Homestead Funds

Quarterly Market Review

Second Quarter 2022

Summary

- Steep challenges faced stocks and bonds again in the second quarter. Benchmarks for both asset classes were down, with stocks into bear-market territory. Inflation continued at a higher-than-expected pace, showing the largest increases in prices for housing, gasoline and food. Supply-side pressures from COVID-19 lockdowns and the war in Ukraine added fuel to the fire.
- The possibility of a "hard landing" grew. Consumer sentiment plummeted amid inflation as the Federal Reserve hiked interest rates twice to combat price pressures. Though company earnings remain sturdy to date, stock markets retreated, bringing price-to-earnings valuations down substantially.
- Bonds were also down again as interest rates continued to climb across maturities. Credit spreads widened over the quarter. The gap between 2- and 10-year U.S. Treasury yields narrowed, flashing a recessionary signal.

This commentary was prepared on July 7, 2022, and reflects our view of events at that time. Please visit our website, homesteadfunds.com, for the latest perspectives.

Bears Rule the Day

The second quarter was another tough period for stocks and bonds. Both asset classes declined again, extending a trend that started in the first quarter of the year. Inflation not only continued but accelerated. The Federal Reserve (Fed) hiked interest rates twice, aiming to cool economic activity enough to bring price pressures down. More rate hikes are expected for 2022.

Inflation Sets the Stage for a Slowdown

Global economies saw little relief in the second quarter from a mix of inflationary factors, including the war in Ukraine, continued COVID-19 lockdowns in China and backlogs in the supply chain. The Consumer Price Index continued to climb. The commonly cited measure of prices, which reflects a basket of goods and services, rose at a year-over-year pace of 9.1% in June, following readings of 8.6% in May and 8.3% in April.

Inflation has taken a steep toll on consumers. Consumer sentiment has been on the downswing since mid-2021 but plummeted in recent months to a record low, as measured in the University of Michigan Consumer Sentiment Index.

Indeed, the day-to-day costs are the categories suffering the worst of the inflation trend: energy, food and housing. Oil prices remained lofty, crossing $100 per barrel again in June after touching similar levels in March. As the

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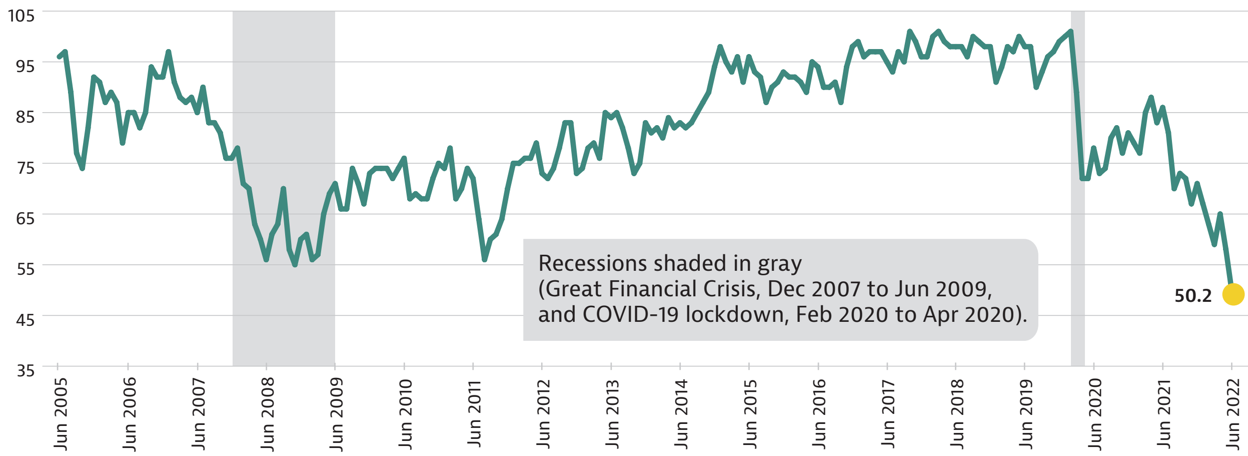
Amid High Inflation, Consumer Sentiment Hits Record Low



Sources: St. Louis Federal Reserve; NBER
Consumer sentiment is an economic indicator that measures how optimistic consumers feel about their finances and the state of the economy. The University of Michigan Consumer Sentiment Index is a consumer confidence index published monthly by the University of Michigan.

Russia-Ukraine war continued, global energy markets faced shortages and steeper prices. Food prices were also affected by these dynamics, as higher global freight and energy costs drove farming expenses higher and output lower. The housing market showed signs of cooling activity while mortgage rates went up, yet home prices continued upward. Many would-be buyers turned to rental markets, pushing rents higher.

The Fed's Bold(er) Moves

To fight inflation, the Fed hiked interest rates twice over the period. Higher interest rates can help cap demand, which has been robust as the economy rebounds from the shock of COVID-19. Yet most of the inflationary pressures at present are coming from the supply side of things — from the ongoing labor shortages connected to COVID-19 and from additional energy- and food-supply shortages due to a war in Europe.

Still, the outlook for inflation could shift quickly. Most of the world is facing inflation and the possibility of recession, factors that naturally dampen demand and could help supply-chain backlogs resolve more quickly. The Fed is trying to reduce demand just enough to ease inflation without causing a recession, but it remains to be seen if the Fed can achieve a "soft landing." Indeed, the possibility of a "hard landing" seemed to increase in the quarter.

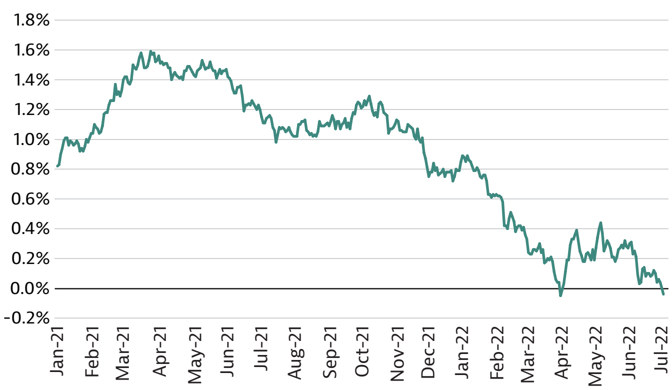
Recession or No Recession?

If GDP contracts again in the second quarter, it would mark two consecutive quarters of declining economic growth. That is the standard definition of a recession offered by the National Bureau of Economic Research (NBER). However, the negative GDP number from the first quarter is widely regarded as a technical fluke. It was driven by lower activity in private inventory investment; lower federal, state and local government spending; and an imbalance in imports/exports. Consumer spending did rise in the first quarter, reassuring markets at the time.

In the second quarter, one recessionary signal did flash again; the gap between 10-year and 2-year Treasury yields shrank, touching zero at quarter-end. In a typical, growing economy, 10-year bonds have higher yields than shorter-term 2-year bonds. Historically, the gap between the two yields has shrunk to zero ahead of recessions. This is not a perfect barometer; the gap has touched zero in periods where there was not a recession. Still, it is considered one of the most reliable market signals for a coming slowdown.

Recessionary Signal Flashes Again

The gap between 10-year and 2-year U.S. Treasury bonds recently dipped below zero, a potentially recessionary signal.



Source: U.S. Department of the Treasury

While the risk of recession did seem to climb in the second quarter, the other typical feature of recessionary environments — a bad labor market — has yet to appear. Employers added jobs in June, with increases across multiple business sectors, and unemployment remained low at 3.6% for a fourth consecutive month.

Bonds

As interest rates continued to climb for all maturities, bond returns were negative in the second quarter. The change in rates was most pronounced for shorter maturities. Inflation readings were higher than expected across the period, prompting markets to adjust expectations for future rate hikes. The Fed raised interest rates by 0.50% in May and 0.75% in June. Markets priced in expectations for about 1.75% of additional rate hikes in the calendar year.

Credit spreads, which measure the difference in yield for corporate bonds compared with similar-duration Treasuries, also continued to widen, which pressured performance in corporate bonds. However, we believe that company earnings and balance sheets are still in strong condition, suggesting the likelihood of default among corporate issuers remains low.

It is atypical for bonds and stocks to underperform in lockstep, as they have in recent months. It is also atypical for the Fed to be hiking interest rates just as the economy is headed for a slowdown, which is the primary driver behind poor bond returns in the current environment.

Performance Attribution for Our Bond Funds

Against this backdrop, the Homestead Short-Term Government Securities Fund (HOSGX) returned -1.14% in the second quarter, trailing its benchmark, the ICE BofA 1-5 Year Treasury Index, which returned -0.81%. The fund's shorter-duration Treasuries weighed on returns as short-term rates rose fastest. Widening credit spreads also weighed on corporate holdings. The fund's yield curve positioning and agency holdings aided relative performance.

The Homestead Short-Term Bond Fund (HOSBX) returned -1.65% in the quarter, lagging its benchmark, the ICE BofA 1-5 Year Corporate/Government Bond Index, which returned -1.12%. The fund's exposure to industrials and financials holdings weighed on relative returns as credit spreads widened.

The Homestead Intermediate Bond Fund (HOIBX) returned -5.02% in the second quarter, trailing its benchmark, the Bloomberg U.S. Aggregate Index, which fell -4.69%. Fund positioning in Treasuries weighed on performance, as did overweight exposure to industrials bonds. Conversely, overweight exposure in asset-backed securities (ABS) boosted fund performance.

Stocks

Stocks fell again in the quarter. Value stocks held up better than growth stocks. There was little distinction between performance for large caps versus small caps. On a sector basis, communications services stocks performed the worst. Defensive sectors such as consumer staples, utilities and health care held up better, but most sectors delivered losses.

Company earnings actually held up well in the period. Analyst expectations for the second quarter are that S&P 500 Index companies will grow earnings around 4%. The P/E ratio is a measure of how much investors are willing to pay for a share of the company's earnings. If the P/E ratio is 16, it means shares cost 16 times annual earnings.

Performance Attribution for Our Stock Funds

The Homestead Value Fund (HOVLX) declined -11.35% in the second quarter, outperforming its benchmark, the Russell 1000 Value Index, which returned -12.21%. In the period, the fund's stock choices and overweight allocation in health care names boosted performance. Stock picks in real estate were also additive. Conversely, stock choices in communications services detracted from relative performance.

Compared with the index, the fund holds significant overweights in industrials 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) declined -14.26% in the second quarter, outperforming its benchmark, the Russell 2000 Index, which returned -17.20%. In the period, stock selection in the industrials and information technology sectors aided returns. The fund's lack of holdings in consumer staples and energy stocks detracted from performance.

Relative to its benchmark, the Small-Company Stock Fund continues to be notably underweight in the energy and consumer staples 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 -10.13% in the second quarter, outperforming its custom benchmark, a 60%/40% blend of the Russell 3000 Index and the Bloomberg Government-Credit Index, which returned -12.00% for the same period.

The fund's stock holdings outperformed their benchmark. Stock selection in the consumer discretionary and real estate sectors boosted relative returns. Conversely, the fund's lack of exposure to energy stocks detracted from performance, as did stock picks in energy names. The fund holds its biggest sector overweights in industrials and real estate, compared with its equity benchmark. The fund's largest underweights are in communication services and energy stocks.

The fund's bond allocation underperformed its benchmark. Widening credit spreads pressured holdings in the industrials sector. The fund's lack of exposure to U.S. Treasuries also weighed on returns. Conversely, fund holdings in the financials sector and a small cash balance helped returns. Compared with its bond benchmark, the fund holds overweights in corporate bonds and agency-issued bonds. It is underweight in U.S. Treasury holdings.

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Total Returns as of 6/30/2022

	Q2	1-yr	3-yr	5-yr	10-yr	Since fund's inception
		Average Annual				
Bond Funds						
Short-Term Government Securities Fund (HOSGX)	-1.14%	-4.78%	-0.11%	0.68%	0.63%	2.73%
ICE BofA 1-5 Year U.S. Treasury Index	-0.81%	-4.61%	0.04%	0.91%	0.89%	3.47%
Expense ratio 0.79% (gross) 0.75% (net) (12/31/21)*						
Short-Term Bond Fund (HOSBX)	-1.65%	-5.80%	0.07%	1.03%	1.41%	3.82%
ICE BofA 1-5 Year Corp./Gov. Index	-1.12%	-5.19%	0.14%	1.11%	1.24%	4.04%
Expense ratio 0.79% (12/31/21)						
Intermediate Bond Fund (HOIBX)**	-5.02%	-10.92%	-0.65%	NA	NA	0.18%
Bloomberg U.S. Aggregate Index	-4.69%	-10.29%	-0.93%	0.88%	1.54%	0.05%
Expense ratio 0.91% (gross) 0.80% (net) (12/31/21)*						
Balanced Fund						
Rural America Growth & Income Fund (HRRLX)***	-10.13%	-11.43%	NA	NA	NA	-9.70%
Blended Index	-11.12%	-11.01%	NA	NA	NA	-9.27%
Expense ratio 5.12% (gross) 1.00% (net) (5/01/21)*						
Equity Funds						
Value Fund (HOVLX)	-11.35%	-8.35%	8.31%	9.62%	11.89%	10.02%
Russell 1000 Value Index	-12.21%	-6.82%	6.87%	7.17%	10.50%	NA
Expense ratio 0.63% (12/31/21)						
Small-Company Stock Fund (HSCSX)	-14.26%	-18.93%	6.22%	3.28%	8.04%	8.10%
Russell 2000 Index	-17.20%	-25.20%	4.21%	5.17%	9.35%	6.92%
Expense ratio 1.06% (12/31/21)						

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.

*Homestead Advisers has contractually agreed, through at least April 30, 2023, to limit the funds' 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). This waiver agreement will terminate immediately upon termination of the fund's Management Agreement and may be terminated by the fund or Homestead Advisers with one year's notice.

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

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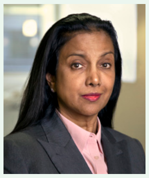
Equity Fund Management



Prabha Carpenter, CFA®
Senior Equity Portfolio Manager

Prabha co-manages the Value, Small-Company Stock and Rural America Growth & Income funds. She is a graduate of the University of Madras, where she received a BA in economics. She received her BS in business economics and an MBA with distinction in finance from American University. Prabha holds the Chartered Financial Analyst designation.

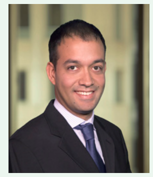
Mark Iong, CFA®
Equity Portfolio Manager

Mark co-manages the Rural America Growth & Income Fund and supports the equity 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

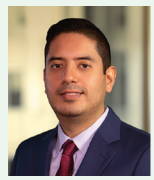
Jim co-manages the Value, Small-Company Stock and Rural America Growth & Income funds. He received a BA in English from Colby College and an MBA from the Olin Graduate School of Business at Babson College. Jim holds the Chartered Financial Analyst designation.

Bond Fund Management



Mauricio Agudelo, CFA®
Head of Fixed-Income Investments

Mauricio co-manages the Short-Term Government Securities, Short-Term Bond, Intermediate Bond and Rural America Growth & Income funds. 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 the Short-Term Government Securities, Short-Term Bond, Intermediate Bond and Rural America Growth & Income funds. 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: July 7, 2022

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.

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. 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. 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 on 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 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 800.258.3030 or download a PDF at homesteadfunds.com.

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