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A QUARTERLY NEWSLETTER FOR HOMESTEAD FUNDS' SHAREHOLDERS

How to Build Savings With Staying Power

Bear markets can test the nerves of even experienced investors. It's stressful to watch accounts decline in value — and there's no way to know when exactly the recovery will begin. Diversification is a way to provide a buffer during turbulent times.

We all connect with that simple age-old advice, "Don't put all your eggs in one basket." In money management, diversification usually means assembling a mix of money markets, stocks and bonds.

This kind of diversification is a must. The winds can turn quickly in financial markets. Stocks took a short-term dive when COVID-19 hit, then rallied for a stretch only to swoon again from inflation. Bonds generally fared better through COVID-19, as interest rates were at record lows, but their performance has struggled in 2022 amid inflation and rate hikes. When you invest, you have the opportunity to capture growth over the long term — but you have to manage the risks. Diversification is a way of spreading risk around and hopefully smoothing out the ride as you go.

But there's more to it than just holding a mix of investments. When you are preparing for the future, you want to sow seeds that have the potential to produce at different times and in different environments. There are ways to "plant" your savings in specialized accounts, for instance, to capture beneficial tax treatments and give yourself choices for which money to access and when.

Indeed, you might benefit by diversifying your thinking on the matter of diversification. Read on to hear our team's input on many ways to diversify. ■

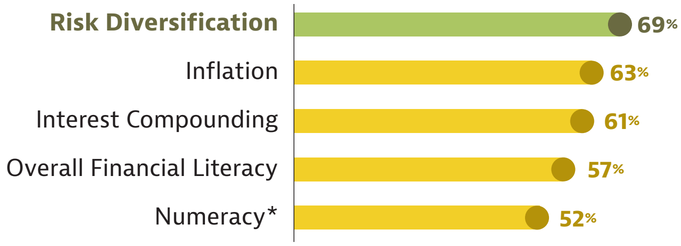
What to Diversify (Besides Asset Classes)

Most Americans understand they should spread their eggs across a few baskets. In fact, diversification is the financial concept that people understand best, according to the Milken Institute.

Continued on page 2

7 IN 10 UNDERSTAND DIVERSIFICATION

The percentage of respondents who correctly answered survey questions associated with...



Source: Financial Literacy in the United States, Milken Institute

**Numeracy means being able to apply math to money, such as multiplying a savings balance by an interest rate to calculate interest earned.*

What to Diversify (Besides Asset Classes) *continued from page 1*

Typically, diversification means holding more than one kind of investment — stock funds, bonds funds and money market funds, for instance. But there are benefits to diversifying in other ways, too. Here are three that rise to the top:

Diversify Your Goals

Saving for retirement is a standard goal. But you might be well served to set other goals too — such as building a rainy day account, saving for your kids' or grandkids' education, planning special-purpose savings like a down payment on a home or a vehicle purchase, or even saving for shorter-term plans like annual holiday gifts or a vacation. Breaking your savings plan into different goals allows you to understand the different time frames and risk profiles.

MORE GOALS, MORE GROWTH INVESTMENTS[1]

2x People with four or more savings goals held twice as much of their savings in stocks compared with people who had no savings goals.

Indeed, people who set more savings goals also tend to invest more in riskier, historically higher-growth investments — stocks — than people who set no goals, according to a recent study. Researchers at the University of Stirling in the U.K. found that households with four or more savings goals invested more than twice as much in stocks as those with no savings goals.[1] We understand this to mean that people who have more conservative investments set aside for short-term goals feel more comfortable taking risks elsewhere in seeking potentially higher returns on their long-term investments.

Diversify Your Account Types

When you invest in a taxable investment account (not an IRA or 401[k]), you can access your funds anytime for any reason — but you'll pay taxes whenever you sell holdings at a gain or receive dividend, interest or capital gain distributions. On the other hand, you can capture powerful tax benefits with retirement accounts or education savings accounts with money compounding tax-free or tax-deferred — but you may have to pay penalties on withdrawals that don't meet IRS requirements.

So there's a trade-off. If you want to take advantage of the tax benefits of IRAs and 401(k)s, you'll have to play by the IRS's rules for qualified distributions or else be subject to taxes and possible penalties. See the table on page 5 for more on distribution flexibility and tax advantages by account type.

This is why account diversification can be compelling. If you spread funds across a few different types of accounts, you can create some flexibility while capturing tax advantages that can help fuel growth while maintaining your ability to access funds without penalty when needed.

Roth IRAs offer a list of exceptions for withdrawal penalties. Did you know you can use Roth funds to pay for higher education for your kids?

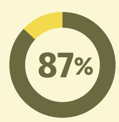
You can also take advantage of the difference in tax treatments. Suppose you continue to work part time in retirement, so you are still in a higher income-tax bracket. If you have a large one-time expense, such as a wedding, car purchase or special vacation, taking a tax-free withdrawal from a Roth can help keep you in a lower tax bracket for that year. In later years, when your income from working is down, you can take the taxable 401(k) withdrawals.

Diversify Your Income

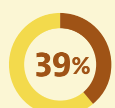
In retirement — and even during your working years — it can also make sense to diversify your income.

Retirees usually rely on Social Security payments and workplace retirement plans. But a diversified income picture could also include personal savings, as from an IRA or even a taxable account, and maybe even income from working part time.

INFLATION EATS AT RETIREES' CONFIDENCE[2]



87% of workplace savers are worried about inflation, but only one-third of that group have increased their savings rate.



Just 39% of workplace savers say they have a strong understanding of the impact inflation can have on their ability to save and spend.

Thinking Big Picture

Diversification is a simple concept, but there are many ways to put it into action. To prepare for and ride out the inevitable down markets, consider a broad approach to diversification. A well-rounded investment plan could provide flexibility when you are ready or need to tap into your savings. ■

[1] University of Stirling, "Setting goals will make you a better saver, says Stirling study," April 21, 2021

[2] The 2022 BlackRock Read on Retirement

5 Steps to Take Toward Diversification

Diversification can turn the dial down on risk and open new opportunities for upside. Ready to diversify? Here are five steps you can take to spread your eggs across a few more baskets.

1. Check up on your investment mix.

First, check on your existing investments. Do you have a good mix of stocks, bonds and cash? Each has a different role in your portfolio. Cash and cash equivalent products (money market accounts, etc.) provide stable value and ready access to cash but typically have low returns. Bonds have the potential to generate steady income and moderate the sharp sting of stock pullbacks. Stocks have historically offered higher long-term returns, but they can suffer short-term losses.

Within each of those investments, you can diversify further. A mutual fund is one way to hold a broad "basket" of securities; instead of holding one stock or bond, for instance, a typical mutual fund can hold 100 or more securities. This is a layer of diversification that lessens the risk that you are overly exposed to a losing sector or individual holding.

NO ONE WINNER, YEAR AFTER YEAR[1]

	2019	2020	2021
HIGHEST RETURN	Large Growth	Small Growth	Real Estate
	Small Growth	Large Growth	Natural Resources
	Real Estate	Diversified Emerging Markets	Mid-Cap Blend
	Mid-Cap Blend	Natural Resources	Large Growth
	Foreign Large Blend	Mid-Cap Blend	Small Growth
	Diversified Emerging Markets	Foreign Large Blend	Foreign Large Blend
	Natural Resources	Intermediate Core Bond	Diversified Emerging Markets
	Intermediate Core Bond	Short-Term Bond	Short-Term Bond
	Short-Term Bond	Short Government	Short Government
LOWEST RETURN	Short Government	Real Estate	Intermediate Core Bond

2. Rebalance if needed.

Any investment account that holds multiple asset classes will need an occasional rebalance. Because asset classes rarely move in lockstep, one class (most typically stocks) can end up taking more than their share of the pie after a while. To rebalance, sell a portion of the overgrown investment and use the proceeds to purchase more of the lagging asset classes. In down markets, this means adding stocks. While hard to do sometimes, remember to keep a long-term focus and take advantage of opportunities to "buy low, sell high."

3. Add something new to the mix — international stocks, small cap stocks or a different bond fund, for instance.

If your holdings are a bit plain vanilla, you could benefit from adding some variety. Are your stocks all U.S. holdings? Consider some exposure to international stocks. Do you hold mostly large-cap stocks? Perhaps small-company exposure would be useful. There are also different categories of bond funds to explore.

4. Expand your list of savings goals.

What plans or aspirations can you make more concrete by setting a target dollar amount and a target timeline? Once you begin to firm up some goals, you may find more momentum to save and invest. Don't forget that time is on your side, in investing: The sooner you can put money to work, the longer it has to compound and grow.

5. Open a new account if the tax benefits fit your goal.

Any time that you can capture tax advantages when investing, it's to your benefit. If you are saving for education expenses, retirement or a down payment for a first house, an IRA could be the right vehicle for you. Need more help figuring out if a new account would suit your needs? Reach out to our team anytime.

Small Changes Add Up

Even small steps toward diversification can prove valuable over time. See what you can do to ensure that your savings and investment accounts are capturing the benefits of diversifying. ■

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[1] Morningstar Direct. Data represents calendar year total returns for various categories of mutual funds tracked by Morningstar. This is not the return for any Homestead Fund or a promise of any investment's future return. Past performance does not guarantee future results.

What Is Asset Allocation?

Imagine that you are the president of a small country called Homesteadia. One of your jobs is to decide which crops to grow for the highest prosperity of your country. You can choose barley, a staple crop that grows reliably but isn't very profitable, or artichokes, an unreliable delicacy crop that is highly profitable. Which do you choose?

Most people, er, presidents, would choose a mix of the two: some investment in the reliable crop, which won't create riches but will provide stability, and some investment in the unreliable crop, which could offer upside in a good year.

THE ASSET ALLOCATION DECISION

The Low-Profit Potential, More-Likely-to-Produce Crop (Bonds)

The High-Profit Potential, Less-Likely-to-Produce Crop (Stocks)

This simple concept is exactly how asset allocation works in your investment portfolio. It's about dividing your money among investments that behave differently from each other. The three key categories of assets are money markets (historically lowest risk, lowest return); bonds (historically low to medium risk, low to medium return); and stocks (historically highest risk, highest return).

Diversification of Risks

Asset allocation is a way to diversify the risks of investing.[1] Often (but not always!), when one struggles, the other performs, and vice versa. Bonds and stocks usually have different performance patterns.

SO, WHY ISN'T DIVERSIFICATION WORKING BETTER THIS YEAR?

In recent quarters, as you may have noticed, asset allocation hasn't been doing a whole lot to protect against investment loss. Stocks have faced headwinds, and bonds have also posted some bad performance numbers.

We can chalk that up to the atypical inflation situation. Normally, when the economy is slowing, policymakers are actually cutting interest rates — which has historically boosted bond prices. But high inflation is forcing the Federal Reserve to raise interest rates at a time when the economy is already softening. When rates rise, bond prices struggle.

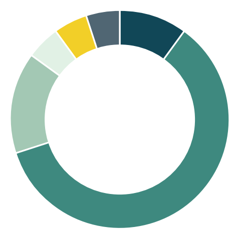
Diversifying the Upside, Too

Asset allocation doesn't just diversify risk — it also diversifies upside. Like that fussy-but-lucrative artichoke crop, there has historically been more upside in stocks compared with bonds or money markets. In fact, that's a good reason to diversify across different types of stocks too — international and U.S., small cap and large cap.

READY-MADE ALLOCATION: MODEL PORTFOLIOS

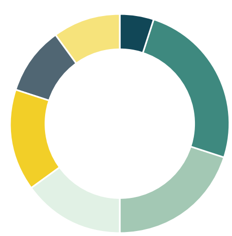
*Did you know we have pre-assembled allocations available for our investors? Visit **homesteadfunds.com/solutions/portfolios**.*

CONSERVATIVE

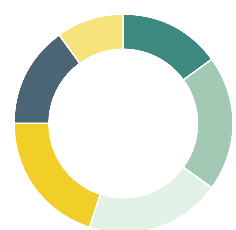


- Cash
- Short-Term Bonds
- Intermediate-Term Bonds
- Large-Cap Value Stocks
- Large-Cap Growth Stocks
- International Stocks
- Small-Cap Stocks

MODERATE



AGGRESSIVE



An Approach for the Long Term

Even though asset allocation isn't always perfectly effective, it is still a way to manage risk while investing for growth, over the long term. You can avoid losses by avoiding investments entirely, but then you miss out on the growth that has historically rewarded investors over the years. ■

[1] U.S. Securities and Exchange Commission, Beginners' Guide to Asset Allocation, Diversification and Rebalancing," August 28, 2009

Tax Treatment 101: When Do You Pay Taxes?

Tax benefits can help you grow your savings by allowing more money to be invested for longer, boosting the base of savings that is compounding. In some cases, the benefit is that you can defer income to a later year when your tax rate may be lower.

As shown in this table, IRAs, 401(k)s and ESAs all offer tax benefits compared with a taxable brokerage account:

	TAXES		
ACCOUNT TYPE	**Taxes in the year of CONTRIBUTING** *Do I pay normal income taxes on my wages before contributing to the account?*	**YEARLY TAXES while savings are invested** *Do I pay yearly taxes on dividends and interest received from investments? On capital gains (profits made from selling investments)?*	**Taxes in the year of WITHDRAWING** *Do I pay income taxes on money that I withdraw from the account?*
Taxable brokerage account *Purpose: Anything*	Yes, contributions are made with after-tax dollars.	Yes, all investment income and realized profits are taxed yearly.	Yes, investment income and realized profits from investment sales are taxed. Withdrawals are not otherwise taxed, however.
401(k) or other workplace retirement account *Purpose: Retirement*	No, if contributions are **qualified**, they are made with pre-tax dollars, meaning you don't pay income tax on those earnings in the year of contribution.	No, investments grow tax-free.	Yes, **qualified** withdrawals are taxed as ordinary income.
Traditional IRA *Purpose: Retirement*	No, **qualified** contributions are pre-tax dollars.	No, investments grow tax-free.	Yes, **qualified** withdrawals are taxed as ordinary income.
Roth IRA *Purpose: Retirement*	Yes, contributions are made with after-tax dollars.	No, investments grow tax-free.	No, **qualified** withdrawals are tax-free.
Education Savings Account (ESA) *Purpose: Education expenses for dependents*	Yes, contributions are made with after-tax dollars.	No, investments grow tax-free.	No, **qualified** withdrawals are tax-free.

DO YOU HAVE A NON-WORKING SPOUSE?

Ordinarily, you can't contribute to an IRA without earned income. But that doesn't apply to spouses. A "spousal IRA" allows a non-working spouse to have a Traditional IRA without having earned income. The working spouse contributes to the IRA, and the money can benefit your spouse or enhance the overall savings of a married couple.

WHAT'S 'QUALIFIED'?

Each account has rules for making contributions or withdrawals that qualify for the tax benefits. To learn more, visit us at **homesteadfunds.com/solutions/accounts** or call us at **800.258.3030**.

Welcome New Account Advisors

We're pleased to introduce you to our newest client relationship advisors. Both look forward to helping shareholders.

Chris Hodges, CFP®

Senior Client Relationship Advisor, Investment Advisor Representative and Registered Representative

Chris has been a Certified Financial Planner™ for almost 30 years. Prior to joining NRECA in 2008, he was a branch manager for Fidelity Investments, ran his own financial planning practice with what is now Ameriprise and served in the U.S. Navy. He has been happily married to Liz since 1985 and has three wonderful children and four awesome grandchildren.

WHAT'S NEW ONLINE

We've added a new site section to **homesteadfunds.com** — What's New — so you can easily find our latest commentary and market updates. Select this from the home page menu.

William Kindle

Senior Client Relationship Advisor, Investment Advisor Representative and Registered Representative

Bill started in the investments industry in 1992 and joined Homestead Funds in 2022. He brings many years of experience managing client relationships from his prior roles at Windham Capital Management, Wellesley Asset Management, Charles Schwab, Fidelity Investments and Lehman Brothers. In addition to his relationship duties, Bill has made contributions in the areas of sales, marketing, product development and thought leadership.

Bill holds a BA in business administration–finance from Hillsdale College and is currently studying for his CFP® designation. He is the father of two and resides in the Boston area. ■

All advisory services are provided by Homestead Advisers Corp., a wholly owned subsidiary of Homestead Financial Services Corp. and a registered investment advisor.

Neither asset allocation nor diversification guarantees a profit or protects against a loss. They are methods used to help manage investment risk.

Homestead Funds does not offer legal or tax advice. Please consult the appropriate professional regarding your individual circumstance.

Rebalancing (discussed in the article on page 3) may entail transaction costs and tax consequences that should be considered.

Debt securities are subject to interest rate risk, credit risk, extension risk, income risk, issuer risk and market risk. The value of U.S. government securities can decrease due to changes in interest rates or changes to the financial condition or credit rating of the U.S. government. Investments in asset-backed and mortgage-backed securities are also subject to prepayment risk as well as increased susceptibility to adverse economic developments. High-yield, lower-rated securities involve greater risk than higher-rated securities. Equity securities generally have greater price volatility than fixed-income securities and are subject to issuer risk and market risk. International investing involves currency, economic and political risks, which may be greater for investments in emerging and frontier markets. Securities of small and medium-sized companies tend to be riskier than those of larger companies.

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 visit homesteadfunds.com.

The views expressed are those of the individuals as of August 11, 2022, and may have changed since that date. The opinions stated may contain forward-looking statements and may discuss the impact of domestic and foreign markets, industry and economic trends, and governmental regulations of the funds and their holdings. Such statements are subject to uncertainty, and the impact on the funds might be materially different from what is described here.

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