Horizons 1Q | 2016

A Quarterly Newsletter for Homestead Funds' Shareholders

In This Issue

00162071

Oil and China: Market Bullies?

For the last nine months or so, stock markets have essentially moved sideways—pulling back about 10%, then climbing upward, only to erase gains and backpedal again.

By many measures, the news on the economy isn't so bad. Earnings reports from U.S. companies weakened in the fourth quarter of 2015, but just a bit. U.S. GDP growth is positive, if low, as are many metrics tracking employment and consumer spending.

But these reassuring numbers can be quite disconnected from market headlines, which continue to circle around a pair of macroeconomic issues today: oil prices and the economy in China. Though our portfolio managers focus far more on the

(continued on page 2)

Investing in an Election Year

Election buzz is permeating much of American conversation and may even be contributing to some of the short-term volatility in the markets. Campaign rhetoric and other news headlines—like the economic and geopolitical topics we discuss in other stories in this issue—tend to rattle investors' nerves. When investors are feeling unsettled, they can be especially vulnerable to making changes to portfolios, even though we know that a volatile or down-market period is usually the worst time to abandon the long-term plan.

Certainly the presidential election has implications for investors, whether it comes to tax code expectations, plans for regulatory policies, or how our country's relationships—from the diplomatic to the economic—evolve on the world stage.

Yet, we can't indulge ourselves too deeply when it comes to the "what ifs." Research studies are divided when it comes to understanding if and how

Stephen Kaszynski, CFA
Director, President and CEO

presidents and parties affect stock and bond markets. And whatever the case, we know that changes in policy are long-term and the effects may lag any presidential post. Not only that, every presidency coincides with a unique economic and political backdrop, a very specific point in the trajectory of history.

For our portfolio managers, the long-term trends facing company managements are always the priority over daily chatter. Changes in taxes, regulation and international relationships really do matter, but the implications are different for each company. That's the real work of a portfolio manager—to track individual operations, understand the path of a company and tease out the real effects of the challenges and opportunities it faces.

Legendary stock investor Benjamin Graham summed up the difference between the flimsy short-term influences and the robust long-term influences with a timely quote: "In the short run, the market is a voting machine but in the long run, it is a weighing machine."

On that note, we are especially proud to have received recognition for the long-term performance of our Small-Company Stock Fund. It's the second year in a row that we've won the award for the longest time period acknowledged—10 year performance. *Past performance is not an indication of future results.* You can read more about this honor in the *News Briefs* section of this issue.

Homestead Funds

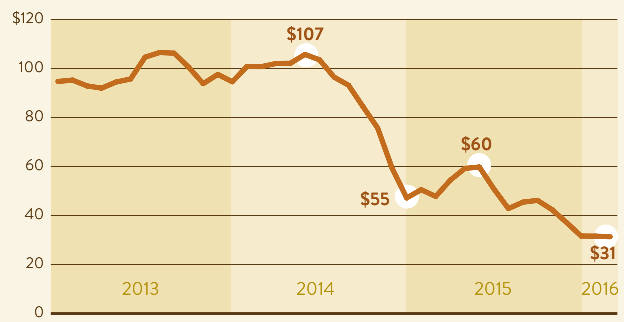
ESTABLISHED 1990

state of individual companies, it's instructive to take a closer look at these issues.

OIL: Climbing Supply, Falling Demand

Oil prices have been in freefall since mid-2014, when the price of West Texas Intermediate Crude Oil peaked at $107 per barrel before tumbling to about $55 per barrel by the end of 2014. Last year wasn't much better, as oil prices climbed back to $60 for the year's peak before nose-diving to the mid-$30s at 2015 year-end. In February of this year, prices went as low as $28 per barrel before recovering back into the $30s.

Oil—$ per Barrel



Source: West Texas Intermediate Crude, from the St. Louis Federal Reserve. As of 2/22/16. https://research.stlouisfed.org/fred2/series/DCOILWTICO/downloaddata

Both supply and demand are responsible for falling prices. Globally, the daily production of oil was up 8% between 2010 and 2015. The uptick in oil production in the U.S. is one major factor, as American oil production climbed an astonishing 55% in that five-year period. Back in 2010, the U.S. was producing about 11% of the world's oil; today it's closer to 16%.[1]

Meanwhile, demand for oil has been flat or even falling in some places. In the U.S., oil consumption is down about –2% between 2010 and 2015; for all Organisation for Economic Co-operation and Development countries, it's down about –5%.[2]

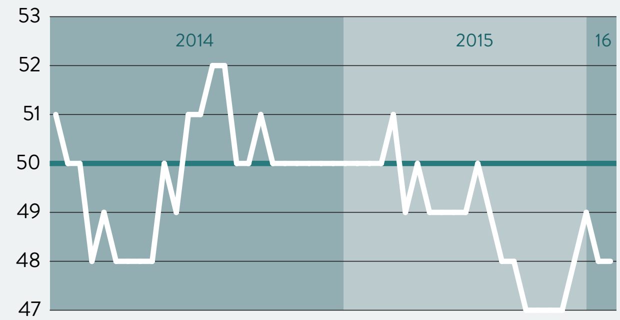
CHINA: Slowing and Uncertain

Slowing activity in China is deeply entwined with falling oil prices.

Just a couple years ago, many market watchers were focused on a gloomy scenario where global users, especially China, might gobble up almost every available drop on the planet, pushing prices over $300 per barrel. Instead, as China's growth moderated, oil prices plummeted.

So how much is China really slowing? The country's reported GDP has gone from 7.7% annual growth (inflation-adjusted) in 2013, to an estimated 6.9% in 2015. From the standpoint of the U.S., which hasn't topped 2% growth in the last three years, the difference between 7.7% and 6.9% seems minor.[3]

China's Manufacturing Activity
(below 50 indicates contraction)



Source: China Caixin Manufacturing PMI Index, from www.investing.com/economic-calendar/chinese-caixin-manufacturing-pmi-753. As of 2/2/16.

But manufacturing activity *is* down. An index that tracks China's manufacturing activity, the China Caixin Manufacturing PMI, posted a recent reading just above 48. Any measure below 50 indicates contraction in manufacturing activity. In fact, the reading has only been above 50 twice in the last year.

The numbers don't appear extreme. Yet, there are two underlying issues: first, that some investors suspect China is careening toward a "hard landing," a result of government incentives that may have encouraged sham building projects, doomed bank loans and other misaligned economic activity. The other worry is that the numbers, rosy as they are, are not trustworthy. Perhaps the real GDP growth rate for the country is not 6.9%, but 5.9%, or 4.9%. Only time will tell.

Putting Little Stock in Macroeconomic Measures

If nothing else, the conundrums of these measures—why oil has fallen so precipitously, yet the numbers out of China don't appear disastrous—are proof of just how complex macroeconomic factors really are. It's not just that oil demand from China has fallen off; it's also that supply is up and technological gains are starting to curb developed market demand in a significant way. And for China, the wild gyrations in the domestic stock market seem to be telling global investors that there's more to the story than official numbers suggest.

Both metrics are also good examples of how quickly macroeconomic measures can veer from expectations. Lucky for us as bottom-up investors, these developments do not affect every company the same way; for some, they're very important, for other firms, these things are inconsequential. As such, issues like oil prices and China's growth are relevant—but secondary—when it comes to our investing process.

[1] Source: U.S. Energy Information Administration. Data as of 10/31/15.
[2] Source: U.S. Energy Information Administration. Data as of 9/30/15.
[3] Source: World Bank. Data as of 2/29/16.

Five Overlooked Ways Mutual Funds Help You Manage Your Money

With news on the economy and markets coming at you 24/7, it's easy to view mutual funds as just a portfolio of securities whose prices shift from day to day.

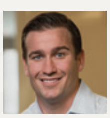
In fact, the popular investor education website, Investopedia, begins its mutual fund definition just that way: "A mutual fund is nothing more than a collection of stocks and/or bonds."[1]

However, if the visionaries who developed the modern mutual fund in the 1920s were still alive, they might gasp at the tone of dismissiveness behind the phrase "nothing more." As envisioned by their inventors, mutual funds would also provide investors of average means with something new for the Roaring 20s: a regulated, rational and transparent method for managing their money.

1. Easily build a plan to grow your assets and receive income through a single vehicle

Establishing an automatic plan for investing, exchanging or redeeming shares between your bank account and mutual fund can help alleviate some of the natural anxiety that accompanies short-term decision making.

Homestead's Automatic Exchange Program provides a convenient way to gradually re-allocate assets among a variety of funds. The Automatic Redemption Program may be well-suited to retirees looking to meet monthly cash flow needs while still maintaining target allocations to different asset classes and investment styles. Investors in taxable accounts should bear in mind that exchanges and redemptions may trigger a capital gain or loss. Diversification does not ensure a profit or protect against loss. It is a method used to help manage investment risk.



"Homestead Funds offers automatic investing and redemption plans to save you time and paperwork."

—**Will Cunningham, CFP**
Senior Client Relationship Advisor and Registered Representative

2. Minimum investments are really low

At Homestead, investors can start their investment for as little as $500, $200—or nothing—for non-retirement accounts, IRA accounts and for participants in an Automatic Investment Plan, respectively. At these prices, giving a gift of shares to a college graduate may seem especially attractive.

And because Homestead Funds are offered without a sales charge, the full amount you invest goes right to work. Investors pay only the fund's operating expenses and, if an IRA or ESA account, an annual custodial fee. All mutual funds incur expenses, which cover the cost of running the fund and include investment management, accounting, legal and compliance services, record keeping and statement production.

3. Regular reports make it easier to monitor your money

It's an axiom of investing that you cannot manage what you cannot measure. Fortunately, shareholders are provided with regular, periodic statements and reports.

Many financial planners recommend that investors review their investment portfolios and gauge their performance objectives against their long-term goals at least once a year.

4. Re-allocation strategies are easily implemented if your objectives change

Mutual funds make it easy to change your investment allocations when your tolerance for risk changes. If you require a more conservative or aggressive tilt to your program, our client services associates can help you. Of course, moving money could have tax consequences that should be considered when determining a re-allocation strategy.

5. Comprehensive regulations are designed to protect shareholder interests

All investments entail risk, including mutual funds. Regulation doesn't mean you won't lose money. But, mutual funds are subject to the provisions of the Investment Company Act of 1940. That means all mutual funds must register with the Securities and Exchange Commission, ensure all shareholders have adequate information about their investments and employ a bank as custodian for all portfolio assets.

Additionally, funds must calculate the value of all portfolio securities daily to determine the fund's daily share price, meet requirements for diversification and liquidity and provide disclosures making the details of their operations, financial condition and contractual relationships more transparent than they are for other financial products.

Investing in mutual funds involves risk, including the possible loss of principal. Investors are advised to consider fund objectives, risks, charges and expenses before investing. The prospectus contains this and other information and should be read carefully before you invest. To obtain a prospectus, call 800.258.3030 or visit homesteadfunds.com.

[1] http://www.investopedia.com/university/mutualfunds/mutualfunds.asp#ixzz41ZITOVoz

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

Portfolio Managers Steer Clear of the "Unknowables"

We asked the portfolio management team for Homestead's Value and Small-Company Stock Funds to talk with us about whether the current investment landscape was affecting their approach to money management.

Q: What's your take on the current volatility in the stock market?

PRABHA CARPENTER: When stock prices are falling quickly, or when they're bouncing around a lot without making upward progress, it can really rattle investors. But for value investors like us, volatile periods can sometimes present the opportunity to buy a new stock, or add to a position that we really like, for what we believe is an attractive valuation.

We aren't doing anything differently in terms of how we research or evaluate companies. Our job as portfolio managers is to focus on the things that we *can* know and control, instead of fretting about the things we can never have any certainty or control over.

Volatility is in the category of "unknowables," things that we can't predict—when it will start or stop, if it'll get better or worse.

Q: If market volatility falls into the category of "unknowables," what are the "knowables" that you do focus on?

MARK ASHTON: Our job as portfolio managers is to exercise good judgment about which companies to invest in, and when. Our goal is to own high-quality companies that are well-positioned today and likely to adapt well to changes in the future, and we are careful to get into stocks at what we believe to be reasonable or discounted valuations.

An important factor in the process is our assessment about a company's management team. We may study a company for a few years before we feel we have sufficient confidence in the management. How do they work through challenges? Do we think they will be successful in executing their strategy? From our perspective, those are the decisions that we have control over. We try to find great teams who are positioned to take advantage of a long-term theme in the market.

Q: What's an investment theme you've been tracking?

GREGORY HALTER: One idea we are following across all sectors is how companies are integrating "big data," meaning how managements are using their access to comprehensive data to either grow their revenue or manage their costs and productivity.

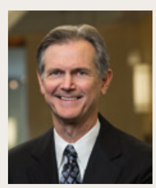
Here's an example: a fast food chain now has incredible data about sales patterns over the day. The company can use that to optimize staffing and output, so that it wastes less in down periods and serves customers faster and with better quality in busy periods. Then think of scaling that practice across a whole country of locations; the benefits are huge.

Q: Why do you think market watchers tend to be so focused on things like volatility or macroeconomic factors?

MARK ASHTON: People will naturally focus on the big movements and then they want a simple way to rationalize them. Investing our way may appear uneventful, even boring to some investors. Our method often involves waiting, waiting for your expectations about a company to materialize, or waiting for the right price to buy a new stock. It's not a style of investing where daily events are the primary factor in making our investment decisions.

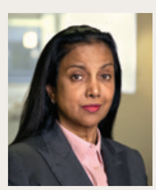
Things like macro data points though, like oil prices or job numbers, they make for interesting news. They can be instructive and we do incorporate them in our investment process and company assessments. Does that make it relevant to long-term wealth? Probably not. ✱

Value and Small-Company Stock Fund Portfolio Managers



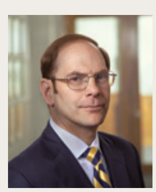
Mark Ashton, CFA

BS, Finance, University of Utah; MBA, Marketing Research, University of Southern California. Mark joined RE Advisers in 1999.



Prabha Carpenter, CFA

BA, Economics, University of Madras; MBA with distinction in Finance and BS in Business Economics, The American University. Prabha joined RE Advisers in 2002.



Gregory Halter, CFA

BBA, Finance, Cleveland State University. Gregory joined RE Advisers in 2014.

Big Picture, by the Numbers

Sometimes the big picture of financial planning can get lost in the busyness of our day-to-day. Take a few minutes to check in on all the zones of your financial life—earning, saving, investing and retiring—with these big picture numbers.

EARNING

4 OUT OF 10

couples can't correctly identify how much their partner makes[1]

Four out of 10 couples can't correctly identify how much their partner makes, according to a recent industry survey. Are you and your partner checking in often enough on financial issues?

For many, finances are a sensitive subject. But when you avoid talking about it, you may sidestep a lot of important planning issues—like your shared vision for earning, saving, investing—even what you'd like your retirement to look like.

When quarterly statements arrive in the mail, it can be a great opportunity to check in with your significant other about the state of your finances. It's never too early or too late to open up the lines of communication.

SAVING

5.2%

U.S. PERSONAL SAVING RATE, JAN 2016[2]

One study finds that speakers of English, along with a handful of other global languages, are unusually terrible about planning for the future—and that includes saving.

Researchers find that in languages where there is a clear distinction between past, present and future, as in English, the population is poorer at planning for the future, perhaps because it truly feels farther away.

In contrast, some languages make less distinction about timelines; in Chinese or German, for instance, it is grammatically correct to say "it *rains* yesterday" or "it *rains* tomorrow." Speakers of such languages have a notably higher saving rate, and have accumulated 39% more wealth by retirement.

The takeaway? By understanding our bias toward the present, we can take steps to save more and put our future selves in a better position.

INVESTING

65%

HOW MUCH OF AMERICAN PORTFOLIOS ARE IN CASH[3]

Americans are still holding too much of their investable assets in cash. According to one recent survey, the average American portfolio is about 65% in cash. For many, the sting of two market downturns in one decade has left them feeling especially risk-averse about investing.

When portfolios have a high percentage in cash, those assets aren't returning enough to even keep up with inflation. Other liquid investment options, like short-term bond funds, can be a good solution for investors who want to keep a conservative mix and limit downside, but still add yield. Even better, a diversified portfolio mix with some portion in stocks can help assets grow over time. Check in on your portfolio mix to see if you're positioned for the long-term. Diversification does not ensure a profit or protect against loss. It is a method used to help manage investment risk.

RETIREMENT

34%

the percentage of workers who said they spent eight hours or more planning for retirement in the last year[4]

According to the same survey, 40% of workers said they spent eight hours or more planning for holidays. Sounds like we could be doing better when it comes to making time to plan for our retirement.

The average life expectancy for all Americans is 78. But if you've made it to 65, your life expectancy goes up to 86. That could mean more than 20 years in retirement, relying on savings, social security and for some, pensions.

One of the most important steps is to figure out how much you'll need. The general rule of thumb is that you'll need 70–80% of pre-retirement income to maintain your lifestyle in retirement.

[1] Source: https://www.fidelity.com/about-fidelity/individual-investing/fidelity-couples-study [2] Source: http://www.anderson.ucla.edu/faculty/keith.chen/papers/LanguageWorkingPaper.pdf Savings rate source: https://research.stlouisfed.org/fred2/series/PSAVERT [3] Source: BlackRock 2015 Annual Global InvestorPulse Survey, released 10/2015. [4] Source: EBRI 2015 Retirement Confidence Survey

News Briefs

NRECA Annual Meeting

Homestead Funds' CEO and members of our sales and service teams just returned from NRECA's annual meeting in New Orleans. In opening remarks, the Association's interim CEO Jeffrey Connor reworked a quote from the history of rural electrification to set a vision of the important and very relevant roles cooperatives will play in the future.

"The greatest thing on earth is to have the love of God in your heart, and the next greatest thing is to have an electric cooperative in your community."

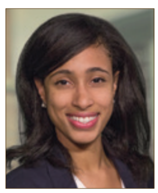
Indeed, rural electric cooperatives provide much more than power. They are vibrant economic partners, strong advocates for the communities they serve and a source of financial stability for their employees. As we look to the future for Homestead Funds, rest assured we will continue to align our mission with that of the rural electric community, with a goal of helping cooperatives and their employees manage assets and build wealth.

Small-Company Stock Fund Wins Lipper Award

For the second year in a row, Lipper named Homestead's Small-Company Stock Fund the top fund in the small-cap core category for the 10-year period ending November 2015. Announced annually, this year on March 22, the Lipper awards recognize funds that have delivered consistently strong risk-adjusted performance relative to their peers.

Past performance does not guarantee future results. In determining the universe of funds considered for an award, Lipper includes those registered for sale in the respective country as of the end of the calendar year that have at least 36 months of performance history. The calculation periods end November 30 of the respective evaluation year. Share prices of small-capitalization stock funds may be more volatile than those of large-capitalization stock funds. Smaller companies may have limited product lines, markets or financial resources, or their management teams may have less depth and expertise, compared with large-capitalization companies.

Welcome, Azure



Azure Pallay joined Homestead Funds in February 2016 and is responsible for providing support to intermediary and institutional clients as well as conducting market research and analysis. She also supports the distribution team in the sales and retention efforts for Homestead investment products. Azure received dual B.A. degrees: one in International Relations and a second in Environmental Studies, both from the University of Southern California.

Moving Up

Congratulations to Will Cunningham and Alaina Schrager, who earned their Certified Financial Planner designations. Three cheers also to Brian Allen, who was promoted to institutional sales consultant; Ken Surick, who will advance and take on Brian's previous role as a senior client relationship advisor on the key accounts team; and Tanya Moat, who has moved up to client services specialist.