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Walt Bettinger
President & CEO
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Time Is Money
Why waiting for a market rebound could cost you.

here’s nothing like a stock market correction to scare off investors. That was certainly the case late last year, when a series of stock market drops triggered panic selling at a record pace. But those who fled for the safety of cash may have done more harm than good. “The problem
The early bird gets the return
Waiting to jump back into the market even a month after it hits bottom can lead to significantly lower gains over time.

### Cumulative returns following market bottom

<table>
<thead>
<tr>
<th></th>
<th>1 year later</th>
<th>2 years later</th>
<th>3 years later</th>
</tr>
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<tbody>
<tr>
<td>Stayed fully invested</td>
<td>46%</td>
<td>70%</td>
<td>83%</td>
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<tr>
<td>Moved investments into cash for 1 month</td>
<td>29%</td>
<td>46%</td>
<td>57%</td>
</tr>
<tr>
<td>Moved investments into cash for 3 months</td>
<td>20%</td>
<td>41%</td>
<td>50%</td>
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<tr>
<td>Moved investments into cash for 6 months</td>
<td>13%</td>
<td>32%</td>
<td>42%</td>
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Source: Schwab Center for Financial Research and Morningstar, Data from 01/1970 through 12/2017. Market returns are represented by the S&P 500 Total Return Index, and cash returns are represented by the total returns of the Bloomberg U.S. 30-Day Treasury Bill Index. Cumulative returns are calculated using the simple average of returns from each period and scenario. Past performance is no guarantee of future results.

with selling when the market takes a dive is that by the time you act, the worst may already be behind you,” says Mark Riepe, head of the Schwab Center for Financial Research.

The risk here is double-edged: If you sell during a slump, you could lock in your losses. And if you’re sitting on the sidelines, you may also miss out. Analysts at the Schwab Center for Financial Research studied the five periods since 1970 when stocks—as measured by the S&P 500 Total Return Index—fell 20% or more. They found stocks generated their biggest gains in the first 12 months of the recovery, and that missing even the first month of gains after the market hit bottom led to substantially lower returns over time (see “The early bird gets the return,” above).

“The problem with selling when the market takes a dive is that by the time you act, the worst may already be behind you.”

“As investors, we often wait to make sure it’s safe to go back in the water.”

“If you have a large stake in the stock market and need to tap those assets soon, for example, increased volatility is a reminder that your portfolio should perhaps be adopting a more conservative stance. If, on the other hand, you’re in it for the long haul and retirement is still many years away, you should generally turn a deaf ear to market noise and stick to your long-term plan.

**Swing Shift**

Putting recent stock market volatility into perspective.

20 years of volatility—ranked

While 2018 may have seemed volatile, it likely suffered from its proximity to the historic calm of 2017.

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Source: Schwab Center for Financial Research. Rankings are based on the S&P 500 Index’s historical volatility each year over the past 20 years. Historical volatility is calculated by measuring the index’s annualized average deviation from the index’s average level during each of the years shown.

See page 42 for important information. Standard deviation is a statistical measure that calculates the degree to which returns have fluctuated over a time period. A higher standard deviation indicates a higher level of variability in returns. (0518-9TK0)

Unsure if your portfolio is in line with your goals and risk tolerance? Visit schwab.com/portfolioevaluation to learn how to benchmark your performance and check your asset allocation.

“Still many years away, you should generally turn a deaf ear to market noise and stick to your long-term plan.”
Take It to the Limit

You can now contribute more to your tax-advantaged savings accounts.

Are you saving enough for retirement? If you don’t regularly increase your contribution amounts, you may not be.

“When you save the same amount year after year, your savings rate actually decreases over time due to inflation,” says Hayden Adams, CPA and director of tax and financial planning at the Schwab Center for Financial Research. “Fortunately, contribution limits for tax-advantaged accounts increase periodically, which can help preserve your purchasing power down the road—provided you take advantage of them.”

To the right you’ll find the 2019 contribution limits for a variety of popular savings accounts and brief explanations of how contributions to each can affect your tax bill.

See page 42 for important information.

◆ This information does not constitute and is not intended to be a substitute for specific individualized tax, legal, or investment planning advice. Where specific advice is necessary or appropriate, Schwab recommends consultation with a qualified tax advisor, CPA, financial planner, or investment manager. (0519-9TFY)

1 For individuals who participate in multiple workplace retirement plans, the aggregate total contributions cannot exceed these amounts. | 2 Single filers must have a modified adjusted gross income under $137,000 to contribute to a Roth IRA, and contributions are reduced starting at $122,000. For those married and filing jointly, the figures are $203,000 and $193,000. | 3 Account holder must be age 59½ or older and have owned the account for at least five years in order to qualify for tax-free income distributions. | 4 See footnote 1. | 5 For full details, see irs.gov/retirement-plans/ira-deduction-limits.

<table>
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<tr>
<th>2019 contribution limits</th>
<th>Increase from 2018</th>
<th>Tax implications</th>
</tr>
</thead>
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<tr>
<td>401(k), 403(b) and 457 plans</td>
<td>$19,000 ($25,000 if age 50+)</td>
<td>$500</td>
</tr>
<tr>
<td>Health savings accounts</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Individuals: $3,500 ($4,500 if age 55+)</td>
<td>$50</td>
<td>Contributions reduce your taxable income dollar for dollar up to the annual limits.</td>
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<tr>
<td>Families: $7,000 ($8,000 if age 55+)</td>
<td>$100</td>
<td></td>
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<tr>
<td>Roth individual retirement accounts (IRAs)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Individuals: $6,000 ($7,000 if age 50+)</td>
<td>$500</td>
<td>Contributions do not reduce your taxable income, but distributions in retirement are completely tax-free.</td>
</tr>
<tr>
<td>SIMPLE 401(k)s and SIMPLE IRAs</td>
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</tr>
<tr>
<td>$13,000 ($16,000 if age 50+)</td>
<td>$500</td>
<td>Contributions reduce your taxable income dollar for dollar up to the annual limits.</td>
</tr>
<tr>
<td>Traditional IRAs</td>
<td></td>
<td></td>
</tr>
<tr>
<td>$6,000 ($7,000 if age 50+)</td>
<td>$500</td>
<td>Contributions reduce your taxable income, so long as your modified adjusted gross income doesn’t exceed certain limits. Your deduction may be reduced if you or your spouse participates in a workplace retirement plan.</td>
</tr>
</tbody>
</table>

Want to contribute to your IRA for 2019? Log in to schwab.com/contribute today.
The Gift of Education

Opening a 529 plan on a grandchild’s behalf can be a boon come college—so long as you wisely manage the distributions.

When a grandchild arrives, grandparents are often eager to help out financially. At the same time, parents facing a whole host of new expenses may find it difficult to prioritize college—which, like retirement, benefits greatly from early action. In such instances, a grandparent-owned 529 college savings plan can be just what the doctor ordered.

Assets in state-sponsored 529s grow tax-deferred, and withdrawals are exempt from federal taxes when used for qualified education expenses.

“Every dollar saved is one your grandchild won’t have to borrow,” says Robert Aruldoss, a senior research analyst at the Schwab Center for Financial Research. “And you may get a tax deduction to boot.” That’s because 34 states and the District of Columbia offer a full or partial tax credit or deduction for in-state contributions to their 529 plans, and seven states offer a full or partial tax deduction to any state’s plan.1

Not only that, but grandparent-owned 529 assets aren’t factored in to the Free Application for Federal Student Aid (FAFSA®), which helps determine eligibility for grants, work-study programs and loans. With parent-owned 529s, on the other hand, 5.64% of assets are counted.2

One potential downside is that once a distribution from a nonparent-owned 529 plan is made, up to 50% of those funds may be counted as income on a student’s future financial aid applications. However, federal financial aid calculations count such distributions only from the “prior-prior year”—that is, two tax years before the funds were distributed. Hence, delaying distributions from nonparent-owned accounts until the final two years of a child’s college career can help sidestep this potential pitfall.

“Some families use parent-owned accounts to help pay for the early years of college and save distributions from grandparent-owned accounts for the final years,” Robert says. “The point is, if you time it right, you can help a grandchild pay for college without affecting financial aid eligibility.”

For a complete list of deductibility by state, see finaid.org/savings/state529deductions.phtml.1

Assets and income may be excluded from calculations if below certain thresholds. For more details, see studentaid.ed.gov.2

Ready to start saving for college?
Learn about Schwab’s 529 Savings Plan at schwab.com/529.

See page 42 for important information. ● Investors should consider, before investing, whether the investor’s or designated beneficiary’s home state offers any state tax benefits or other state benefits such as financial aid, scholarship funds, and protection from creditors that are only available in that state’s qualified tuition program. (0519-9TDC)
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Investments are not FDIC-insured, nor are they deposits of or guaranteed by a bank or any other entity, so they may lose value. Investors should carefully consider investment objectives, risk, charges, and expenses. This and other important information is contained in the fund prospectuses and summary prospectuses, which can be obtained from a financial professional and should be read carefully before investing. For details, please contact your financial professional.

*Morningstar, Fund Spy, Russel Kinnel: “28 Terrific Funds,” September 2018. Morningstar’s criteria for the Terrific list included: cheapest quintile of broad level category groupings; manager investment of more than $1 million in the fund; Morningstar Risk rating below the High level; Morningstar Analyst Rating of Bronze or higher; Parent rating of Positive; returns above the fund’s benchmark over the manager’s tenure; category benchmark for allocation categories; no institutional share classes; and no funds of funds.

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Dear Carrie,
My husband and I are trying to scrape together enough money for a down payment on our first home. Because we live in an expensive real estate market, we need to be creative and consider all our potential resources. Would it be OK if we borrowed from our 401(k)s?

Q

Dear Reader,
How exciting that you’re buying your first home! I know how hard it can be to come up with a down payment in an expensive market, so this is a great question.

The traditional financial advice has long been, “Never take an early withdrawal from retirement savings”—and I generally agree. One exception, however, might be exactly the situation you describe. Why? For two
reasons. First, because you’re taking a loan rather than a permanent withdrawal. Second, because you’re using the money to buy a first home, which can be a challenging—but ultimately worthwhile—financial goal.

That said, you need to proceed with caution. A study by TIAA found nearly a third of Americans who participate in a retirement plan have taken out a loan from it—and 44% regretted it.¹ So, if you want to borrow from your 401(k) without regret, it’s best to understand how such loans work, as well as the benefits and risks involved.

The basics
First, not all 401(k) plans allow loans. Even if yours does, every 401(k) plan limits how much you can borrow: one-half of the vested value of your account or a maximum of $50,000, whichever is less. If both you and your spouse have $100,000 or more in separate accounts, you’re eligible to borrow $50,000 each, for a total of $100,000—a big chunk toward a down payment.

The repayment period is typically five years, although that can vary by plan and may not apply if the loan is used to purchase a home. Repayment options usually include regular deductions from your paycheck or a lump sum by a specific date, and there’s no penalty for repaying the loan early.

In general, I recommend you pay back the entire amount as soon as possible, preferably in three years or less. No matter which option or time frame you choose, it’s important to create and stick to a repayment schedule.

Revisit your budget and make this a line item. If you miss even one payment, the loan could be recategorized by the IRS as a “distribution,” which means you would have to pay federal income tax on the loan amount, plus a 10% early withdrawal penalty if you’re under age 59½.

The potential benefits
One of the best parts of borrowing from your 401(k) is you don’t have to go through the lengthy process of applying for a loan. There are no credit checks and you can usually place a call or make a quick visit to your 401(k) provider’s website to secure the loan and have a check in hand within a week.

The other upside is that principal and interest on the loan are paid to your own account. Hence, a 401(k) loan effectively becomes an interest-free loan—provided you repay it on time.

The potential risks
One of the biggest risks of borrowing from your 401(k) is you’re usually required to repay the loan immediately if you lose your job. Depending on your plan, this might be at termination or within 60 days. If there’s a chance your job is at risk and you’d be unable to repay the loan on such short notice, I’d caution against borrowing from your 401(k).

There are also considerable long-term risks to consider. While borrowing from a 401(k) may allow you to buy your first home, it still diminishes your retirement assets. By taking out a loan, you’ll lose the tax-deferred growth on that part of your savings until the funds are put back.

In addition, some plans don’t allow you to make new contributions during the repayment period. This means you could miss out on adding to your savings, the earnings from such contributions and any matching contributions offered by your employer—which could derail your retirement plans. So if you’re already behind on your retirement savings, taking out a loan is probably a bad idea.

Final thoughts
As a rule of thumb, you want to build up your retirement assets, not deplete them. Therefore, resist the temptation to borrow from your 401(k) to pay for anything other than a down payment.

That said, a short-term loan from a 401(k) to buy a house can make sense in some cases, especially if your job is secure, you’re generally on track with your retirement savings, and you’re buying into what you believe is a healthy real estate market. Just be sure you have enough of a cash cushion to cover contingencies. You don’t want to be so house poor that you can’t properly maintain the property or respond to an emergency.

If you do decide to take out a short-term loan for your down payment, make sure the size of the loan payment doesn’t impede your ability to keep contributing to your 401(k), if your plan allows it. Even if you can’t afford the maximum contribution, put away at least enough to capture the company match. You don’t want to walk away from free money.

¹TIAA-CREF Borrowing Against Your Future Survey Executive Summary, tiaa.org, 06/18/2014.

Carrie Schwab-Pomerantz (@carrieschwab), CFP®, is president of Charles Schwab Foundation and senior vice president of Schwab Community Services at Charles Schwab & Co., Inc.

See page 42 for important information. Please read the Schwab Intelligent Portfolios Solutions™ disclosure brochures for important information, pricing, and disclosures related to the Schwab Intelligent Portfolios and Schwab Intelligent Portfolios Premium programs. Schwab Intelligent Portfolios™ and Schwab Intelligent Portfolios Premium™ are made available through Charles Schwab & Co. Inc. (“Schwab”), a dually registered investment advisor and broker dealer. (0519-9869)
Just Do It

Financial plans work—so why do so few of us have one?
By Mark Riepe

ike any good road map that gets you where you’re going, a financial plan is designed to keep you on the path toward your goals—from college and retirement to everything in between.

Financial planning is helpful because it encourages people to do a better job of budgeting, which in turn helps control spending and saving. Those who plan are also better able to spot potential problems and address them in a timely manner. In fact, Schwab’s 2018 Modern Wealth Index survey of 1,000 Americans revealed that those who were following a financial plan ranked highest in accumulating wealth, managing debt and achieving multiple savings goals.

Unfortunately, the same survey found that those folks are squarely in the minority: Only one in four respondents had a formal financial plan. In other words, we like to dream big when it comes to our financial goals, but many of us don’t root those dreams in reality by creating a plausible step-by-step strategy for getting there.

The good news is there are proven tactics for training ourselves to overcome inertia and choose a more predictable path forward.

**TACTIC 1: Identify your goals**

You can’t create an effective plan until you know what you’re trying to achieve, so start by listing each of your goals.
The vaguer your goals, the harder it is to measure your progress toward them, so be as specific as possible. For instance, if one of your goals is to “live comfortably in retirement,” push yourself to define what that means in practical terms. Perhaps you want to pay off your mortgage before you stop working to eliminate your housing payment, or budget for potentially expensive hobbies like golf and skiing.

Think, too, about things like quality health care and even the possibility of working in retirement to supplement your savings (see “Going Back to Work in Retirement,” page 30). Defining clear, actionable goals—and the means to achieve them—can be challenging, so consider enlisting a financial planner to help you think through your vision. He or she can help fine-tune your objectives, determine how to approach your goals in practical terms and even act as a reality check for your vision should you need it.

**TACTIC 2: Break it up**

As with any complex undertaking, it pays to break the task into clear, discrete pieces. Computer programmers, for example, use this strategy when troubleshooting software. They don’t tackle every programming problem at once but rather resolve each individual bug before bringing all the code back together to form a working whole.

It can be helpful to approach financial planning in much the same way:

- First, rank your financial goals and attach a price tag to each.
- Next, set a deadline for achieving each goal.
- Finally, determine how much money you need to set aside per month to reach each goal.

If, after running these numbers, you decide your goals feel unattainable, take a step back and reassess your assumptions. Perhaps that second home needs to be smaller or in a more affordable location than originally envisioned. Or maybe you need to rethink your spending to free up funds for a goal down the road. The point is not to eliminate today’s comforts in order to achieve tomorrow’s dreams, but rather to find a balance that satisfies both near- and long-term needs.

While there are as many priorities, price tags and target dates as there are individual investors, a host of online tools can help you run the numbers, weigh competing priorities and determine the best course of action for you. At schwab.com/planningtools, for example, you can find calculators for retirement and college savings, various worksheets and questionnaires and even sign up for workshops at Schwab branches near you.

**TACTIC 3: Base it in reality**

Guestimates are part and parcel of any planning process—but some are more realistic than others. One way to combat overly optimistic expectations is to pay attention to base rates, or prior probabilities. For example, you can look to the past for historical growth rates in everything from inflation and the S&P 500® Index to specific expenses such as health care and higher education.

That said, base rates are just a starting point, and past performance is never a guarantee of future results. Between 1970 and 2018, for example, U.S. large-cap stocks returned an average 10.1% annually. But many analysts, including those at Charles Schwab Investment Advisory, are projecting much lower returns during the next decade, due to a combination of historically low inflation and interest rates, and relatively high equity valuations. If such a scenario comes to pass, predating your future on past performance could leave you well short of your goals.

It can also help to rerun your projections using a more pessimistic number. For example, if your plan is based on a 7% average annual rate of return over 30 years, how would 6% or 6.5% change your results? If achieving even a slightly lower rate of return would upend your goals, you might consider saving more each month, if possible, to make up for the projected shortfall.

**You’re not alone**

Dreams are important. They give us goals to go after. But realizing them often involves an honest reckoning of what’s possible and what we’re willing to sacrifice to get there.

Whatever your goals, be sure to root them in a plan that is considered and practical—and be sure to revisit it regularly to ensure your assumptions still hold true.

---


See page 42 for important information. If possible, to make up for the projected shortfall, be sure to revisit your plans regularly and ensure your assumptions still hold true.
Tuition, fees, books, room and board. It all adds up, and quickly. Whether you are saving for your child, grandchild, or other loved ones, a Schwab 529 Plan can offer the tax advantages, professional management, and flexibility you’ll need to pursue your education savings goals.

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If you are not a Kansas taxpayer, before investing consider whether your or the beneficiary’s home state offers a 529 plan that provides its taxpayers with state tax and other benefits such as financial aid, scholarship funds, and protection from creditors that are only available in such state’s qualified tuition program. Tax and financial aid treatment of 529 plans is subject to change.

As with any investment, it is possible to lose money by investing in this plan.

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Cracks in Corporate Debt?

Why a staple of fixed income portfolios may be headed for trouble, by Collin Martin

What happened? And could the U.S. corporate bond market continue its recent slide?

More of the same

We believe U.S. corporate bond yields are poised to move modestly higher throughout 2019 and into 2020—which could continue to pull prices lower and negatively impact total returns from U.S. corporate bond funds. (Remember, bond prices fall when yields rise.) Four key factors are to blame:

- A surge in U.S. corporate debt: Over the past decade, the amount of debt issued by nonfinancial U.S. companies ballooned 48%, to nearly $9.8 trillion—which is raising fears of a potential bubble (see “Precarious heights,” below).
- Rising interest rates: Repeated interest rate hikes have caused Treasury yields to rise, giving income-seeking investors a viable alternative to riskier U.S. corporate bonds, even as they’ve made it more expensive for corporations to borrow. Higher borrowing costs can eat into not only a company’s profitability but also its ability to service outstanding debt, increasing the risk of default.
- The risk of downgrades: The investor base for high-yield U.S. corporate debt is limited, and if the glut of triple-Bs previously mentioned is downgraded, the price of high-yield U.S. corporate bonds may need to move sharply lower in order to sufficiently entice prospective buyers.

What can you do?

As a result of these risks, we suggest investors take a more cautious stance toward U.S. corporate bonds in 2019. Investors needn’t abandon their U.S. corporate fixed income holdings, but they should consider moving up in quality.

Precarious heights

Total nonfinancial U.S. corporate debt surged 48% from year-end 2008 through year-end 2018, raising concerns of a bubble.

Investors in triple-B-rated U.S. corporate bonds, for example, might consider reducing their exposure in favor of those with ratings of A or above. Although triple-B-rated corporate bonds were yielding 4.5% in mid-February, those rated A were yielding 3.6%—among their highest levels since 2011.

Bond-fund investors, in particular, should bear in mind that many index-tracking investments have a lot of exposure to BBB-rated securities. If that’s outside your comfort zone, you may want to consider strategies that take a more active approach and focus on higher-rated parts of the market.

Finally, if you’re a high-yield U.S. corporate bond investor, make sure you’re comfortable with the risks. High-yield bonds can suffer large price declines in short periods of time. In the fourth quarter of 2018, for instance, the average price of the Bloomberg Barclays U.S. Corporate High Yield Bond Index dropped by more than 6%. If that kind of price decline is too steep for your tastes, consider moving up to higher-rated, intermediate-term bonds.

Past performance is no guarantee of future results. • Past performance is no guarantee of future results. • Fixed income investments are subject to increased loss of principal during periods of rising interest rates. Fixed income investments are subject to various other risks including changes in credit quality, market valuations, liquidity, prepayments, early redemption, corporate events, tax ramifications and other factors. Lower rated securities are subject to greater credit risk, default risk, and liquidity risk. (0519-9EAF)
Reasons for REITs

There’s more to real estate investment trusts than just income.

By Anthony Davidow

Real estate investment trusts (REITs)—typically publicly traded companies that finance or own real estate—are prized for the income they provide. That’s because by law REITs must pass along at least 90% of their income to shareholders as dividends.

Critics believe REITs are poor investments during periods of increasing interest rates, when rising yields from fixed income investments make REITs—which are riskier—less attractive. They may have a point: REITs generated their lowest returns in a decade in 2018, a year in which the Federal Reserve raised rates four times. (Distributions from REITs are also taxable, unlike some fixed income investments.)

That said, we believe short-term underperformance is rarely sufficient reason to jump ship, whatever the investment. And despite last year’s paltry returns, REITs actually outperformed several other asset classes, including U.S. stocks.

The case for REITs

Here are four reasons why REITs might deserve a place in your portfolio:

1. Diversification: REITs rarely perform in lockstep with stocks or bonds. In recent years, the divergence was partly the result of low interest rates, which caused yield-hungry investors to drive REIT prices higher. Additionally, REITs tend to follow the real estate cycle, which typically lasts a decade or more, whereas bond- and stock-market cycles typically last an average of roughly 5.75 years.

2. Income: In 2018, U.S. REITs yielded 4.68%, outpacing most other income-generating investments (see “REIT returns,” left).

3. Inflation hedge: Real estate has tended to fare well in the face of rising prices. In particular, REITs with commercial holdings frequently have agreements that allow them to raise rents in tandem with inflation.

4. Long-term growth: Past performance is no guarantee of future returns, but U.S. REITs have outperformed U.S. stocks in seven of the past 10 years. Globally, real estate investments outperformed equities by an average of more than a full percentage point per year from 1960 through 2015.

Investing in REITs

As with stocks, it can be difficult to consistently make successful choices when investing in individual REITs. Therefore, investors might be best served by an exchange-traded fund or a mutual fund that tracks a broad-based REIT index, such as the MSCI U.S. REIT Index or the S&P U.S. REIT Index.

And because REITs tend to be volatile, they should constitute no more than 5% of your portfolio. However, even that small allocation can help capture a degree of diversification, growth potential and income that would be tough to replicate with any other asset class—without taking on undue risk.

To research REIT funds for your portfolio, log in to schwab.com/fundfinder, select Asset Class, then Sector Equity, then Real Estate.
When Market Ups and Downs Make It Tough to Navigate...

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¹ Source: Lipper as of 12/31/18, based on Class A shares at NAV and Class A assets. Keep in mind that a high relative ranking does not always mean the fund achieved a positive return during the period. Lipper rankings do not take into account sales charges and are based on historical total returns, which are not indicative of future results.

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People approach vacation differently. Some want a complete break from their day-to-day lives. Others see it as a chance to focus on their passions. Traders are often caught between these two desires. For many, trading is an activity that provides satisfaction along with potential profits. Stepping away from that can be tough, even when it comes time to unwind.
But trading while on vacation can itself be problematic. Depending on where you’re traveling to, internet access may be spotty. Even under the best of circumstances, it’s unlikely you’ll be able to monitor your positions as closely as when you’re sitting at your desk.

So before you head out, think through the following four questions to help decide whether—and how—to trade on your next vacation.

1) What kind of trader are you?

First off, consider your time horizon. If you’re a short-term trader accustomed to buying and selling positions within a single day, you might want to leave the laptop at home. After all, you’ll have time for little else if you’re constantly monitoring the market for profit opportunities.

It’s a different story for swing and intermediate-term traders, who hold positions from a couple of days to several months, respectively. The question isn’t whether to pack a laptop but rather which order types you can use to protect your positions while you’re away. The key is to add some built-in protection, so be sure to place bracket orders—identifying your stop and profit prices—on every open position before you leave. This can help limit your losses if the market moves against you, or lock in your desired profit if things go as you hope.

2) How much time will you realistically have to trade?

If the answer is none, you should close out your positions before heading out, particularly if you’ll be away for a while. Otherwise, you should be able to keep them open, with a bracket order in place, even if you have only a few minutes to check on them each day.

If that’s the case, here’s how to make the most of your limited time online:

- Each day, either after the market closes or before it opens for trading, briefly scan the news to see how the market is shaping up and if there are any developments that might change your views on your existing holdings.
- If your views have changed, consider altering your bracket order to align with your new thinking.
- You could also add a position, assuming you’ve done your homework and the price is right.

For the latter, use a conditional order—one that triggers a purchase only if certain conditions are met— and even then place a bracket order to protect your downside and lock in your upside.

3) How connected will you be?

Traveling can mean hours or even days without a reliable internet connection. Roughing it on a weeklong African safari is a grand adventure—but it’s no place to trade. Neither is a Paris apartment that promises speedy Wi-Fi but fails to deliver.

If you suspect your internet access may be unreliable, set up email or text alerts so you’ll be notified via cellular service if certain market conditions are met. You can do this not only for price and volume changes but also stop losses, margin warnings, and bid and ask prices. You can even set expiration dates for each alert to keep intrusions to a minimum (see “Alerts on the go,” left).

Of course, if you think there’s a chance your internet access may be compromised completely, you might want to play it safe and close out your positions ahead of time.

4) How has your trading performance been?

Let’s face it: We all go through rough patches. Emotion can get the best of us when losses start to pile up, leading to some less-than-optimal decisions. At times like these, the best course of action may be to take a mental break—and there’s no better time for doing so than a holiday.

Even if your trading portfolio has been performing well, it can help to step away from the screen. We’ve all felt the push and pull of watching market prices move minute by minute, and sometimes the best way to enforce discipline is to hang back and let your automatic orders mind the store.

The time away might also give you a chance to reflect on your performance. The storied investor Jesse Livermore, for example, made a point of locking himself in a Chase Manhattan bank vault the last weekend of every year to analyze all the trades he’d made over the previous 12 months.

Nobody’s suggesting you spend your hard-earned vacation inside a bank vault, but a little self-reflection without the day-to-day distractions of the market can help recharge your batteries for when you do return to trading.

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Lee Bohl, CMT, is trading services manager at Charles Schwab & Co., Inc.

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See page 42 for important information. Investing involves risks, including loss of principal. Hedging and protective strategies generally involve additional costs and do not ensure a profit or guarantee against loss. There is no guarantee that execution of a stop order will be at or near the stop price. (0519-9AL2)
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Regaining Lost Ground

Not all recoveries are created equal.

Sometime the stock market takes a beating and bounces right back. Other times—not so much. After the start of the past five bear markets, for example, it took the S&P 500® Index from as few as 21 months to as many as 7½ years to return to its previous peak.

If you won’t need to tap your savings for at least three to five years, it’s reasonable to have a meaningful portion of your portfolio invested in equities. But if you’ll be drawing on some funds sooner, that portion should be kept in relatively safer, more stable investments (think bonds and cash).

“This chart shows why your portfolio needs to reflect your time horizon,” says Mark Riepe, head of the Schwab Center for Financial Research. “In a worst-case scenario, a retiree who needs the money to live on could be forced to sell stocks in a down market, locking in steep losses. It’s much tougher for a portfolio to bounce back in those circumstances—especially if the recovery proves to be protracted.”

Source: Schwab Center for Financial Research. Data from 01/02/1970 through 02/15/2019. Bear markets are defined as stock market declines of 20% or more. Past performance is no guarantee of future results.

Get a personalized portfolio recommendation when you enroll in Schwab Intelligent Portfolios®. Learn more at schwab.com/intelligentportfolios.
Like the weather, the financial future is often difficult to predict. That’s one reason it’s so valuable to diversify your portfolio. By holding a mix of assets, you’re better positioned to ride out a rough patch for any one investment.

But diversification isn’t just for your investment portfolio. It’s also possible to diversify your tax exposure. In fact,
diversifying both how and when you pay taxes on your savings can help you successfully navigate two unknowns in retirement:

How much taxable income will you have? You need to consider not just your retirement savings but also Social Security, pensions, nonretirement investments and other potential sources of income.

What will your future tax rate be? Today’s rates are relatively low by historical standards, and it’s conceivable they could rise before or during your golden years.

Given these unknowns, what’s a saver to do? “One approach,” says Rob Williams, CFP® and vice president of financial planning at the Schwab Center for Financial Research, “is to use accounts with a variety of tax treatments so you can better control your taxable income in retirement.”

The big four

Broadly speaking, you have four account types at your disposal, each with its own unique tax advantages:

**Tax-deferred:** Contributions to these accounts—which include 401(k)s, 403(b)s and traditional individual retirement accounts (IRAs)—generally reduce your taxable income dollar for dollar in the year you make the contribution (see “Take It to the Limit,” page 8). What’s more, pretax contributions and gains typically aren’t taxed until retirement, at which point withdrawals are subject to ordinary income tax rates. You can’t leave your savings in these accounts forever; though, the IRS mandates annual required minimum distributions (RMDs) from your tax-deferred savings accounts beginning at age 70½.

**Roth:** Unlike tax-deferred accounts, contributions to Roth 401(k)s and IRAs are made with after-tax dollars, meaning contributions won’t reduce your current taxable income. However, you won’t owe taxes on appreciation, income or withdrawals in retirement. A Roth IRA is exempt from RMDs, but a Roth 401(k) is not—though you can still avoid RMDs by rolling it into a Roth IRA when you retire.

**Taxable:** These traditional bank and brokerage accounts are also funded with after-tax dollars. You can sell securities and contribute or withdraw money at any time and for any reason without penalty; any taxable investment income is taxed in the year it’s earned; and investments sold for a profit are subject to capital gains tax. If you sell an investment for a loss, on the other hand, you may be able to use it to offset any gains—and be up to $3,000 of ordinary income. These accounts are also exempt from RMDs.

**Health savings:** Although not traditionally considered retirement accounts, health savings accounts (HSAs) can be an effective savings vehicle (assuming your employer offers one and you’re covered by a high-deductible health plan). Contributions reduce your taxable income up to annual limits; investments grow tax-free, and you pay no tax on withdrawals used for qualified medical expenses. Once you reach age 65, withdrawals made for nonmedical purposes will be taxed as ordinary income. HSAs are also exempt from RMDs.

Tax diversification in action

So, what’s the right mix of retirement accounts for you? “That depends on several factors, including your current marginal tax rate, your projected tax rate in retirement and how much flexibility you’d like when making withdrawals in retirement,” says Hayden Adams, CPA, CFP® and director of tax planning at the Schwab Center for Financial Research. Nevertheless, there are basic guidelines you can consider when deciding which retirement accounts to fund first:

**Capture your match:** If your employer offers matching contributions to your retirement account, your first priority should be to save enough to get the full match. “That’s free money,” Rob says.

**Consider an HSA:** “We’re all likely to have increased medical expenses in retirement,” Hayden says. “So why not pay for them with tax-free dollars?” In 2019, individuals can contribute up to $3,500, families can contribute up to $7,000, and account holders age 55 or older can contribute an additional $1,000. Employers sometimes provide matching contributions, though they’ll count against the annual limits.

**Maximize your tax-advantaged savings:** Next, consider an appropriate combination of tax-deferred and Roth accounts, depending in large part on your current tax bracket:

- **If you’re in a lower tax bracket (0%, 10% or 12%), consider maxing out your Roth accounts.** “There’s a chance your tax bracket in retirement will be equal to or higher than it is today, particularly when you consider that tax rates are at the lowest levels we’ve seen in decades,” Rob says. “Workers early in their careers, in particular, may start out in a lower tax bracket than those later in life.”
- **If you’re in a middle tax bracket (22% or 24%), consider splitting your retirement savings between tax-deferred and Roth accounts.** “It can be especially difficult for people in the middle tax brackets to predict their future tax rates, but if you contribute to both types of tax-deferred accounts, you may alleviate some of that uncertainty,” Hayden says. If the majority of your workplace savings are in a traditional 401(k), for example, you might opt to diversify with a Roth 401(k), if offered by your employer.
- **If you’re in a higher tax bracket (32%, 35% or 37%), there’s a good possibility that your tax rate in retirement will be the same as or lower than it is today, so maximizing your tax-deferred accounts might make the most sense.**
- **Consider a Roth conversion:** If your income precludes you from contributing to a Roth IRA, one potential option is a Roth conversion. With this strategy, you convert all or a portion of funds from a traditional IRA to a Roth IRA and pay ordinary income taxes on the converted amount in the year of the conversion.
- **Despite the additional taxes, a Roth conversion can help diversify a mostly tax-deferred portfolio.** Rob says, “the conversion amount is considered income, which could nudge you into a higher bracket if you’re not careful.” Hayden warns, “That’s why many people opt to perform several Roth conversions over multiple tax years.”

If you’re unsure how much to convert in a given year, a tax professional can help you decide.

Exchange-traded funds, index mutual funds and other tax-efficient investments typically don’t create as many taxable distributions as actively managed funds.

The bottom line

No matter your tax bracket or personal situation, it’s always a good idea to consult with a tax or financial planning professional.

“Anticipating future tax rates is always a bit of a guessing game,” Rob says. “But with a number of account types at their disposal, today’s retirement savers can build in flexibility and a surprising level of control over their future tax bills.”

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*Contributions are subject to ordinary income tax, and, taken prior to age 59½, may be subject to a 10% penalty tax for early withdrawal. Capital gains are subject to capital gains taxes. The account holder must be age 59½ and has held the account for at least five years. Health savings account contributions are not used for nonmedical purposes before age 65 may subject to ordinary income tax plus a 20% penalty. “To contribute to a Roth IRA, one must have a modified adjusted gross income of less than $137,000, and contributions are reduced starting at $222,000, for those married filing jointly, the figures are $253,000 and $311,000.”

See page 42 for important information. Tax-exempt bonds are not necessarily a suitable investment for all persons. Information related to a security’s tax-exempt status (federal and in-state) is obtained from third parties and Schwab does not guarantee its accuracy. Tax-exempt income may be subject to the Federal Minimum Tax (UMT). Capital appreciation from bond funds and discounted bonds may be subject to state or local taxes. Capital gains are not exempt from federal income tax.

**TALK TO THE EXPERT**

Need help thinking through your retirement savings plan? Call 888-484-5340 to speak with a Schwab investment professional.
Going Back to Work in Retirement

Pros, cons and other considerations.

Gone are the days when retirement signified the end of one’s working life. Thanks to increased life expectancy, the shift away from physically demanding labor and a host of other factors, Americans are increasingly embracing what was once an oxymoron: working in retirement.

For the decade ending in 2024, the Bureau of Labor Statistics predicts a 55% rise in labor participation among those 65 to 74 years old and an 86% increase for those 75 and older. This compares with an estimated increase of 5% for the labor force as a whole during the same period—and far exceeds the projected growth rate for any other age group (see “The growth in gray workers,” page 32).
GOING BACK TO WORK IN RETIREMENT

While some retirees continue to work out of financial necessity, the bulk of older workers “tend to be among the more educated, the healthiest and the wealthiest,” according to the Center for Retirement Research at Boston College. “People in the highest percentiles of household income may not need to work, but often they want to continue to take advantage of their skills and the opportunities that come with them,” says Robert Auadano, a senior financial planning analyst at the Schwab Center for Financial Research.

While working in retirement has advantages beyond the additional income, there are potentially negative consequences for health care coverage and Social Security benefits, along with a host of other important considerations. Here, then, are the pros, the cons and the intangibles when contemplating this alternative to full-fledged retirement.

The potential advantages

Additional income: The benefits of increased cash flow in retirement should not be underestimated, even for those who are financially well-off. After all, every additional dollar you don’t need to withdraw from your retirement savings is a dollar that can remain invested,” says Rob Williams, vice president of financial planning at the Schwab Center for Financial Research.

What’s more, such outside income can give you more flexibility as to when, or even if, you tap retirement savings, so you aren’t forced to liquidate assets during periods of market upheaval—which can be particularly damaging to retirees (see “Timing is everything,” opposite page).

The growth in gray workers

The coming decade may see a significant increase in older workers.

Mental agility: Perhaps equally important, working can help retirees socialize and remain mentally sharp, which can further improve quality of life and extend longevity. “Social contacts are a side effect of employment that keep workers mentally agile,” report Axel Börsch-Supan and Morten Schuth of the Munich Center for the Economics of Ageing. Indeed, men in countries with later ages of retirement tended to perform twice as well on cognitive tests than those in countries with earlier ages of retirement, according to another study.

The potential disadvantages

Additional expenses: Going back to work may bring in more income, but it can also involve new expenses, including clothing, food and transportation. The additional income could conceivably bump you into a higher tax bracket, as well, which is one reason both Rob and Robert suggest consulting a financial planner and tax professional to help with the more complex tax implications of returning to work in retirement.

Potentially decreased Social Security benefits: If you’re already collecting Social Security, a greater percentage of your benefit may be taxable as a result of an additional paycheck. That’s because as your modified adjusted gross income increases above certain thresholds, a greater percentage of your benefits is subject to income tax.

There are also limits to how much you can earn without incurring a reduction to your Social Security benefits. Specifically:

- If you go back to work before reaching your so-called full retirement age (currently 66 but rising to 67 for those born in 1960 or later), $1 is deducted for every $2 you earn above the annual limit, which in 2019 is $17,640.
- If you go back to work in the year in which you reach your full retirement age, $1 in benefits is deducted for every $3 you earn above the annual limit.
- If you go back to work any year after reaching your full retirement age, your benefits are not reduced no matter how much you earn.

That said, any reduction in benefits is temporary. “Once you reach full retirement age, your Social Security benefits will revert to whatever amount you were entitled to before you went back to work—plus any benefits that were withheld—so you can recoup those funds over time,” Rob says. For more information, visit ssa.gov/planners/retire/whileworking.html.

Potentially higher Medicare premiums: Although retirees generally don’t pay premiums for Medicare Part A, which covers hospitalization, they do have to pay premiums for Part B, which covers outpatient visits. Returning to work can push those premiums up if your total annual income is above certain thresholds (see “Premium premiums,” far right).

If you already have Medicare parts A and B and your employer offers a group health plan, you need to decide whether to accept or reject the plan. The decision often comes down to your employer’s size:

...
Reducing Risk

Your game plan for playing defense in turbulent times.

ILLUSTRATIONS BY BEN KIRCHNER
REDUCING RISK

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ometimes it takes a stock market drop to get you thinking about how to better protect their downside.

Case in point: the market correction at the end of last year, which resulted in the first negative full-year return for the S&P 500 Index in a decade. “People who kept their stock allocations unchanged may have inadvertently taken on more risk than they realized as the stock market climbed year after year,” says Anthony Davidek, CIMA®, vice president and alternative beta and asset allocation strategist at the Schwab Center for Financial Research. “In fact, if you weren’t regularly rebalancing, you may have found out the hard way that you were overexposed to equities at the expense of other asset classes.”

With many analysts forecasting a slowdown in the global economy, now may be the time to rebalance your portfolio—and to reexamine your investing strat­egy through the lens of your current risk appetite and time horizon. Here are some basics to keep in mind about playing defense, along with specific tactics for managing risk during turbulent times.

1. Re-assess

Before you make any adjustments to your holdings, make sure your financial plan is up to date:

○ Does your portfolio mix still match your risk tolerance?
○ Does your risk tolerance still match your goals?

A spike in volatility can remind investors why it’s often the hard way that you were overexposed to equities at a time horizon. Here are some basics to keep in mind about playing defense, along with specific tactics for managing risk during turbulent times.

2. Rebalance

Your portfolio should match your appetite for risk. If the recent stock market volatility made you want to jump ship, you may consider revisiting your allocation. Equally important, you want to make sure your intended asset allocation matches your actual one. If it doesn’t, consider rebalancing by selling overweight positions and buying underweight ones.

When you fail to reconstitute as stocks climb, your equity allocation can become an ever-larger part of your portfolio. A portfolio that began in 2009 with 60% equities and 40% fixed income, for example, would have shifted to roughly 79% equities and 21% fixed income 10 years later, if left unchecked. That means not only less diversification but also greater risk and volatility,” Anthony says, “all without the investor ever consciously changing strategy.”

3. Remain calm

By all means, reassess and rebalance, but don’t forget to stay calm while doing so. “That head-for-the-exits feeling is just— it’s panic,” says Anthony. If such feelings are familiar, you may be the kind of investor who would benefit from a more conservative portfolio—as part of your long-term strategy, not as a response to a market upset.

“It’s not about timing the market; it’s about time in the market,” Anthony says. “In fact, our research shows that even bad market timing beats sitting on the sidelines” (see “Get in, stay in,” right).

Moves you can make

If, after reassessing your plan and rebalancing your portfolio, you want to take an even more defensive stance, there are other minor adjustments you might make. Particularly, you could bump up your holdings of less-risky asset classes and trim your long-term allocation to riskier ones, for example:

Consider more

○ Cash: Anthony keeps at least 5% of his portfolio in cash for the diversification benefit, even when markets are climbing steadily. “Generally speaking, your upside with cash is capped, but it retains its value in the face of even the steepest market declines,” he says. That said, the three-month Treasury bill, a form of cash investment, delivered better returns in 2018 than both 10-year Treasuries and the S&P 500 Index.

○ Consumer staples, health care and utilities: When the economy slows, companies that sell products most people need regardless of the state of the economy—think food, prescription drugs and other household necessities—tend to lose less value than those that produce nonessential products. “Even if you cut back during tough times, you’re still going to need laundry detergent,” says Brad Sorenson, managing director of market and sector analysis at the Schwab Center for Financial Research. Owning these and other so-called defensive stocks can be a good way to potentially capture at least some of the market’s gains while remaining relatively protected from its bigger swings.

○ Gold: The precious metal has a history of holding its value—and even rising—when other asset classes are under pressure. In fact, it was one of the few investments with positive returns during the worst days of the 2008 market crash. Keep an eye on the stock from time to time, while that gold and other precious metals can shine when market conditions are uncertain, their prices can be volatile.

○ Treasuries: Backed by the full faith and credit of the U.S. government, these are the safest fixed income investments you can own. Short-term Treasuries (which mature in a year or less) and intermediate-term Treasuries (which mature in less than 10 years) can provide decent income with low risk. Longer-term Treasuries may offer even more income, though their prices may decline a bit if interest rates continue to rise.

○ Corporates and high-yield debt: “The value of outstanding debt owed by businesses outside the financial sector has nearly doubled over the past decade, to a record $9.8 trillion,” as companies capitalized on historically low interest rates—raising concerns of a potential bubble (see “Cracks in Corporate Debt?” on page 16).

4. Reexamine your investing strategy

With many analysts forecasting a slowdown in the global economy, now may be the time to reexamine your investing strategy.

5. Reassess your financial plan

Make sure your financial plan is up to date:

○ Before you make any adjustments to your holdings, make sure your financial plan is up to date:

○ Does your portfolio mix still match your risk tolerance?
○ Does your risk tolerance still match your goals?

6. Reassess your financial plan

Investor who would benefit from a more conservative strategy through the lens of your current risk appetite and time horizon.

7. Reassess your financial plan

Consider less

○ Corporate and high-yield debt: The value of outstanding debt owed by businesses outside the financial sector has nearly doubled over the past decade, to a record $9.8 trillion,” as companies capitalized on historically low interest rates—raising concerns of a potential bubble (see “Cracks in Corporate Debt?” on page 16).

8. Reassess your financial plan

“Emerging-market stocks: Slowing growth in develop­ ing countries has helped make some of the recent market turmoil. China, for example—the mother of all emerging markets—is growing its economy at its slowest pace in more than a decade, with ongoing trade tensions (as of publication) threatening to make matters worse.

9. Reassess your financial plan

Small-cap stocks: Publicly traded companies with a market capitalization ranging from roughly $300 million to $2 billion tend to be more volatile than their large-cap counterparts, particularly during a downturn.

10. Reassess your financial plan

Tech stocks: Large-cap technology stocks such as Apple, Alphabet and Microsoft led the market to new heights over the past decade, but when market volatility in late 2018, these stocks fell fast. Apple shares lost 31% in the fourth quarter of the year, for example, compared with a 14% drop for the S&P 500.

De-risking the right way

“There are a lot of ways to dial back the risk in your portfolio,” Anthony says. “The trick is to embrace these options in appropriate amounts.”

For example, taking a more aggressive tactical approach might be right for investors with the inclination, time and skills to watch the market closely. But if—like most investors—you’re focused on the long term, one of the best ways to play defense is to maintain an asset allocation that matches your time horizon and risk tolerance.

If you decide to add or trim exposure to certain asset classes, make sure you’re doing so in response to your needs and goals—not because of short-term mar­ ket gyrations. “The goal is to follow a strategy you can live with through the ups and downs,” Anthony says.
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• International stock funds
• Sector funds
• Taxable and tax-free† bond funds
• And more

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ETF SELECT LIST

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• International stock funds
• Taxable and tax-free‡ bond funds
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• Commodity funds
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Step 1: Evaluate your portfolio. Use the Portfolio Comparison tool (schwab.com/comparefunds) to help identify opportunities to diversify or gain exposure to other asset classes, such as large-cap U.S. stocks or tax-free‡ bonds.

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3The ETFs in this list have been identified as the lowest-cost ETFs in up to 70 asset categories; many trade commission-free online.† Categories:

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The Alerian MLP Index is a composite of the most prominent energy Master Limited Partnerships (MLPs) that provides investors with an unbiased, comprehensive benchmark for this emerging asset class.

• The Bloomberg Barclays Global Aggregate ex-USD Total Return Index is a measure of global investment grade debt from 24 local currency markets.

• The Bloomberg Barclays U.S. 7–10 Year Treasury Bond Index is a component of the U.S. Treasury Index that is designed to measure U.S. dollar-denominated, fixed-rate, nominal debt with maturities of seven to 10 years issued by the U.S. Treasury.

• The Bloomberg Barclays U.S. Aggregate Bond Index is a component of the U.S. Aggregate Bond Index that is designed to provide a broad, comprehensive measure of the U.S. investment grade fixed-rate bond market. The index covers the U.S. investment grade fixed-rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities.

• The Bloomberg Barclays U.S. Corporate Bond Index covers the U.S. dollar-denominated investment-grade, fixed-rate, taxable corporate bond market.

• The Bloomberg Barclays U.S. Corporate High-Yield Bond Index covers the U.S. dollar-denominated, non-investment-grade, fixed-rate, taxable corporate bond market. Securities are classified as high-yield if the middle rating of Moody’s, Fitch, and S&P is Ba1/BB+/BB- or below.

• The Bloomberg Barclays U.S. Credit Index measures the investment grade, U.S. dollar-denominated, fixed-rate, taxable corporate and government related bond markets. It is composed of the US Corporate Index and a non-corporate component that includes foreign agencies, sovereigns, supranationals and local authorities.

• The Bloomberg Barclays U.S. High Yield Very Liquid Index is a component of the U.S. Corporate High Yield Index that is designed to track a more liquid component of the USD-denominated, high yield, fixed-rate corporate bond market.

• The MSCI EAFE Index® is a free float-adjusted market-capitalization index that is designed to measure the equity market performance of developed markets in Europe, Australasia, and the Far East.

• The S&P 500® Index is designed to measure the performance of 500 leading publicly traded companies from a broad range of industries.

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Charles R. Schwab
Founder & Chairman

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