Horizons 2018

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A QUARTERLY NEWSLETTER FOR HOMESTEAD FUNDS' SHAREHOLDERS

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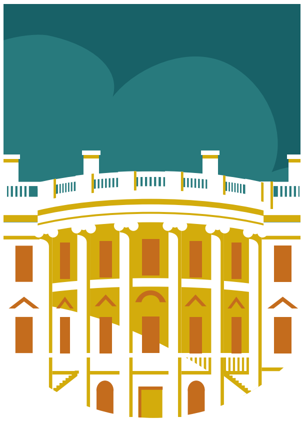
Tackling the Planned and Unplanned

In all matters financial, events tend to fall into one of two categories: planned or unplanned. We can plan a regular saving schedule and know exactly what our mortgage payments will be. But what about those features of life that are out of our control — how much investments will earn, how the cost of living will rise, what our incomes might be in a decade? And what about those headlines that dominate a complicated moment in history — trade wars, scandals, outlooks that shift from hour to hour?

At a particularly volatile time for both national and global events, it may feel like the "unplanned" category has completely overtaken those things you can control. Among economists and investment professionals, every headline and tweet sets off a flurry of analysis aiming to quantify the unplanned. But we would argue that these things should have little effect on your day-to-day saving and investing activities.

Even in an uncertain environment, we can't lose sight of those things that remain firmly in our individual control when it comes to building lasting savings. In this issue, we tackle those plannable pieces. We'll look at whether an unpredictable political environment should affect your investment plans. We offer some reasonable guidelines for setting retirement goals, even amid uncertain assumptions. And we sort through research to offer proven tips for sticking to a plan, once you've set it up.

When it comes to the future, there's only so much we can ever reliably know. But that can't stop us from making some very reasonable plans.



Do Unpredictable Politics Change Your Investment Plan?

Should an unpredictable president change your investment plan? In one recent survey, 60% of Americans were stressed about the impact of the Trump presidency on their finances.[1] Trade wars, rotating cabinet appointments, scandals — which of these actually matters for invested savings? We look at the challenges of planning around unpredictable politics.

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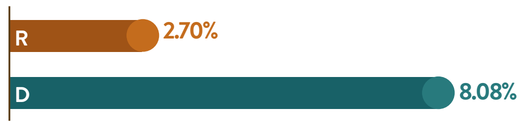
STOCKS OUTPERFORM UNDER DEMOCRATS — BUT WHY?

Average annual returns of the S&P 500 Index from 1947 through 2013.

Republicans: *2.70% per year, on average*
Democrats: *8.08% per year, on average*



Source: www.princeton.edu/~mwatson/papers/Presidents_Blinder_Watson_July2014.pdf

An Atypical Republican

Economists generally agree that typical Republican priorities — lower taxes, a balanced budget, less regulation and free trade — are good for corporations and thus good for stocks. Trump is following some of these positions, as in the case of taxes. When 211 economists from the National Association of Business Economists (NABE) were asked about the newly passed Tax Cuts and Jobs Act, 93% said they expect it to boost corporate profits in 2018. 68% still anticipate positive effects in 2027.[2]

The Trump administration is also following the standard playbook on cutting regulation. But in other ways, it's veering from traditional Republican positions. For one, its policies are set to increase the budget deficit. Most economists favor a balanced or surplus budget to bring the country's overall debt levels down, since a heavy federal debt load can hurt long-term growth.

Trump also diverges from the traditional Republican thinking on free trade, another area that's troubling economists.

HOW ECONOMISTS FEEL ABOUT TRUMP ADMINISTRATION POLICIES

Based on a survey of 211 economists in the National Association for Business Economics, conducted Jan 29 – Feb 8, 2018.

93%	expect Tax Cuts and Jobs Act to boost growth in 2018
68%	see it still benefiting growth in 2027
43%	see a positive impact from the administration's regulatory actions
40%	believe regulatory actions will be positive in the short term but negative in the long term
69%	say executive actions on immigration have been unfavorable
74%	believe executive actions on foreign trade have been unfavorable
61%	believe the government should reduce the deficit as a % of GDP
86%	said current Trump administration policies are likely to *increase* the deficit

Source: files.constantcontact.com/668faa28001/6279cc45-156e-41dc-8cbc-c22c7aeea425.pdf?ver=1519611505000

According to the same NABE survey, three-quarters believe Trump's trade views are bad for the U.S. economy, and two-thirds believe his immigration views are likely to harm economic growth.

Being an atypical Republican has thus earned Trump a mixed economic outlook for his policies — short-term gains from the tax and regulatory changes, but thumbs down for the long-term impact of higher national debt and protectionist trade and immigration moves.

How Much Do Policies Matter, Anyway?

How much effect do presidential policies even have on the economy and on stocks? A quick survey of historical periods shows that since WWII, terms with Democratic presidents have had slightly better economic growth and stock market patterns.[3]

However, there are a number of issues with reading too much into that pattern. First, it could be that there's a lag in policies such that changes by Republican presidents end up benefiting Democrats. It could also be a case of pure luck, or to put it another way, dominated by factors out of the administration's control — oil price shocks, the dot-com bust, or leaps in productivity growth, for example.[4] A third theory is that presidential policies matter on the margin — that they can only tweak the direction of growth one way or the other.

Planning for the Long Term

History suggests that political leadership is only one piece of the puzzle. Broader trends — like the massive shift in technology we are witnessing across sectors — will likely have a stronger effect on the direction of economies and markets. With any administration, portfolio managers have to consider the specific laws, regulations and programs to forecast the effect on industries and specific companies.

But when it comes to the choice of whether to invest or not invest, our view is that these factors are too unpredictable to plan investment decisions around. The short term is always at risk for bumps — whether generated by political shocks or any of the many other reasons that can send the stock market temporarily tumbling. The typical Homestead Funds investor is a long-term saver, which means that investment choices should be based on a much longer horizon than a presidential term.

[1] studentloanhero.com/featured/survey-americans-stressed-over-trump-impact-on-finances/

[2] www.bloomberg.com/news/articles/2018-02-26/economists-take-dim-view-of-a-range-of-trump-policies-in-survey

[3] docentes.fe.unl.pt/~psc/Politics.pdf

[4] www.chicagotribune.com/news/opinion/commentary/ct-perspec-labor-employment-president-role-1023-20171020-story.html

A Reasonable Retirement Plan

"We cannot direct the wind, but we can adjust the sails."

A million. One-point-five. Eight times your income. What is the right number for your retirement nest egg?

The final number depends on your individual circumstances. But it also relies on a lot of broad assumptions, like the future rate of inflation and investment returns, expected Social Security payments, timing of retirement and life expectancy. Though it's a simple math problem, it turns out you need to make a lot of assumptions.

We decided to work out the math for the "average American" — using things like average retirement age, average Social Security payment and average income level. We came to the magic number of seven — that if this fictional average person retired with about seven times their pre-retirement income, they'd be in pretty good shape. For instance, when this average worker makes $59,000 per year in the final year before retirement, he should have about $413,000 saved in a retirement nest egg. ($59,000 times 7.)

Saving Milestones to Reach 7x

To get to this 7x number, about how much should you have saved at each age along the way? The chart shows some ballpark milestones based on our assumptions.

Let Time Do the Work

Thanks to the effect of compounding earnings, a longer timeline can really ease the burden of how much you have to save each year. So if you're starting late, you can achieve more by delaying retirement. This also shortens the time that the nest egg needs to provide cash in retirement.

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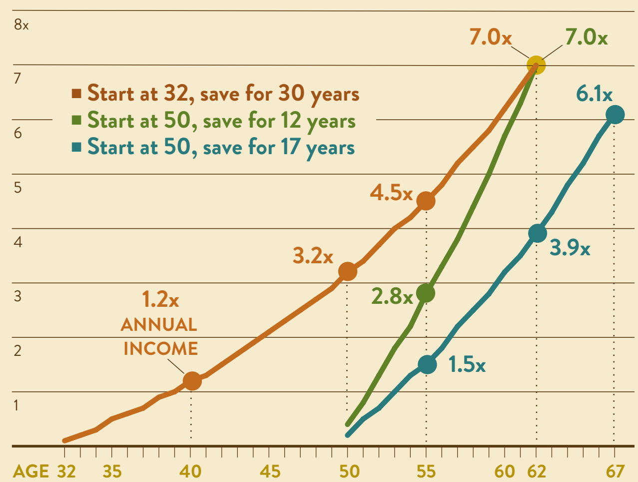
RETIREMENT MILESTONES

The Multiple of Annual Income to Have Saved by Each Age



We assumed our fictional person saved the same percentage of his income each year to get to the final nest egg. For each of the three scenarios, here's how much he had to save:

Start at 32, save for 30 years: **11% of income per year**

Start at 50, save for 12 years: **41% of income per year**

Start at 50, save for 17 years: **23% of income per year**

Source: Calculations by Homestead Funds.

HOW DID WE GET TO SEVEN?

Here's what we assumed:

Life expectancy: 87 years

Target replacement rate: 85% of pre-retirement income, with a combination of Social Security benefits and drawing from your nest egg

Annual income while working: $59,000 in current dollars[1]

Social Security benefits: $1,342 per month in current dollars[2]

Annual inflation: 2.5% (used to grow each year's annual income and projected Social Security benefits)

Investment return: 7% (a reasonable annual average for a stock/bond portfolio over a very long time period)

Average retirement age: 62[3]

[1] fred.stlouisfed.org/series/MEHOINUSA646N

[2] time.com/money/4644332/maximum-social-security-benefit-2017/

[3] money.usnews.com/money/retirement/articles/2014/05/12/the-ideal-retirement-age-and-why-you-wont-retire-then

Focus on a Reasonable Plan

Most of the factors that determine these calculations are largely out of your control. Still, you can make most of the necessary headway by focusing on what you can plan:

- when you start saving
- how much you save
- when you retire
- how you invest during your earning and retirement years

We assumed that our saver was fully invested in a stock/bond portfolio through his saving and retirement years. If these averages don't match your own circumstances, you should adjust your retirement saving goals accordingly. For instance, if you make a higher income or anticipate a lower Social Security payment, you'll want to save more than 7x your pre-retirement income. If you expect to have other sources of cash such as a pension in retirement, you could aim for a smaller nest egg.

Five Ways to Stick With Your Plan

Making a great plan will take you far on your path to retirement readiness. But what about sticking with it? Here are five methods that have sticking power.

1 One thing at a time.

You may have more success if you tackle one thing at a time. But good changes in one area may spill over to benefit other aspects. Consider spending cuts: when you spend less, you save more. You also adjust to living on a smaller amount, so you can retire on less or retire sooner.

Living on less can be a tall order, however. Pare down your budget one category at a time, starting with an area where a little discipline would make the biggest difference.

2 Get specific.

Good intentions are important, but *specific plans to implement intentions* may double or triple success. In one study, health psychologists looked at how often a group of people exercised. In a control group, 38% of participants exercised once per week. In a second group, participants were read a motivational speech about the health benefits of exercise — and only 35% exercised once per week. In a third group, participants were asked to complete the following sentence outlining their specific plans:

"During the next week, I will partake in at least 20 minutes of vigorous exercise on [DAY] at [TIME OF DAY] at/in [PLACE]."

In the third group, 91% of participants actually exercised once per week![1] Think about how you can apply this to your retirement plan — how can you get specific?

3 Make it a habit.

To form a habit, try doing an action in response to a contextual clue. For instance, if you want to develop a habit of getting more exercise, you might take a short walk after breakfast every morning — soon enough, the action of eating breakfast will trigger the habit of going for a walk.[2]

How can you do that with your money? You can attach your "plan action" time to another activity. Perhaps every morning after you check your email, then you do some action to help your monthly savings, like planning a cooking menu for the week, or contacting a friend to borrow something instead of buying something. Soon enough, it'll be a habit.

4 Automate.

Habit-forming is so productive because it removes willpower from the equation. In this digital era, automation is another tool that can override willpower. (Though automation won't lace up your sneakers for that daily walk...yet.) Nowadays, you can set your bills to autopay, automatically transfer money into savings and investment accounts, automatically invest in pre-determined choices, and automatically reinvest investment earnings.

5 Put up a picture of your future self.

There's one interesting theory about why we procrastinate when it comes to preparing for the future: that we view our future selves as strangers.

A Harvard study found that when people see an image of themselves digitally aged, they identify more closely with their future self, and are more likely to save for the future. In fact, study subjects who looked into a mirror and saw themselves digitally aged were twice as likely to put money in a retirement account as those who saw their regular image in a mirror.[3]

Try it: use your smartphone to download an age progression app that will show you what your older self looks like.

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[1] Milne, Sarah, Sheina Orbell and Paschal Sheeran. Combining motivational and volitional interventions to promote exercise participation: Protection motivation theory and implementation intentions. British Journal of Healthy Psychology (2002), 7, 163, 184.

[2] www.ncbi.nlm.nih.gov/pmc/articles/PMC3505409/

[3] hbr.org/2013/06/you-make-better-decisions-if-you-see-your-senior-self

What's The Current Status of Our Planning Efforts?

Too many Americans are operating without much of a financial plan at all, it would seem. While these particular stats are generally improving over time, the portion of Americans who are financially secure and planning well for the future remains troublesome.

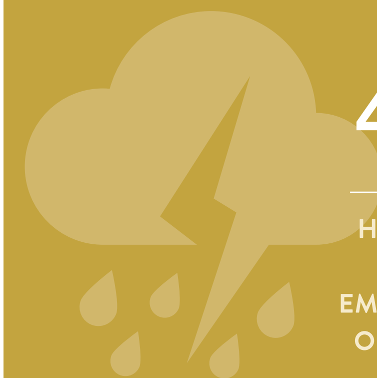
THE SAVING GAP

53%

AMERICANS WHO SPENT MORE THAN THEY EARNED IN 2016

More than half of adults saved nothing or went into debt over the year.

CRISIS MANAGEMENT



44%

HOW MANY COULD NOT COVER AN EMERGENCY EXPENSE OF $400 WITH CASH OR SAVINGS

Notably, this number has improved from the 50% who said they could not produce $400 when the question was first asked in a 2013 survey.

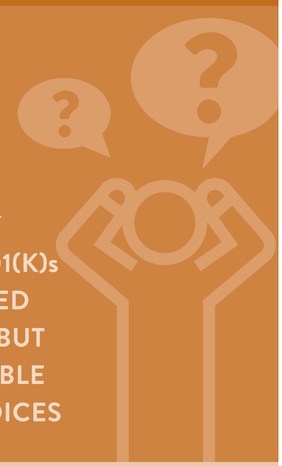
WITHOUT A PLAN

28%

NON-RETIRED ADULTS WHO HAVE NO RETIREMENT SAVINGS OR PENSION WHATSOEVER

A quarter of workers have an employer pension, while about half have a 401(k) or similar plan.

UNCOMFORTABLE INVESTING



53%

THOSE WHO HAVE IRAs, 401(K)s OR OTHER SELF-DIRECTED RETIREMENT ACCOUNTS BUT DO NOT FEEL COMFORTABLE MAKING INVESTMENT CHOICES

Comfort is generally lower among men with less education, and among all women.

Source of all statistics: **Federal Reserve: Report on Economic Well-Being of U.S. Households in 2016**
www.federalreserve.gov/publications/files/2016-report-economic-well-being-us-households-201705.pdf

News Briefs

We Welcome Our New CEO

We are pleased to announce that **Mark Santero** will serve as president and CEO of Homestead Funds and the fund company's investment advisor RE Advisers. Mark, who joined us in June, brings more than 30 years of investment management experience, including leadership roles at Dreyfus, BNY Mellon and Oppenheimer.

NRECA Conferences

A Homestead Funds' representative was in Salt Lake City, UT this May for CONNECT, NRECA's national conference for electric cooperative communications, marketing and member service professionals. We're looking forward to the INTERACT conferences this summer, where we'll meet with benefits administrators and other HR professionals.

April Was Financial Literacy Month

According to the S&P Global FinLit Survey, a comprehensive measure of global financial literacy, barely half of adult Americans understand basic financial concepts such as interest rates, compounding, inflation and risk diversification.[1]

That's a big problem! People who lack knowledge of these principles are less likely to plan and save for retirement and they tend to carry higher levels of debt. To celebrate Financial Literacy Month, Homestead Funds posted a retirement savings quiz and investing basics quiz to our Facebook page. They are still available if you want to test your knowledge.

At Homestead Funds, we know that informed investors are better-positioned to reach their financial goals. To help our investors get up to speed, we created a fun series of Investing Basics videos. You'll find them online at *homesteadfunds.com*.

[1] Source: S&P Global Financial Literacy survey accessed at: http://gflec.org/initiatives/sp-global-finlit-survey/

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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.

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