ULTI0152

Horizons 2024 1Q

A QUARTERLY NEWSLETTER FOR HOMESTEAD FUNDS' CLIENTS

Individual retirement arrangement — doesn't that sound sophisticated?

That's the official name for the IRA, which most people refer to as an individual retirement *account*. But *arrangement* might actually be a better moniker for the setup. Though IRAs are indeed just a type of account, they offer a surprisingly wide and creative menu of ways to arrange your investment dollars and, for some, the timing and rate of tax payments.

IRAs always come up at this time of year because you can make contributions for tax year 2023 up until the filing date of April 15, 2024, in addition to making this tax year's contribution. There's a good chance your own household has an IRA of some kind, given their tenure and popularity. They became a mainstream savings tool in the early 1980s. More than 40% of households in America have an IRA today, according to recent findings from the Investment Company Institute. Yet, for all their potential, they probably should be even more popular than they are. We suspect IRAs aren't as well understood as they deserve to be.

In this issue, we take a deep dive into all things IRA. We start with a little primer on the "why" — a look at some of the benefits that IRAs confer on their owners. Then we share a good long list of all the ways people can and do use IRAs, coupled with another list to clarify the different types of IRAs available. Finally, we discuss the latest updates on contribution and income limits for 2024, which include some noteworthy increases.

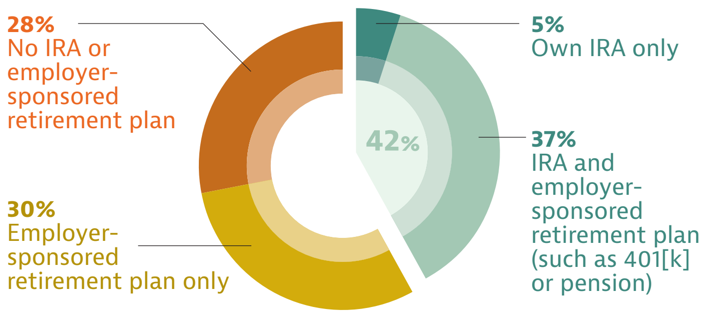
Busy working people aren't spending much time on tax code, we know. But we think it's worth knowing a little more about this particular tool, which may be gathering dust in your toolbox when it should be hard at work helping you reach your goals. ■

What's the Big Deal With IRAs?

IRAs are a popular topic with the financial gurus of the world. But they are just a specific kind of account. You may have wondered, what's the big deal?

Continued on page 2

FOUR IN 10 U.S. HOUSEHOLDS OWN AN IRA



Source: Investment Company Institute, Feb. 2023

Homestead Funds

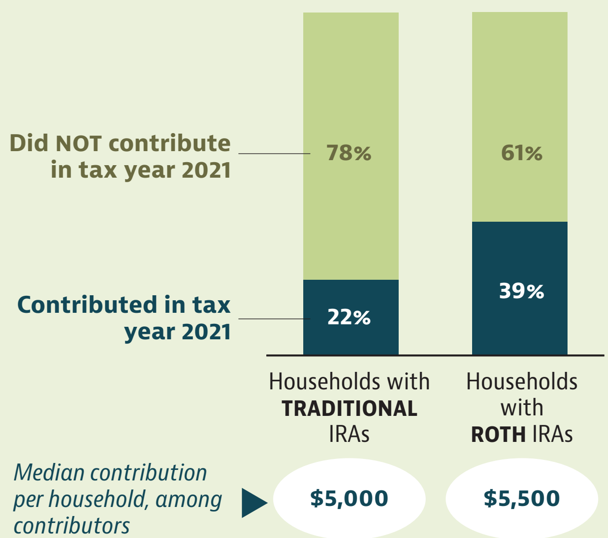
What's the Big Deal With IRAs? *continued from page 1*

We see primarily two advantages that IRAs offer over other investment account types, and most people stand to benefit from those two advantages. If you're not clued in, you could indeed be missing out on big benefits.

The first big benefit: **tax treatment**

The main reason that leads people to open an IRA is the tax treatment. If your contributions to an IRA meet the qualifications, you either get to *defer* taxes you would pay or you get to *forgo* them altogether, depending on the situation. For most people, that's a substantial incentive to set money aside, invest it and let it grow until retirement arrives.

ROTH IRA OWNERS ARE MORE LIKELY TO BE ACTIVELY CONTRIBUTING



Source: Investment Company Institute IRA Owners Survey 2022

With traditional IRAs, the tax benefit works the same way it does in a 401(k) or similar employer-sponsored defined contribution plan. Qualified contributions, which we talk about in more detail later in this issue, are made with "pre-tax dollars." In other words, every dollar you contribute from your wages or salary this year is a dollar you don't have to pay income taxes on this year. You will *defer* that income tax until later — until whenever you withdraw the money from your traditional IRA, hopefully many years down the road.

Those traditional IRA contributions go into your account, where you can purchase investments to suit your goals, preferably low-cost investments. Then when you reach 59½ years old, you can begin taking penalty-free withdrawals, also known as distributions. Only then do you pay the income taxes. When you take the distributions, those are taxed like income, as though you were earning it from your job in that year.

A Roth IRA's tax treatment can be even more appealing. A Roth is considered an after tax vehicle: There are no tax deductions in the year of contribution like there are with 401(k)s and traditional IRAs. You put your after-tax contributions into your Roth account where, again, you can purchase investments to your own preference, hopefully making low-cost choices. When you begin taking withdrawals from your Roth, however, there are NO taxes on qualified withdrawals. So one key difference between the two IRA types is that your investment earnings in a Roth are never taxed at all, while the traditional IRA does tax them at withdrawal.

*One key difference between traditional and Roth accounts is that the **investment earnings in a Roth are never taxed** if the qualifications are met.*

The second big benefit: **flexibility**

The other thing that IRAs are known for is their flexibility.

This actually manifests in two different ways. One is that IRAs are flexible in terms of what kinds of investments you can put in them. In comparison, an employer-sponsored retirement plan such as a 401(k) is usually limited to a specific menu of investments. IRAs can hold all kinds of things — mutual funds and other low-cost investments of your choosing — basically anything you can put into a regular investment account.

The withdrawal rules also offer some element of flexibility. Generally speaking, IRAs are meant to go untouched until age 59½. Withdrawals before that age incur a 10% penalty. But there are exceptions, including withdrawals for higher education expenses, a down payment on your first home purchase and even extreme medical bills. In a Roth IRA, contributions can be withdrawn without penalty at any time (but investment earnings must stay in the account until 59½ and the account has to have been opened for at least five years to be to be penalty-free).*

Two carrots and a stick

IRAs are intended to encourage long-term saving and investing. The 10% early-withdrawal penalty is definitely a stick, while the tax benefits and flexibility are some pretty big and tasty carrots. Retirement savers are finding this an appealing combination, with many choosing to use IRAs in conjunction with employer-sponsored plans such as 401(k)s. See *IRA Strategies to Use at Every Age* for more on which type of IRA strategy might be advantageous for you. ■

*Note that in the case of a converted or rollover Roth, a five-year rule applies before contributions can be removed penalty-free. Consult your tax advisor before making any withdrawals from your Roth to be sure that you are meeting the qualifications for proper tax treatment.

3 IRAs You May Not Know About

Roth and traditional IRAs are like the chocolate and vanilla of personal retirement accounts — the two main flavors. But you may hear discussion of three other IRA types and wonder how they relate to the two main options. Spousal, inherited and rollover IRAs — are those new flavors?

No, not exactly. IRAs are investment accounts, and the type — Roth or traditional, chocolate or vanilla — is really just a name to tell the IRS what kind of tax rules should apply.

These other three options are not new types of IRAs; they are just special rules for how people can create or qualify for an IRA.

Typically, people can qualify to make contributions to a Roth or traditional IRA by their income status and level (see page 5 for more detail). With spousal, inherited and rollover IRAs, however, there are some exceptions to those rules. They are all still just Roth or traditional IRAs. You can have a spousal Roth IRA, an inherited traditional IRA or a rollover traditional IRA. These aren't new ice cream flavors; they are like special-entry doors to the ice cream shop.

1 A spousal IRA

Normally, to qualify for an IRA, you have to have earned income in a tax year. What if you are a non-earning spouse — a caregiver or homemaker? Well, non-earning spouses qualify for IRAs as well!

What this means is that a single-income married couple can actually double their IRA contribution eligibility by opening an IRA for the non-earning spouse and contributing on his/her behalf each year in addition to contributing for the income-earning spouse. For couples over age 50, with catch-up provisions, the spousal IRA could expand annual contribution limits as high as $16,000 in 2024!

2 An inherited IRA

IRAs can be inherited, fully intact — investment holdings and all. What happens after inheritance can get complicated, so we won't try to cover it all here.

One thing to know is that a Roth remains a Roth and a traditional IRA remains a traditional IRA after inheritance. The other thing to know is that the rules about distributions and tax treatment are complex and differ depending on who inherited the account. If you inherit an IRA, it's critical to seek tax advice from a professional before making trades or taking any withdrawals from the account.

3 A rollover IRA

Workplace retirement plans can be "rolled over" into IRAs under certain conditions, such as when you switch employers or retire. In fact, one of the reasons that IRAs were invented was so that workplace savings could retain their tax advantages if workers left their employer. ■

A ROLLOVER IS ONE OF YOUR FOUR MAIN DISTRIBUTION OPTIONS

When you leave your job or retire, you have to decide what to do with the money in your current employer's retirement plan. Each of these options has advantages and disadvantages to consider. Please see pages 6–7 for a list of pros and cons of each choice.

LEAVE
your 401(k) money where it is

ROLL OVER
your 401(k) money to an IRA

TRANSFER
your 401(k) money to your new employer's 401(k) plan

WITHDRAW
all your 401(k) assets now (as a cash distribution)

IRA Strategies to Use at Every Age

IRAs are just accounts with special tax rules, right? Wrong! People use IRAs in a mix of surprisingly creative ways. Here are the most common strategies for putting this useful, flexible tool to work, no matter what your age or situation.

EARLY ADULTHOOD AND BEYOND

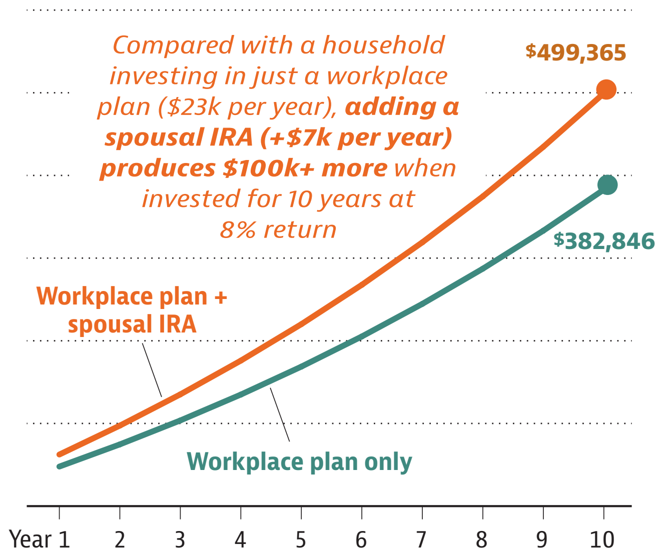
STRATEGY: Use an IRA as a main retirement savings vehicle.

Typically used for: People of any age who do not have a retirement plan available through their employer, including those who are self-employed. This can even include high schoolers with part-time jobs!

STRATEGY: Use a spousal IRA to double annual IRA contribution limits or to add to an earning spouse's workplace plan.

Typically used for: Married couples with one income-earner.

ADDING A SPOUSAL IRA: A HYPOTHETICAL EXAMPLE



Source: Homestead Funds' hypothetical calculations, assuming workplace plan contributions of $23,000 per year, spousal IRA contributions of $7,000 per year and investment returns of 8% per year after fees.

STRATEGY: Hold savings in a Roth for special purpose, no-penalty goals, such as a first-home down payment and higher-education expenses.

Typically used for: Young and midlife adults whose savings might be used toward a home and education for themselves or kids.

MIDLIFE AND BEYOND

STRATEGY: Use an IRA to supplement workplace savings.

Typically used for: People who maxed out their workplace savings but can still get more savings out of their income, especially high earners.

STRATEGY: Use a Roth conversion, aka "back-door Roth," to make contributions to a Roth IRA each year.

Typically used for: Households whose income exceeds the Roth qualifications but who would like to capture the tax-free growth that a Roth can provide.

STRATEGY: Use a rollover IRA when switching employers to consolidate and better track your investments.

Typically used for: People who have "left behind" retirement savings at former employers, or IRA account balances at multiple banks or investment brokerages.

STRATEGY: Keep some emergency funds invested in a Roth IRA, since contributions can be accessed anytime.

Typically used for: Households who have some wiggle room in their finances, who can tolerate putting some of their emergency funds one extra step out of reach. Investment earnings cannot be removed from a Roth before the age of 59½ without incurring a 10% penalty, but you can remove contributions anytime. The account also has to have been open for at least 5 years to avoid the 10% penalty.

RETIREMENT

STRATEGY: Use a rollover IRA at retirement to have more investment options and to make it administratively easier to take distributions.

Typically used for: People who want to choose their own investments, rather than being limited to the set menu at their workplace plan, and people who want easier access to their withdrawals compared with workplace plans. This is not necessarily the best option for you, since some workplace plans offer extremely low investment fees. Be sure to compare plans carefully. ■

Take It to the Limit

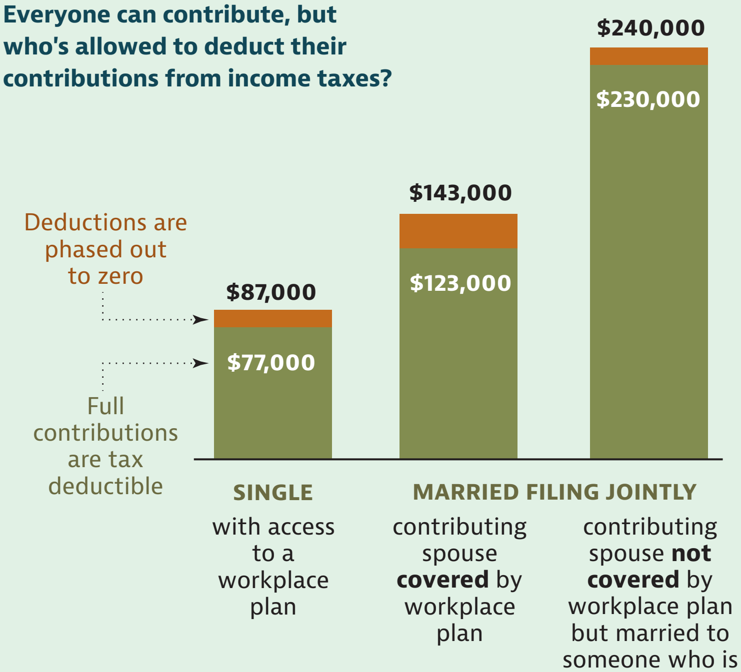
IRA contribution limits have increased in 2024, along with the income levels that determine who can contribute or take tax deductions. Here's an update.

2023 CONTRIBUTION LIMIT: $6,500 plus $1,000 catch-up for 50+

2024 CONTRIBUTION LIMIT: $7,000 plus $1,000 catch-up for 50+

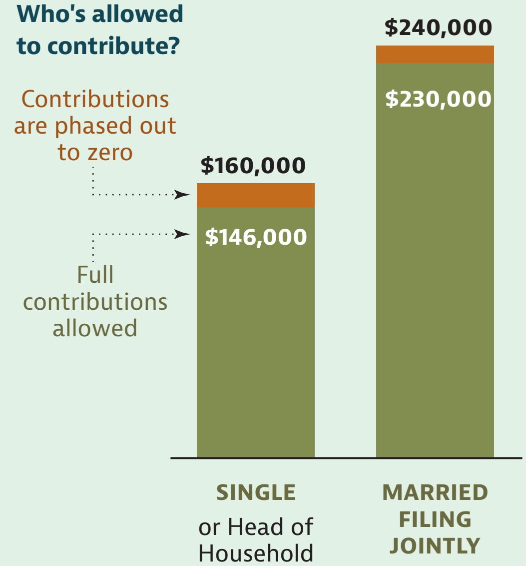
TRADITIONAL IRA 2024 INCOME LIMITS:

Everyone can contribute, but who's allowed to deduct their contributions from income taxes?

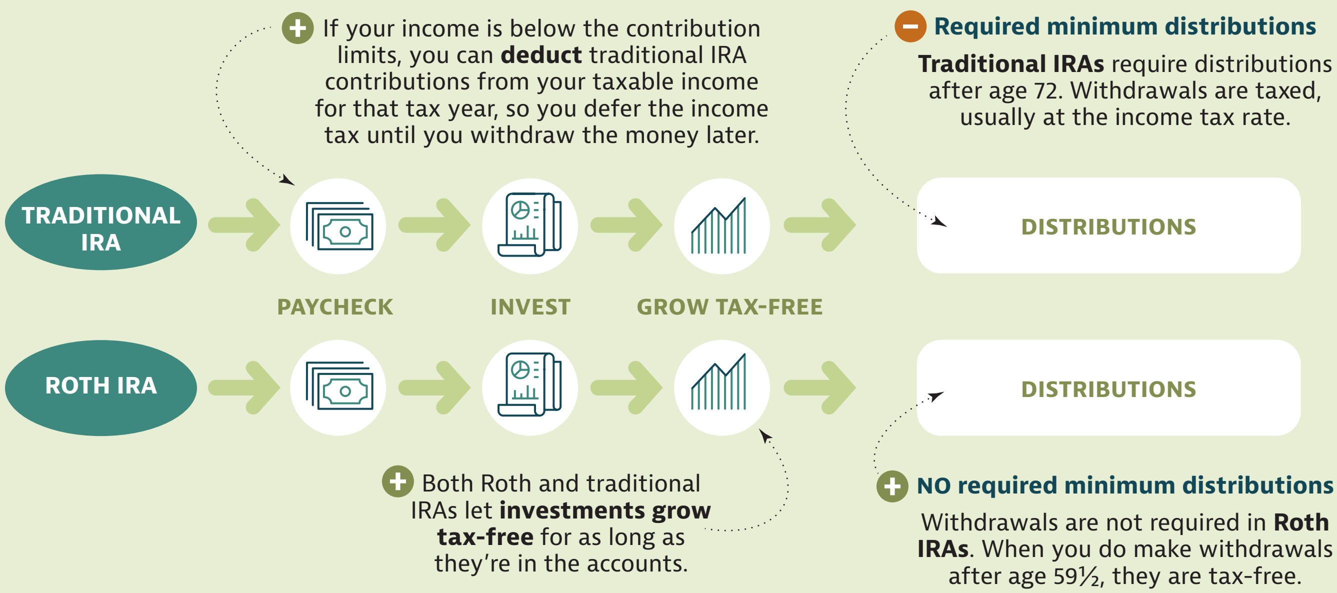


ROTH IRA 2024 INCOME LIMITS:

Who's allowed to contribute?



HOW IRA TAX BENEFITS WORK



Source: IRS News Release; Nov. 1, 2023; 401(k) limit increases to $23,000 for 2024, IRA limit rises to $7,000. For Illustration purpose only.

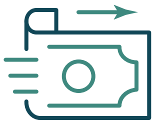
Four options for your 401(k)

The table below lists pros and cons of each choice. When considering your choices, keep in mind your own situation and your specific needs to determine what works best for you.

OPTIONS	ADVANTAGES	DISADVANTAGES
Leave your 401(k) money where it is	Your money continues to compound tax-deferred until withdrawal. Your account is not depleted by payment of income tax or a premature distribution penalty. In the case of bankruptcy or other judgments, 401(k) accounts generally offer greater protection from creditors than IRAs.	Not all employer plans permit this. If you take a distribution from the plan, there is a 20% federal tax withholding. If you are below age 59½, you may face a 10% penalty. (Exception: Participants who terminate employment in the year they turn 55 or later are exempt from the premature distribution penalty.) Your employer plan may not be able to help you choose how to allocate your funds. You may have limited access to your money or extra paperwork to authorize a redemption. If you're married, then your spouse is required to sign-off on distributions. Your spouse is automatically your beneficiary unless they waive that right in writing. When you pass away, beneficiaries can only keep the money in the 401(k) for five years.
Roll over your 401(k) money to an IRA	Your money continues to compound tax-deferred until withdrawal. Your account is not depleted by payment of income tax or a premature distribution penalty. Self directed funds selection or many IRA providers can help you decide which funds to purchase (asset allocation). You can consolidate other Rollover IRA accounts into one account to simplify your retirement savings. You may be able to use these savings penalty-free, for example, if taking an early distribution for education or the first-time purchase of a home. IRAs provide easy access to your money, no waiting period and no need to obtain spousal consent. You can withdraw assets at anytime. You have more flexibility regarding beneficiary selection.	If you take a distribution from your IRA prior to age 59½, you may face a 10% penalty. Mutual fund fees and expenses are typically higher than 401(k) investments. Direct rollovers are not limited in number, but you may only make one indirect rollover every 12 months across all your IRA accounts.

Continued

Continued from previous page

OPTIONS	ADVANTAGES	DISADVANTAGES
Transfer your 401(k) money to your new employer's 401(k) plan 	Your money continues to compound tax-deferred until withdrawal. Your account is not depleted by payment of income tax or a premature distribution penalty. Consolidates your retirement accounts.	You may not be eligible for the plan right away. Investment choices may be limited. You may have limited access to your money. Fees in new plan may be higher.
Withdraw all your 401(k) assets now (as a cash distribution) 	You can use the cash for immediate needs.	Your money loses its tax-deferred status. Your distribution is subject to a mandatory 20% income tax withholding (your actual tax may be more or less) and may be subject to a premature distribution penalty (10%) if you are below age 59½. (Exception: Participants who terminate employment in the year they turn 55 are exempt from the premature distribution penalty.) You lose out on future growth opportunity. The tax rate you pay on the distribution could be higher than if you spread the distribution over multiple tax years.

This table does not address your options for a Roth 401(k) or Roth IRA.