

Attribution Analysis Small-Company Stock Fund

Third Quarter 2016



Homestead
Funds

Fund Performance

The Homestead Small-Company Stock Fund was up 0.55 percent in the third quarter and 3.84 percent year-to-date. It trailed its benchmark, the Russell 2000 Index, for both periods, though it was outperforming the benchmark for the year through July. A number of factors have contributed to the gap in returns over the last two months of the third quarter.

Market and Benchmark Performance

The third quarter was a “risk on” environment in the market. Small-cap stocks outperformed large caps, and emerging markets outperformed developed markets. More volatile, lower-quality industries led performance. In information technology, the top-performing sector in the quarter, semiconductors, delivered the best returns, while in health care, the second-best performer, pharmaceuticals were the leader. The lowest-performing sectors in the benchmark were telecommunication services, utilities and real estate, all sectors where the fund does not have holdings.

Relative Contributors and Detractors

Stock selection was the primary reason for the fund’s below-index results in the third quarter, but in looking at the fund’s positions in any given sector relative to the index’s holdings in that sector, there were no evident themes or specific reasons

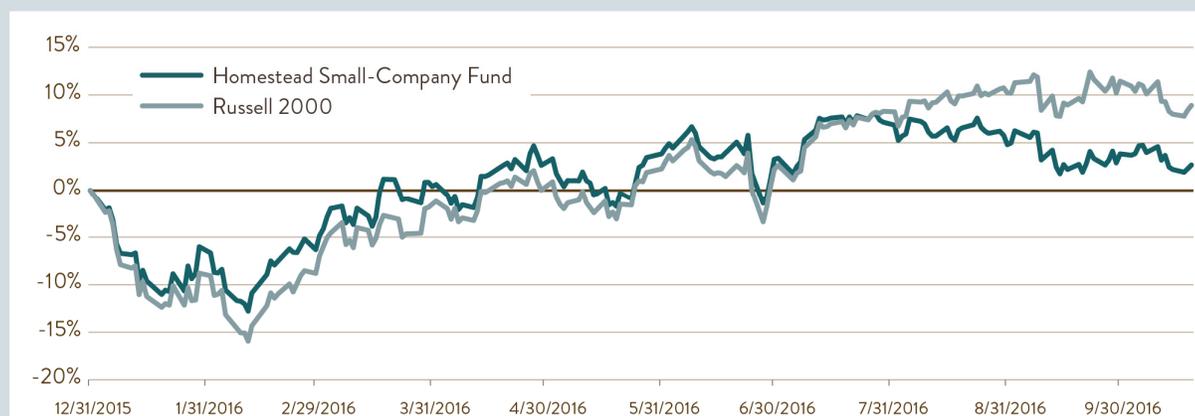
the fund’s stocks lagged. For instance, in the industrials sector, a few key stocks underperformed, including telecom construction company Dycom Industries (the strongest contributor to returns in Q2), and two aerospace and defense holdings, Triumph Group and Huntington Ingalls Industries (held in the fund but not the index).^{*} Dycom actually reported revenue growth in its latest earnings call, while Triumph Group secured a key role on the maintenance of an Air Force program. Shipbuilder Huntington Ingalls declined after a slight miss on revenues, but won several new U.S. Navy contracts since. For some holdings, bad news was mild, while for others, there was no discernible reason for the stock’s underperformance. The key point is that the investment team gave full evaluation to the key detractors, and decided its investment thesis remained intact.

Another driver of underperformance was the portfolio’s avoidance of the best-performing industries, like semiconductors. The investment team has a history of avoiding semiconductors because of their cyclical nature and high sensitivity to productivity gains, which can dry up unpredictably. The fund’s investment team also avoids pharmaceutical companies, the top-performing category in the health care sector this quarter. The team believes pharma is unattractive for this small-cap strategy because of its boom or bust (and thus high-risk and unpredictable) payoffs.

^{*}As of September 30, 2016, the percentage of the fund’s total investment in the companies mentioned previously was as follows: Dycom, 7.66 percent; Triumph, 1.99 percent; Huntington Ingalls, 1.70 percent.

Daily Total Returns

Year-to-Date period ending 9/30/2016



Source: Bloomberg

Confirming Our Strategy

The portfolio management team employs fundamental, bottom-up stock selection and rigorous analysis in pursuit of capital growth over the long-term.

Desired Characteristics

- Strong earnings potential
- Solid balance sheets
- Ability to self-finance
- Financial-returns-oriented management
- Proactive management

The team's analysis focuses heavily on management strength. In addition to this being a compelling investment opportunity, does company management have a track record of success and a plan for allocating capital in support of the company's growth strategy?

The portfolio managers continually review the portfolio and the team believes the current holdings represent solid companies with good balance sheets. The market doesn't always reward their analytical confidence in the short term, but portfolio managers believe the investment thesis is intact and patience will be justified over the long term.

Total Returns as of 9/30/2016

	Aggregate		Average Annual				
	3Q	YTD	1 yr	3-yr	5-yr	10-yr	Since inception
> <i>Small-Company Stock Fund (HSCSX)</i>	0.55%	3.84%	5.24%	5.10%	15.16%	9.22%	8.91%
Russell 2000 Index	9.05%	11.46%	15.47%	6.71%	15.82%	7.07%	6.92%
Expense ratio 0.87% (12/31/15)							

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 costs. For some funds, the investment advisor has agreed voluntarily or contractually (for at least the current fiscal year) to waive or reimburse a portion of expenses. The net expense ratio is the expense ratio minus the portion of expenses waived or reimbursed. Please see the current prospectus for additional details.

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Past performance does not guarantee future results.

The views expressed in this market commentary are those of the individual as of the date noted 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.

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.

The Russell 2000 Index is a subset of the Russell 3000 Index representing approximately 10 percent of the total market capitalization of that index. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership. Indices are unmanaged and investors cannot invest directly in an index. Unless otherwise noted, performance of indices do not account for any fees, commissions or other expenses that would be incurred. Returns do not include reinvested dividends.

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 download a PDF at homesteadfunds.com.

Homestead Funds' investment advisor, RE Advisers Corporation, and distributor, RE Investment Corporation, are indirect, wholly owned subsidiaries of NRECA. RE Investment Corporation, Distributor. 10/16

