ULTI0162

Horizons 2024 2Q

A QUARTERLY NEWSLETTER FOR HOMESTEAD FUNDS' CLIENTS

Don't Let the Election Sway Your Investment Plans

The economy affects who wins the presidential election, but the presidential election doesn't necessarily affect the economy!

The U.S. economy's recent condition and outlook are major factors to voters. Much academic research has been devoted to studying this relationship, pointing to a firm conclusion that the state of the economy affects the vote for the incumbent's party when it comes to presidential elections.[1]

But the relationship doesn't seem to be very strong in the other direction: Presidents and their political affiliations do not seem to have a significant effect on how the market or economy performs. This might be surprising to many given that 45% of Americans in a recent poll said that the election is going to affect their investments.[2]

This information is actually very relevant to today's savers. Some may be tempted to make changes to their investment plans based on the upcoming election. But as we often say, *timing* the market is usually an unsuccessful strategy, while *time in* the market is usually a successful plan.

In this issue, we put the relationship between presidents and markets under the microscope. We consider why people attribute market performance to presidential influence. We also put a spotlight on the most relevant academic research, which shows that so much of the market and economic performance associated with a president or party is actually down to other external influences — which are a matter of happenstance.

Politics play an important role in American culture, but we believe they should not play a significant role in your portfolio. ■

Why So Many People Make the Election/Markets Mistake

Elections and presidents have limited effect on the markets in the short term, says rigorous research on the question.[3] Yet, nearly half of Americans believe the election outcome will affect their investments, according to a recent survey by insurer Nationwide.[2] Why are people so convinced of the connection between presidents and markets? It's probably a matter of emotion.

Continued on page 2

[1] Ray C. Fair, "Predicting Presidential Elections and Other Things," Second Edition

[2] Nationwide, "Nearly Half of Investors Believe the 2024 Election Will Have a Bigger Impact on Portfolios Than Market Performance"

[3] NBER, "Presidents and the U.S. Economy: An Econometric Exploration"

countries + the EU have elections in 2024, representing 49% of the global population

Homestead Funds

homesteadfunds.com

Why So Many People Make the Election/Markets Mistake *continued from page 1*

Why one individual doesn't matter as much as you think

Stock markets and economic growth have been strong under Democratic presidents and Republican ones. They've also faced turmoil under either party's leadership. Researchers have debunked the idea that a president or party is the primary force behind eras of prosperity or eras of underperformance (for more on this subject, turn the page to read "4 Things That Matter More to Markets Than Presidents").

Of course, it's not a completely detached relationship. When a president or candidate makes comments about potential trade tariffs with a certain country, for instance, stocks of companies that trade or manufacture goods from that country falter minorly.[3] But looking at GDP and stock performance over the full course of presidencies, the political forces in power are a small input compared with the other massive inputs driving the U.S. economy.

What people fear will happen

Though the link between presidents and markets is weak in the U.S., plenty of people believe it is strong. Forty-five percent of investors in the recent Nationwide survey believe that the 2024 election results will have a bigger impact on their investments than actual market performance will.

AMERICANS ARE NEGATIVE ABOUT THE OPPOSING PARTY'S IMPACT

45% of investors, regardless of political affiliation, believe the results of the 2024 federal elections will have a bigger impact on their retirement plans and portfolios than market performance

32% believe the economy will plunge into a recession within 12 months if the opposing political party gains more power in the 2024 elections

31% believe their finances will be negatively affected if the opposing party gains more power

For those who are just worried about election-year volatility, again, historical data offers reassurance. The S&P 500 Index has delivered higher average returns in presidential election years than it has in post-election years (i.e., the first year of a president's term). In fact, the third year of a president's term averages the highest performance — but none of the term-year averages veer too far from the overall yearly average of 12.2% for the S&P 500 Index.[4]

STOCKS HAVE DONE JUST FINE IN ELECTION YEARS[4]

11.6% — **Average S&P 500 Index performance in an election year** (4th year of presidential term)

10.7% — Average in **post-election year** (1st year of term)

7.5% — Average in **2nd year** of term

18.8% — Average in **3rd year** of term

12.2% — Average, **all years**

Emotions are driving the bus

As in so many issues of perception and decision making, emotions are a huge piece of this human puzzle. Why do people in one party think that the people in the other party will ruin the markets? In our opinion, it's because their trust in one another is low, and that influences the other assumptions they make about each other. It may also seem to lead some people to ascribe more market influence to political leadership than is warranted.

Here's where the good news comes in. As with any financial decision, emotions can't be the main driver of the bus. Reason and facts are far better drivers. In the case of presidents, historically the political leadership of the U.S. does not have enough influence on markets to override all the other factors shaping performance. ■

[4] Bloomberg, Homestead Funds' calculations. Averages reflect calendar-year total returns for the S&P 500 Index from 1926-2023. Indexes are not available for direct investment.

4 Things That Matter More to Markets Than Presidents

What's the real relationship between presidents, stock markets and economic growth? It seems that outside factors matter much more for market performance than does the party or president in power.

The most comprehensive available study on this topic was done by the National Bureau of Economic Research (NBER), who published a working paper called "Presidents and the U.S. Economy: An Econometric Exploration." In that analysis, the NBER researchers identified four external factors which had such an effect on the economy that they largely "explained" the performance differences between different presidential terms. Importantly, the four factors they identified were out of any politician's control.[1]

The factors that DID NOT contribute to political-party outperformance

First, NBER researchers examined the idea that it was really the makeup of Congress that explained differences between the economic performance of one political party versus another; it was not. Then they tested the idea that some presidents coincided with higher growth momentum/trends and the idea that certain politicians "inherited" better conditions than other presidents — both no.

POLITICAL-PARTY LEADERSHIP HAS LESS INFLUENCE ON THE ECONOMY THAN OTHER FACTORS

The effects of wars were also studied, and the researchers concluded that the timing of wars and expanded military spending did not explain differences between the performance of each political party. They even found that there was little measurable economic difference arising from the general trends of fiscal and monetary policy, which can differ between Democrats and Republicans.

The factors that DID contribute to periods of economic outperformance

The NBER team identified four specific factors that boosted real GDP growth in the eras of certain presidents compared with others.

The first is oil-price shocks. For instance, the analysis identified a significant negative effect from rapid oil-price increases during the Republican administrations of Nixon-Ford, Carter and George W. Bush's second term — mainly a factor of luck.

THE FOUR (EXTERNAL) FACTORS THAT BOOSTED ECONOMIC PERFORMANCE[1]

1 **Favorable oil-price trends**

2 **Productivity gains,** which can come from technology advancements, a jump in the skill or experience of a workforce, and even gains in energy-conversion efficiency

3 **A favorable international environment**

4 **More optimistic consumer expectations** about the near-term future (lesser effect)

Luck rules again in the case of the second factor: productivity gains. Productivity is an efficiency measure, showing how much output (goods and services) was produced in the economy given the level of input (capital and labor). Some presidents were, by luck, the beneficiaries of better productivity trends than others.

A third factor that proved statistically relevant was the backdrop of international growth. When global growth was better, presidential "performance" was better, and vice versa.

Finally, a more minor effect came from changing consumer expectations. The researchers found that more optimistic consumer expectations prevailed during the terms of particular presidents, possibly related to oil prices and global growth, among other things.

What will the next four years hold for these four factors? The next president will be eager to find out. ■

[1] NBER, "Presidents and the U.S. Economy: An Econometric Exploration"

Why investors should consider ignoring election noise

Financial professionals frequently advise savers to "ignore the noise" when it comes to their investments, suggesting that news headlines, opinions and rumors outweigh the "signals" of legitimate, relevant investment information.

With a presidential election on the horizon, emotions are running high. Investors may be wondering if they should make changes to their investments. While political issues are excellent at grabbing headlines and dominating the national conversation, the true connection between politics and market performance has historically been much weaker than you might expect.

Why markets are so noisy

Financial markets are constantly recalibrating prices based on information. Consider the stock of your favorite tech company; anytime there is news or even rumors of a new product launch or flagging demand among customers, it represents potentially important information for the future of the company.

Some of these tidbits of information are signals and some are noise. Given the historical evidence about markets and presidents, we think it's fair to rule out election news as "noise," not "signals."

Why to avoid politically driven investing

In the last article, we debunked the myths of politically driven investing and the mistaken view of "my party is better for the markets than the other party." Investors can be biased toward participating in the markets when their party leader is in power. This is based on investors' optimism that their party's president and administration are best for the country and the economy for the foreseeable future.

The chart below shows the growth of the S&P 500 from January 1926 to December 2023, across varied party control of the White House. The good news is that if you stayed invested during multiple administrations and not just your party's control of power, you may have realized positive returns through several wars, depressions, global recessions and the like. It's just one more piece of evidence to emphasize our theme here: Market and economic performance are about major external factors outlined in our previous article, outside the president and the presidential party's control. If you are a patient, long-term investor, data shows investor rewards no matter who sits in the Oval Office.

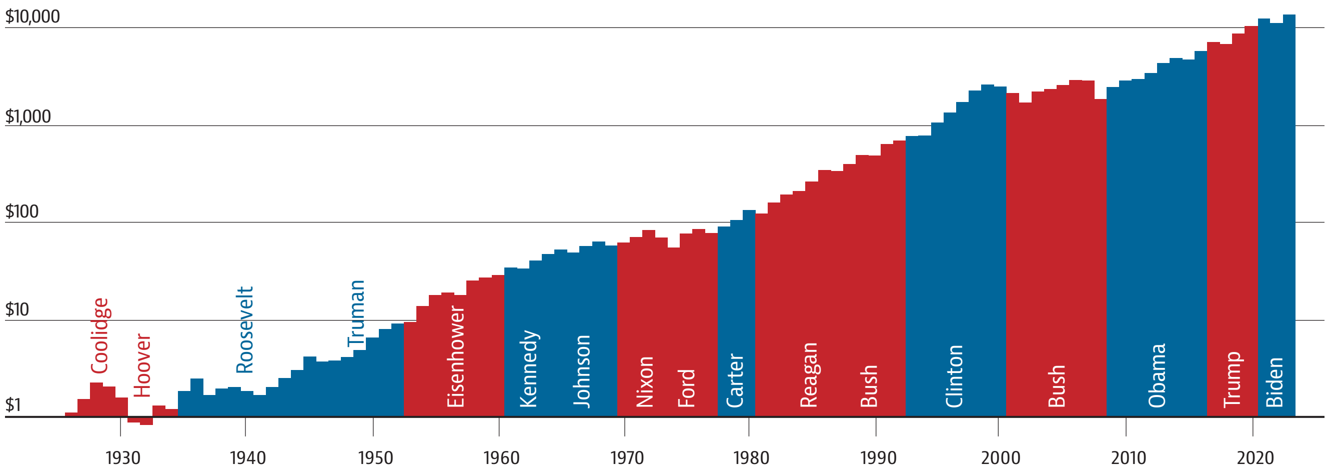
The time-tested advice to ignore the noise

When people say to ignore the noise in markets, what they really mean is this: Don't let headlines and single data points prompt you to buy, sell, sit on the sidelines or otherwise choose your investment course.

The better option, in our view, is to align your long-term goals with your investment plan. An all-weather plan is intended to survive any headline, including election news, thus keeping investors in the market to capture those long-term growth patterns that emerge over much longer horizons. ■

LONG-TERM INVESTORS HAVE SEEN GROWTH ACROSS PARTY LINES

Growth of a dollar invested in the S&P 500 January 1926 – December 2023



Source: Official Data Foundation, "Growth of Dollar Invested in the S&P 500 January 1926-December 2023"

Half of the world's population will vote in 2024

Countries with 49% of the world's population and 54% of global GDP will hold elections this year.[1]

UNITED STATES:

The world's largest economy

GDP: $28 trillion as of March 31, 2024[2]

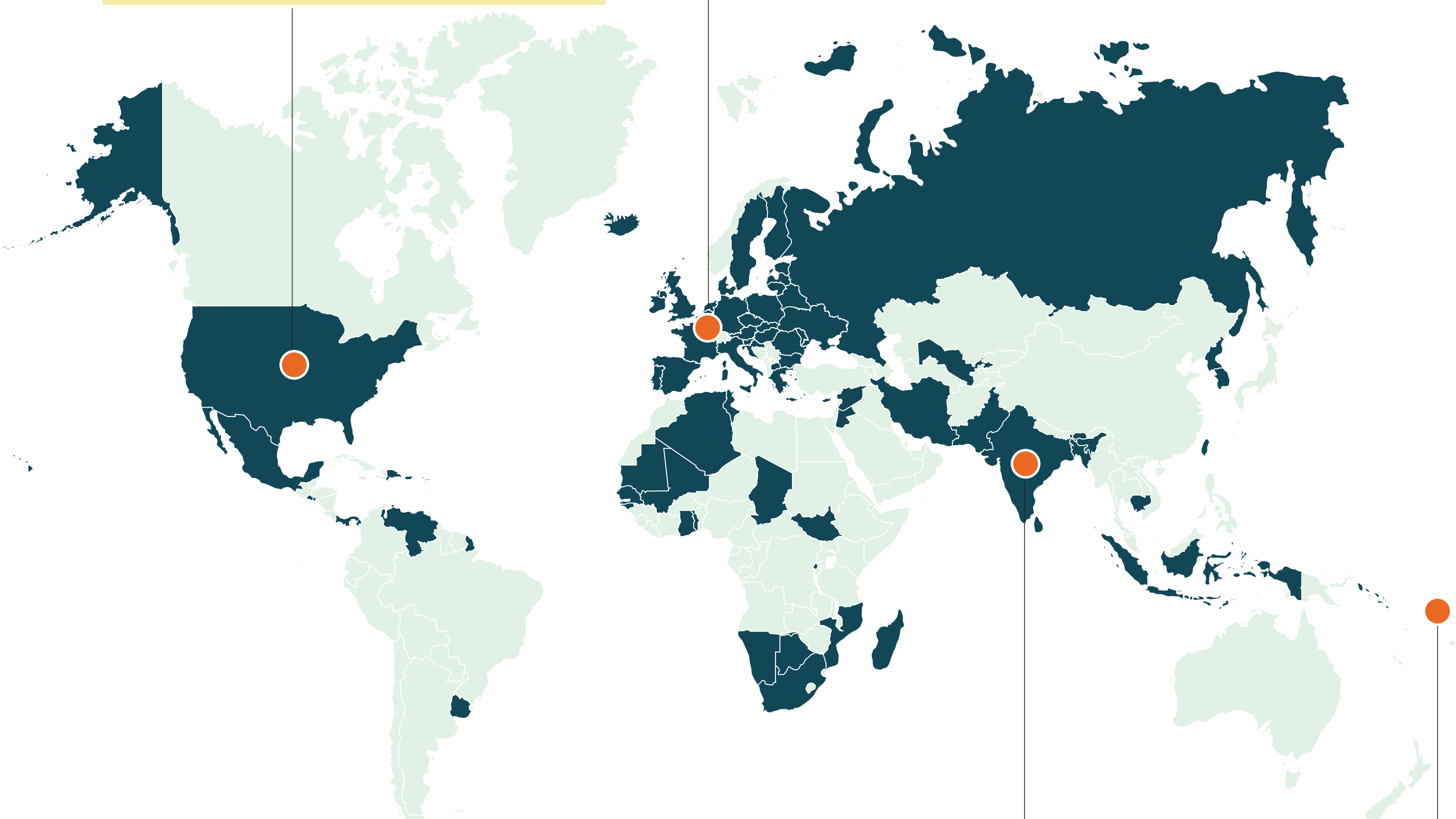
Election:
Presidency
Senate
House of Representatives

EUROPEAN UNION:

Largest number of countries involved

27 countries representing 448,922,216 people[3]

Election: European Parliament



INDIA:

Largest number of voters

Population: 1.4 billion[3]

Election: Lok Sabha (House of the People)

TUVALU:

Smallest number of voters and one of the smallest economies

Population: 11,466[2]

GDP: $60 million as of December 31, 2022[4]

Election: Parliament

[1] Time, "The Ultimate Election Year: All the Elections Around the World in 2024"
[2] U.S. Bureau of Economic Analysis
[3] Worldometers, "Countries in the world by population (2024)"
[4] Worldometers, "Tuvalu GDP"

News Briefs

Welcome to Our New Equity Analyst

Ryan Deedy is an equity analyst supporting Homestead Advisers' large- and small-cap value strategies. Ryan brings 15 years of investment experience to the team, most recently working as an equity analyst at Millennium Management. Prior to that, he served as an equity analyst at Manulife Investment Management and Putnam Investments, supporting their value-based investment strategies.

Ryan received a Bachelor of Science in business administration from the University of Connecticut and holds the Chartered Financial Analyst designation. ■

Barron's Names Homestead Value Fund One of the "5 Winning Funds to Consider"

Value stocks are gaining attention as investors broaden their portfolios beyond mega-cap tech stocks, fueled by economic data that shows rates could stay higher for longer. Barron's highlighted the **Homestead Value Fund** as one of the "winning funds to consider" for its strong, long-term performance and for being "among the cheapest active value funds with an expense ratio of 0.62% [as of 12/31/22] and several banks among top holdings." ■

Past performance does not guarantee future results. Equity securities generally have greater price volatility than fixed-income securities. The market price of equity securities may go up or down, sometimes rapidly or unpredictably. Equity securities may decline in value due to factors affecting the issuer or equity securities markets generally. Value stocks are subject to the risk that returns on stocks within the style category will trail returns of stocks representing other styles or the market overall over any period of time and may shift in and out of favor with investors generally, sometimes rapidly, depending on changes in market, economic, and other factors. Investments in value securities may be subject to risks that (1) the issuer's potential business prospects will not be realized; (2) their potential values will never be recognized by the market; and (3) their value was appropriately priced when acquired and they do not perform as anticipated.

The S&P 500 is a broad-based measure of U.S. stock market performance and includes 500 widely held common stocks. Indices are unmanaged, and investors cannot invest directly in an index. Unless otherwise notated, the performances of indices do not account for any fees, commissions or other expenses that would be incurred. Returns do not include reinvested dividends.

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.

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 May 6, 2024, 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.

Homestead Funds' investment advisor and/or administrator, Homestead Advisers Corp., and distributor, Homestead Financial Services Corp., are indirect wholly owned subsidiaries of NRECA. Homestead Financial Services Corp., Distributor 6/24

HRZNNEWS

PHOTO CREDITS: PAGE 1: PHOTO © ISTOCK/VLADIMIR VLADIMIROV. BALLOT ILLUSTRATION © ISTOCK/ MAYSTRA. WORLD ICON © ISTOCK/CALVINDEXTER. **PAGE 3:** ICONS © ISTOCK/SOULCLD. **PAGE 5:** CONTINENTS © YEVHENII DUBINKO.