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## Q3 2020: Amid Support, the Rally Continues

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### **Mark Santero:**

Hi, this is Mark Santero, and today we're going to cover the third-quarter market review presented by the Homestead Funds. Today's presentation is titled "Amid Support, the Rally Continues."

I'm Mark Santero, president and CEO of RE Advisers and the Homestead Funds. And with me today is Mauricio Agudelo and Prabha Carpenter, both senior portfolio managers with the Homestead Funds, and it's a great pleasure to have both of them join us today to share their thoughts.

Today, we're going to cover the macroeconomic conditions and factors, and then we'll discuss fund absolute and relative performance followed by drivers of return, and then finally outlook and fund positioning.

With that, I'd like to turn it over to Prabha first to discuss third-quarter market conditions: Amid support, the rally continues. Prabha, please.

### **Prabha Carpenter:**

Thank you, Mark. Thank you all for joining us today. Amid support from global central banks, some fiscal initiatives and other supportive measures, stock markets continued to rally in the third quarter. It was the second consecutive quarter of notable gains. The S&P 500 [Index] was up over 8% in the quarter and up over 4% year to date at the end of September. We have had a pullback in recent weeks. Stocks are down with virus resurgence and reimplementing of lockdowns in Europe, lack of progress on stimulus packages, uncertainties regarding the election, and therapies and vaccines seen later rather than sooner. But we received favorable news this morning on gross domestic product (GDP) and employment. Third-quarter GDP rebounded 33.1% in the third quarter and unemployment claims fell, so the employment picture is improving. We had 622\* stimulus initiatives and witnessed a rebound in third-quarter earnings across our portfolio holdings. My colleague Mauricio will now address the bond markets.

### **Mauricio Agudelo:**

Thank you, Prabha. Following along the same lines, overall the bond market posted modest gains during the third quarter. U.S. Treasury yields remain anchored near the all-time low levels, in particular, five-year and in part of the yield curve. Chairman Powell and the Federal Reserve have emphasized their commitment to economic recovery. The Fed is basically committed to keeping borrowing rates at or near zero until economic conditions improve to pre-COVID levels. The Fed is also willing to let inflation run over the 2% target in order to achieve its dual mandate of maximum employment and stable inflation over the long run. The overall stance by the Fed and a rebound in the economy contributed to corporate bonds performing well during the quarter, following what we saw in the second quarter. Overall credit spreads tightened, meaning they performed better than Treasuries, by 14 basis points. Finally, corporations were able to raise capital in the primary market to increase liquidity.

**Mark Santero:**

Just so everyone knows, this recording is taking place on October 29, Thursday. Prabha referenced the GDP numbers and unemployment, just to put in perspective where the markets are today relative to the end of the third quarter. Thank you, Prabha and Mauricio, for that market backdrop. Now let's talk about the funds. And Mauricio, if you can continue and cover the fixed-income portfolios, please.

**Mauricio Agudelo:**

Absolutely. In terms of the individual fund performance during the quarter, the Short-Term Bond Fund posted a positive 0.4% return versus 0.42% for the benchmark, the Bank of America 1-5 Year Corp./Gov. Index. Year to date, the fund has posted a 4.56% return versus 4.26% for the benchmark. Now what worked during the quarter? Our overweight to corporates, more specifically industrials and financials, outperformed the benchmark during the quarter. Our allocation to front-end asset-backed securities (ABS) in the form of auto loans and consumer loans also worked quite well during the quarter. Now on the flip side, what didn't work? Our underweight allocation to Treasuries. We are underweight Treasuries because we see better value in other sectors like corporates and ABS. And our underweight in sovereigns and supranationals, where we basically have zero exposure, also detracted from performance in the quarter.

Next in the portfolio snapshot, I will highlight that we still remain overweight corporates and ABS while we are underweight Treasuries. The fund's duration is still slightly short versus its benchmark, and that gap has remained consistent in the last two to three quarters.

Now turning to the next slide, I will review the performance for the Intermediate Bond Fund for the third quarter. The Intermediate Bond Fund returned 0.75% versus 0.62% for the benchmark, the Bloomberg Barclays U.S. Agg Bond Index. Year to date, the fund has posted a 7.08% return versus 6.79% for the benchmark through September 30.

What worked during the quarter? Very similar to the Short-Term Bond Fund, our overweight allocation to corporates — that would be financials and industrials — contributed to our performance during the quarter. Additionally, our allocation to short-term ABS was also a positive factor to overall performance. What didn't work? Our underweight allocation to agency mortgage-backed securities (MBS) detracted from performance. Also, our underweight position in U.S. Treasuries detracted as well. From a sector allocation perspective, these are two sectors where we see better value elsewhere. Finally, in terms of portfolio composition, we ended the quarter with an overweight allocation to corporate and asset-backed securities. While we are underweight agency MBS and Treasuries, duration for the fund is slightly short versus its benchmark by roughly 0.21 years.

**Mark Santero:**

Thank you, Mauricio. I appreciate the fixed-income update. Now let's turn to the equity funds, and Prabha, if you could go over the Value Fund performance review? Thank you.

**Prabha Carpenter:**

Thank you, Mark. Thank you, Mauricio. We now turn to our flagship fund, the Homestead Value Fund. Our 30-year anniversary is coming up next month, and we have a proud history of active management. We'd like to point out the performance record: We've outperformed the benchmark, the Russell 1000 Value Index, in each of the periods listed. For the quarter, we were up 5.97%, that's 38 basis points ahead of the benchmark, and year to date we're up 533 basis points ahead of the benchmark.

What worked during the quarter? Again, our overweight in info tech helped. We had an overweight position and we outperformed the benchmark. Our energy underweight aided performance, and our industrial position also helped in terms of performance; we were slightly overweight and outperformed. Detractors during the period —

again it's only a quarter and we're long-term investors — but financials detracted, especially insurers. Part of the reason is the lower, for longer, interest rates did not help this group.

I like to point out the valuation metrics of the portfolio in terms of the snapshot, and we're slightly higher price to earnings (P/E); we're less leverage and much higher return on equity (ROE). So quality is emphasized in terms of our portfolio holdings.

Next I'd like to cover the Homestead Small-Company Fund, small cap. For the quarter, we were up 8.29% — that's 336 basis points ahead of the benchmark — and for the year to date, we're up 860 basis points. So, we're ahead for the quarter, year to date, one year and since inception date.

What worked during the quarter? Again, our health care names worked and infotech names worked, and we had some financials that also worked during the quarter. Detractors in the quarter included consumer discretionary, where we were underweight and underperformed, and industrials. Industrials is a broad category, but industrial distribution was weak and some truckers were modestly weak.

I also like to point out the valuation metrics for this fund. Again, it's less leveraged and a much higher ROE — 7.4% versus 1.3% for the benchmark. So, we feel the portfolios in large- and small-cap are well positioned over the long haul. Now I'll turn it back to Mark.

#### **Mark Santero:**

Thank you, Prabha, thank you, Mauricio. It's always important to review history of the portfolios — you know, looking in the rearview mirror. But I know our investors care about what's ahead, especially in light of what's going on within our country and globally. Obviously, it goes without saying, things, markets, economies getting back to normal will happen when we get a health response and we get therapeutics or vaccines, by every account, every economist, every prognosticator. But we also are, as Prabha pointed out, long-term investors. So what's ahead for the portfolios based upon our views of the market going forward? Let's look at what's going ahead. I'm going to ask Mauricio to kick it off and talk about business activity surges to 2019 levels.

#### **Mauricio Agudelo:**

Thank you, Mark. Yes, I'd like to point out to our audience today, the sharp decline that took place in manufacturing and services during the second quarter came back during the third quarter, bringing overall activity above the 50 mark, which indicates the conditions were expansionary for economic activity. Any rating above 50 indicates economic expansion. We also saw inventories being drawn down in the second quarter and third quarter, and we believe that a buildup in inventories in the coming quarters will provide a boost to overall GDP.

Next, I'd like to update our shareholders and listeners: We've been displaying this chart for the last few updates in regards to credit spreads in the fixed-income markets. Overall, a lower rating indicates tighter spreads, which indicates healthier conditions in the marketplace. And while we are not at pre-COVID levels, we have certainly recovered a good amount of the spread widening that took place in the month of March. We still believe that corporate credit offers great opportunities from a risk/reward perspective given that many corporations have been able to increase liquidity and safeguard their balance sheets. The Fed continues to provide different programs to support the market, and the expectations of less issuance for corporations in the fourth quarter also provides a positive technical. We are also hopeful that Congress will come to an agreement and a fiscal plan. So, we are certainly optimistic about the long-term prospects for the economy and the continued recovery. That being said, we remain nimble and we are aware that COVID still presents a great risk to the global economy. As such, we still anticipate certain periods of volatility. And with that, I will hand it back to you, Mark.

**Mark Santero:**

Thank you, Mauricio. And now to talk about the equity markets, Prabha, why don't you give us your views going forward?

**Prabha Carpenter:**

Thank you, Mark. I agree with Mauricio that the fundamentals of the economy are reemerging, are stronger. The proof is in the results. Third-quarter earnings have been strong, have exceeded expectations and managements, though guarded, feel stronger about results in the next few months and definitely in 2021. Some sectors that have been particularly strong are housing, autos and recreational vehicles. These subsectors have been particularly strong, and the consumer net worth is also strong. So, we have many indicators that show the underlying strength of the economy. We are optimistic about our portfolios and we are looking at opportunities to reward shareholders over the long haul. Now, I'll turn it back over to Mark.

**Mark Santero:**

Thanks, Prabha. I think it would be remiss and negligent on our part not to cover the elections that are literally five days away. And we'll be at the polls, if we haven't already been at the polls, and cover what that means going forward. Mauricio and Prabha talked about the technicals, but in a broader sense, how have U.S. stocks reacted to major political news? You can see that instantaneous market reaction to various disruptive events obviously affects the markets, but the following day or the following days, the market then returns to some semblance of normalcy and or recovery, as evidenced by the slide that we showed.

We think it's very important for our investors to think about the long term. That's what we think about in managing the Homestead Funds. We've always put ourselves out as long-term investors. And what does that mean for your individual goals and corporate account goals? Our tagline here is, don't stress about elections and politics, because major events around elections — when we talk about the 90s recession, the dot-com bust, and the financial crisis and now COVID — all four of these actions or episodes are around major election periods in the 90s, with Clinton and the dot-com bust going to Bush, and then Bush to Obama and the financial crisis. And now either Trump to Trump or Trump to Biden, depending upon what happens on November 3 or thereafter, the simple fact to take out of this slide is there does exist recovery from episodic events, and we want to stress to our investors that no matter what happens on November 3, either that day — as the previous slide shows — you may see correction back the following day, but certainly over time, the markets recover, and here in the U.S. there's a lot of pent-up cash on the sidelines. We've seen inventories depleted because of lack of ability for production. We have seen people out of work, awaiting businesses to get back on track and hire again. So there is a lot of pent-up demand. So, no matter what happens post this election, you will see, as Mauricio pointed out, another stimulus bill to advance the economy and certainly infrastructure spending to get the country going again.

So please don't stress; this too shall pass. We want to thank you for your continued support of the Homestead Funds. As Prabha pointed out, we have our 30th anniversary on November 19. For all of you who are our shareholders, we thank you for your support and your trust in us managing your assets. If you have any questions, please, this is my direct line, and my email address notify me directly. We want to hear from our shareholders.

We'd like to close with, we hope everyone please stays safe and takes care of their people, their employees, their family, their neighbors, their loved ones in these times. Winter is approaching, and we hope everybody takes that extra special care. So with that, thank you very much for all your continued support.

The next few slides are disclosures that we'd like you to read before we close. Thank you very much.

\*Speaker originally stated 62. Transcript has been corrected to 622.

**Asset-backed securities (ABS)** are bonds or notes backed by financial assets.

**Basis points (BPS)** refers to a common unit of measure for interest rates and other percentages in finance. One basis point is equal to 1/100th of 1%, or 0.01%, or 0.0001, and is used to denote the percentage change in a financial instrument.

**Gross domestic product (GDP)** is the monetary value of all finished goods and services made within a country during a specific period.

**Mortgage-backed securities (MBS)** are an investment similar to a bond that is made up of a bundle of home loans bought from the banks that issued them.

**Price to earnings (P/E)** is the ratio of a company's stock price to the company's earnings per share. The ratio is used in valuing companies.

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