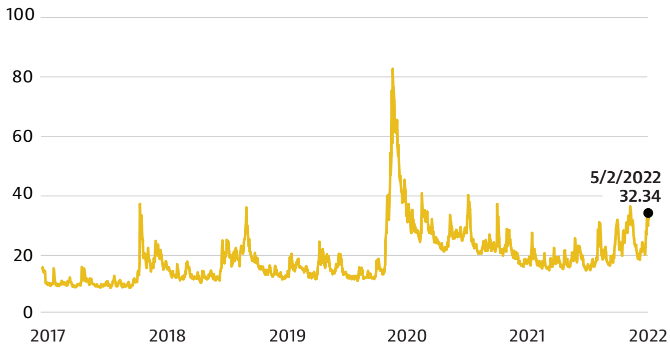
The world economy has entered a new phase of volatility — one that could be with us for a while. The invasion of Ukraine by Russia marks the first major upset to the peacekeeping arrangements of World War II. The situation could potentially expand to an even more complex and disruptive conflict for the global community. In the meantime, it has prompted surging prices for oil, natural gas and wheat produced by the two countries.

The inflationary trend that began as COVID-19 restrictions were lifted has also upended a long, peaceful era for prices in much of the developed world. Since the early 1980s, inflation in the U.S. has been relatively low and steady. With multiple forces driving prices up — strong economic growth, a tight labor market, continued supply shortages and commodity price pressure from the Ukraine situation — inflation could prove tricky to stabilize. This trend is not limited to the U.S.; most developed economies, including the U.K., Europe and more recently Asia, are facing escalating inflation.

Global Markets Reacting to Inflationary Pressures

Both stocks and bonds have taken a turn into more volatile territory. The Chicago Board Options Exchange Volatility Index (VIX), a benchmark that measures stock price volatility, has begun to tick upward again after drifting slowly down from the COVID-19 shock. Credit spreads (i.e., the difference in yield between corporate bond issues and U.S. Treasuries of similar maturity) have also climbed since the start of the year.

The VIX Turns North Again



Source: Bloomberg

The Case for U.S. Investing During Global Volatility

No two economic eras are quite the same, but history tells us one thing: Upheaval and geopolitical issues can take a long time to resolve. With that in mind, investors may be considering how to navigate the current volatility and the potential for longer-term stress for financial markets.

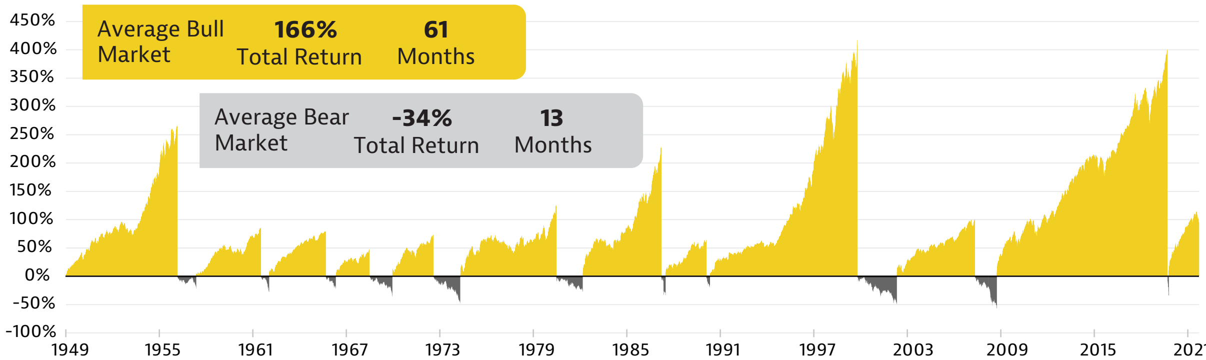
Investments in U.S.-based companies, through both stocks and bonds, provide a number of attributes that can be especially important when markets are extremely volatile. Here are six reasons why:

1 U.S. companies are resilient, and they can perform well during inflation.

Historically, stocks have performed well even in inflationary environments. To understand why, it's important to remember what a stock is: a small piece of a company. If companies can perform well and even thrive in inflation, their earnings can remain stable. As long as earnings remain healthy, stocks tend to hold their value over long periods.

Over the Long Term, Stocks Have Recovered From Setbacks

S&P 500 Index Cumulative Price Return



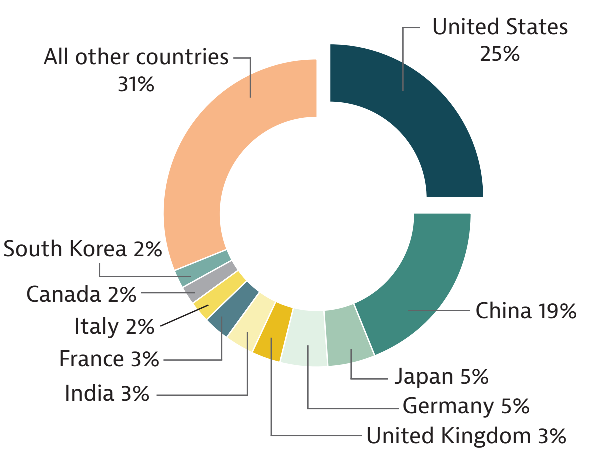
Source: Bloomberg and Strategas. *Past performance is no guarantee of future results.* The Standard & Poor's 500 Stock Index is a broad-based measure of U.S. stock market performance and includes 500 widely held common stocks. Indices are unmanaged, and investors cannot invest directly in an index Unless otherwise noted, performance of indices does not account for any fees, commissions or other expenses that would be incurred. Returns include reinvested dividends. Bull markets represent peak-up-trough price declines of 20% or more. Returns are show from June 13, 1949, to February 28, 2022.

Bonds and Cash Are Still Important

Stocks are often considered the go-to investment during inflationary periods, but bonds and cash are still important. Stocks are much more susceptible to periods of steep declines. Bonds can offer income and retain asset values more reliably, while cash offers true liquidity and preservation of face value.

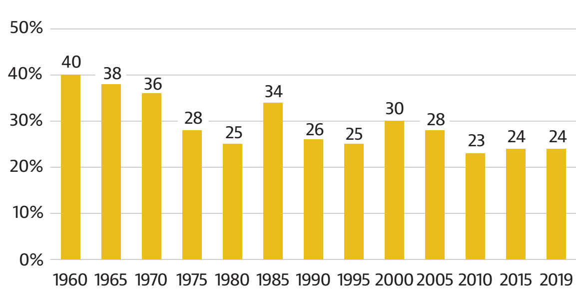
The U.S. Economy Remains a Cornerstone

World GDP, 2022



Source: Latest official GDP figures published by the World Bank, accessed at worldometers.info

U.S. Share of Global Economy Over Time



Source: World Bank

Can companies actually perform well in an inflationary environment? Absolutely, if there is demand for their products and services. Strong demand means companies can “pass through” the higher costs they face for supplies or labor by adjusting their own prices higher, preserving their profits.

Companies also have the benefit of being incentivized to be profitable and resourceful. They can pivot and adjust to their environments just like households and individuals do. This fundamental nature of companies — their incentives and their flexibility — is the root of why companies have historically done well over long periods and generated value for shareholders.

2 The U.S. economy remains the global leader.

The U.S. has a lot of appeal as an investment location thanks to the sheer size of the economy. U.S. GDP was $23 trillion in 2021, representing nearly a quarter of global economic output.

China, the next-largest economy, has grown its share of world GDP significantly in the post-war era. In 1960, it represented 4% of world output; by 2019 it represented 16%. Emerging economies often enjoy a faster pace of economic growth as they catch up to the standards of living of their developed peers, suggesting they should naturally gain share over time. While the U.S. has declined in GDP share over the years, it has held steady in the past decade. This speaks to the resilience and staying power of the U.S. economy.

3 U.S. consumers are a powerful force.

Another important feature of the U.S. economy is its primary source of growth: consumers. Roughly 70% of U.S. GDP comes from consumer spending. Consumers do adjust their spending: When times are tight, they spend less and that affects GDP, and when times are great, they spend more. But those tweaks up and down are relatively mild compared with countries whose economies rely on volatile commodities.

4 The U.S. dollar remains king.

The U.S. dollar is used internationally as a stable store of value compared with the currencies of other countries that face more fluctuation. Many countries around the world issue their sovereign debt in U.S. dollars or hold their central bank reserves in dollars.

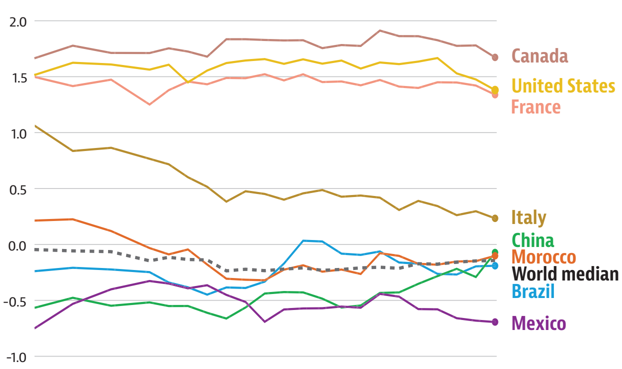
Part of the reason why the dollar remains so stable is because of the durability of the U.S. economy. This naturally ties back to the earlier points: With the world's largest economy and broad-based consumer power, the U.S. government's debt obligations remain creditworthy and the dollar reflects that. Indeed, when a downturn or shock hits, global investors often flock to dollar holdings, as they did during the 2008/2009 financial crisis and during the early days of COVID-19 lockdown.

In contrast, countries whose currencies are connected to volatile commodity prices have a more vulnerable credit profile. Erratic currencies affect businesses and consumers relying on imported goods. For emerging market countries holding their government debts in dollars, a sudden "flight to the dollar" can be doubly painful, strengthening the dollar and requiring more of their home currency to pay off the same amount of debt.

5 Rule of law is solid in the U.S.

The U.S. ranks highly among global peers for its rule of law — meaning that the typical person has high confidence in the rules and laws of society and is likely to abide by them. This matters when it comes to the fundamental function of things such as contract enforcement and property rights. It also figures into the effectiveness of police and whether rulings by courts are meaningfully upheld.

U.S. Scores High on 'Rule of Law'



Source: World Bank

This high level of trust throughout U.S. society is what allows for a high-functioning market economy. Markets rely on transactions between strangers and institutions, strangers and strangers, and institutions and institutions. If participants in those transactions cannot trust their counterparties to stick to the rules, an alternate system of enforcement will develop — one based on bribes and tribes, essentially. Rule of law is an important component of governance.

6 Other key governance factors, such as accounting conventions, reinforce trust.

If you can't believe the accounting figures, how can you make good decisions about investing in companies? In the U.S., strict accounting conventions lend another layer of trust to the market system. Another dimension of this is transparency. Shareholders in the U.S. are accustomed to being able to get timely and reliable information from the companies that trade publicly.

These conventions lead to accountability for companies and for management teams. There are exceptions, of course; every so often, a public company is caught in fraud or accounting scandals. But by and large, the U.S. system of accounting and transparency reinforces the functioning of capital markets.

Diversifying Internationally Still Makes Sense

Many investors hold some exposure to international stocks and bonds for the benefit of diversification, and that practice still makes sense in times of volatility. The international markets open the door to thousands of investment opportunities in companies whose stocks or bonds trade on foreign exchanges. Other geographic regions can offer different growth trends and opportunities.

Still, the sheer size of the U.S. economy and other characteristics we discuss here have historically benefited investors. Americans are fortunate in many ways, and one of them is the access to a domestic investment market that has historically been resilient.

Let's Connect. Homestead Funds client services team would be happy to talk with you about your goals and current investment program. Give us a call at 800.258.3030, option 2.

The VIX is a trademarked ticker symbol for the Chicago Board Options Exchange Market Volatility Index, a popular measure of the implied volatility of S&P 500 index options. Often referred to as the fear index or the fear gauge, it represents one measure of the market's expectation of stock market volatility over the next 30-day period. Indices are unmanaged and investors cannot invest directly in an index. Unless otherwise noted, performance of indices does not account for any fees, commissions or other expenses that would be incurred. Returns do not include reinvested dividends.

Investing internationally carries additional risks such as differences in financial reporting, currency exchange risk, as well as economic and political risk unique to the specific country. This may result in greater share price volatility. Shares, when sold, may be worth more or less than their original cost.

Gross domestic product (GDP): One indicator used to track the health of a nation's economy. When the economy is healthy, there is usually a lower level of unemployment, and wages tend to increase as businesses hire more labor to meet the growing demand of the economy.

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.

Past performance does not guarantee future results.

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Investing in mutual funds involves risks, including the possible loss of principal.

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 visit homesteadfunds.com.

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