Ready for Anything
How to keep your financial plan on track—wherever the road may take you.
Page 30
Dear Client,

Numerous studies have shown that those who create and stick to a financial plan achieve significantly more wealth than those without a plan. Of course, any plan is only as good as the assumptions that underpin it. If those assumptions are wrong, your goals could suffer. On page 30, we examine seven incorrect assumptions investors often make—and provide tips for addressing them.

Onward aims to provide insights that help you create and sustain a healthy financial life, so elsewhere in this issue you’ll find stories on combating increasingly sophisticated phishing scams (page 6), the impact of the Tax Cuts and Jobs Act on charitable giving (page 34) and guidance for starting a business in retirement (page 38).

If you need help creating or reevaluating your financial plan, I encourage you to reach out to us at 877-297-1126. We welcome every opportunity to help you achieve your goals.

Sincerely,

Jonathan Craig
Senior Executive Vice President
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In Schwab’s new *WashingtonWise Investor™* podcast, host Mike Townsend takes a nonpartisan look at the policy and political news that matters most to markets—and expert guests share actionable investment insights. Listen and subscribe at schwab.com/washingtonwise.

Chuck Schwab reflects on Schwab Charitable’s 20th anniversary—plus, several generous donors explain how they’re using their donor-advised fund accounts to make a bigger charitable impact at schwabcharitable.org/20stories.

A flower shop and a barbecue joint have more in common than you might think. See how Schwab Bank’s loan to small-business lender Opportunity Fund creates a tangible impact for underserved communities at aboutschwab.com/our-communities.

Chuck Schwab reflects on Schwab Charitable’s 20th anniversary—plus, several generous donors explain how they’re using their donor-advised fund accounts to make a bigger charitable impact at schwabcharitable.org/20stories.

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Learning From the Best

What Chuck Schwab has taught me about business—and people.

When I assumed the responsibilities of CEO of The Charles Schwab Corporation in 2008, I knew I had some big shoes to fill. Chuck Schwab, as both a person and a leader, is a force to be reckoned with. He cares deeply about our clients, and when faced with competing business decisions, he will always choose the one that benefits investors—even if that means turning our business model on its head.

Indeed, when I asked him what I should focus on during my tenure as CEO, I expected a typical response: grow client assets, or reduce operating expenses, or get the stock price up. But Chuck isn’t your typical businessman. “Do your part to make sure Schwab is a strong, independent company 50 years from now,” he said, “because investors deserve a firm that’s on their side.”

Our team recently sat down with Chuck to talk about what it took to build and grow the company that bears his name, as well as what he thinks are the keys to becoming a successful investor. Read the interview on page 27.

If I had to distill all I’ve learned from Chuck into a single sentence, it would be this: Doing what’s best for the client is always the right business decision. It’s such a simple idea, and yet it’s ultimately what sets Chuck—and Schwab—apart.

Sincerely,

Walt Bettinger
President & CEO

See page 46 for important information.
(1119-9UHT)
Schwab Intelligent Portfolios®

Automated investing with human help when you need it.

Our robo-advisor builds, monitors, and automatically rebalances a diversified portfolio based on your goals.

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Sure-Fire Savings

Auto-enrollment in workplace retirement plans couldn’t be easier—but is it enough?

According to research from the Pew Charitable Trusts, companies that auto-enroll employees in workplace retirement plans such as 401(k)s have participation rates that exceed 90%—well above the 50% for opt-in plans. Unfortunately, many savers leave their contributions set at the default rate, which averages just 3.4% nationwide. That’s substantially lower than the
amount workers need to contribute to receive the maximum company match, which averages 5.1% nationwide.1 “And even that is about half what workers should be socking away each year to adequately fund their retirement,” says Mark Riepe, senior vice president at the Schwab Center for Financial Research.

For example, imagine someone who makes $80,000 per year, contributes 3.4% to her 401(k) and receives an equal amount from the employer’s match, and earns 6% annual returns. After 30 years, she would have saved $457,657 for retirement. Increasing her contribution rate—and therefore the employer’s match—to 5.1% would boost the total portfolio value by 50%, to $686,486.2

However, even saving enough to get the full company match might not be adequate, Mark cautions. For example, someone who expects to withdraw $40,000 in the first year of a 30-year retirement—and then increase their withdrawals annually to account for inflation—should aim to amass a portfolio of about $1 million if they want to be highly confident their money will last. “That’s why we advise saving at least 10% of your annual pay, to give you more cushion,” he says. “That may mean making small compromises now, but it will help you avoid making big compromises down the road.”

Creating a financial plan can help you determine how much you should actually be saving for retirement. Start your plan with the help of your Schwab financial consultant. Call today to schedule an appointment.

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Next-Level Phishing

How to protect against increasingly sophisticated scams.

Fraudsters are increasingly using phone calls and text messages to steal logins, passwords and other personal information, putting people’s financial accounts at risk.

“The criminals are doing their homework,” says Kara Suro, vice president of fraud surveillance and investigations at Charles Schwab. “They continue to find ways to trick people into providing information via phone or text.”

Such schemes follow a typical pattern: The scammer sends a text message to the potential victim asking if he or she made a specific purchase. If the victim responds “no,” the fraudster follows up with a phone call claiming to be from the victim’s financial institution and asks for sensitive personal information.

If you receive this kind of suspicious communication, immediately contact the financial institution in question at a known number. At Schwab, that number is 800-435-4000. You can also protect yourself by:

- Creating unique, hard-to-guess passwords—particularly for financial accounts.
- Keeping login credentials secret. Schwab will never ask for your password over the phone—nor will most other financial institutions.
- Relying on known phone numbers and websites. Don’t assume the link or phone number in an email is authentic. Instead, initiate contact using a published phone number or website, so you can be sure you’re talking with a legitimate source.
- Reporting suspicious emails. If you are unsure about an email, avoid clicking any links. And if it’s suspicious and purportedly from Schwab, forward it to phishing@schwab.com.

“Vigilance is key to not becoming a victim of financial fraud,” Kara says.
Sharing the Load

College costs can be covered by more than just your savings.

According to the College Board, the average annual cost of tuition, fees, and room and board at a four-year in-state public university for the 2018–2019 school year was $21,370—representing a 30% increase from a decade earlier. For private non-profit schools, the total was $48,510, or a 25% increase. Multiply those costs by four years, factor in inflation, and you could be looking at hundreds of thousands of dollars per child. But do you really need to save every last penny of the total cost of college? Maybe not. “Thanks to financial aid, grants and scholarships, many families don’t pay the full published price for college,” says Robert Aruldoss, a senior research analyst at the Schwab Center for Financial Research. “So don’t automatically rule out schools based on the price of admission.”

You can use the National Center for Education Statistics’ Net Price Calculator, available at nces.ed.gov/collegenavigator, to browse published prices and the net cost that families typically pay after subtracting the average amount of federal, state/local government, grant or scholarship aid from the total cost of attendance.

Then it’s time to estimate a likely combination of financial aid, savings and out-of-pocket payments that works for your family. For example, if your child’s education will cost $100,000 in total, you could aim to save roughly a third before college, cover another third using a combination of your regular income and your child’s contributions from part-time work, and fund the remaining third with a mix of loans and the like.

You can use a calculator like the one available at schwab.com/collegecalculator to determine just how much you’ll need to sock away each month in order to reach that goal. “Of course, every additional dollar you can put toward your child’s college fund today—without sacrificing your retirement savings, which should always take priority—is a dollar you or your child won’t have to borrow tomorrow,” Robert says. “But however you choose to apportion the high cost of college, tapping multiple sources can help you successfully pursue your other savings goals while still keeping your college-savings efforts on track.”

When four becomes more

What if it takes your child longer than expected to earn that undergraduate degree?

According to the National Center for Education Statistics, only 42% of students complete their undergraduate degree in four years, whereas 60% graduate by year six. But does that mean you should be saving for more than four years? Not necessarily. Sitting for Advanced Placement® or College-Level Examination Program® tests while still in high school and taking classes at a local community college are two ways to reduce the amount you might pay for higher education.

“That said, it’s always a good idea to set expectations with your child regarding how much you’re willing to help—and for how long,” Robert says.

Data is for those who began undergraduate programs in 2011.

Get a jump-start on college savings with Schwab’s 529 Savings Plan. Learn more at schwab.com/529.
Proceed With Caution

Actively managed ETFs are growing in popularity but carry risks.

At first glance, actively managed exchange-traded funds (ETFs) might seem like a contradiction. After all, most ETFs are considered passive investments because they’re designed to replicate the performance of specific market indexes rather than outperform them.

Active ETFs, on the other hand, rely on fund managers to select assets in response to changing market conditions. Broadly speaking, their goal is to deliver returns in excess of whatever index they use to benchmark their performance.

While actively managed ETFs are growing in popularity—with record inflows of $27.5 billion in 2018—they currently represent only about 2% of the $3.4 trillion U.S. ETF market. And most active ETF money is in ultra-short bond funds.

“That’s because, with short-term interest rates so low, some fixed income fund managers are assuming a bit more risk as they strive to generate additional returns,” says Michael Iachini, vice president and head of manager research at Charles Schwab Investment Advisory. Should the current bull market begin to lose strength, equity fund managers may follow suit.

But while better returns might sound appealing, there are other aspects to consider. “These funds likely will have fees that fall somewhere between those of a garden-variety index fund and those of an actively managed mutual fund,” Michael says. “And additional fees come at a cost to returns.”

Risk is another factor. “In pursuit of greater returns, active ETF managers must, by definition, take on additional risk,” Michael says, “so investors will want to take that into consideration, as well, before seeking to beat the market.”

See page 46 for important information.

Investment returns will fluctuate and are subject to market volatility, so that an investor’s shares, when redeemed or sold, may be worth more or less than their original cost. Unlike mutual funds, shares of ETFs are not individually redeemable directly with the ETF. ETF shares are bought and sold at market price, which may be higher or lower than the net asset value (NAV). Investing involves risk, including loss of principal. (1119-9P4U)
If you recently started a new job, you may not be aware of all the benefits available to you—and thus you may be leaving money on the table. “The value of these extras—including retirement-savings plans, paid time off, health insurance and other benefits—can add up to about a third of your total compensation,” says Robert Aruldoss, a senior research analyst at the Schwab Center for Financial Research.

Here are some common (and not-so-common) benefits to investigate—and how to maximize them.

1. Health care

- Carefully weigh your health care options, taking particular note of coverage, copayments and deductibles. (Cheaper monthly premiums don’t always pay off if they result in substantially higher out-of-pocket health care costs.) If your spouse or domestic partner also has health care coverage, compare the plans to ensure you’re getting the best coverage for your money. If you’re covered by a high-deductible health plan, ask whether the company offers a Health Savings Account (HSA). Contributions are federally tax-deductible; capital gains, dividends and interest accumulate tax-free; and you pay no tax on withdrawals for qualified medical expenses.
- Also see whether the company offers a tax-deductible Flexible Spending Account (FSA), which allows you to contribute up to $2,700 per year to cover certain out-of-pocket health care costs. (Generally, individuals can contribute to HSAs and FSAs simultaneously only if they are using an “HSA-compatible” FSA. When used in conjunction with an HSA, FSA funds may be limited to dental and vision expenses.)
- If your spouse or domestic partner also has health care coverage, compare the plans to ensure you’re getting the best coverage for your money. If your spouse or domestic partner also has health care coverage, compare the plans to ensure you’re getting the best coverage for your money.
- If your spouse or domestic partner also has health care coverage, compare the plans to ensure you’re getting the best coverage for your money. If your spouse or domestic partner also has health care coverage, compare the plans to ensure you’re getting the best coverage for your money.

2. Retirement

- Check whether the new company offers a 401(k) or similar workplace retirement plan—and whether there’s a company match. If so, contribute at least enough to capture the match, though you may need to kick in a lot more to reach your goals (see “Sure-Fire Savings,” page 5).
- Look into the pros and cons of rolling existing 401(k) funds into your new employer’s plan or an Individual Retirement Account at schwab.com/rolloveroptions.

3. Other benefits

- Determine if your new company offers life insurance, or whether you might be better off purchasing it independently. (To compare term and permanent life insurance, visit schwab.com/lifeinsurance.)
- If you have or plan to have children, find out whether the company offers a tax-deductible FSA for dependent care, which allows married couples filing jointly or single parents filing as heads of household to contribute up to $5,000 per year to cover child care expenses.
- Inquire about commuter benefits, such as pretax parking and transit passes.
- See whether the employer offers other potentially valuable benefits, such as adoption coverage, low-cost legal plans or tuition reimbursement—some employers even offer discounts on gym memberships and technology purchases.
- Look into any employer-offered short- and long-term disability coverage. As with life insurance, individual disability insurance may supplement or be a better fit than group coverage.

Finders, Keepers

Are you taking full advantage of your workplace benefits?

Finders, Keepers

Are you taking full advantage of your workplace benefits?

Finders, Keepers

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Skipping the Skip Tax

The generation-skipping transfer tax can reduce estates by nearly half. Here’s how to avoid it.

If your gifts or estate exceeds the federal estate tax exemption, the IRS could keep up to 40% of the excess that would otherwise go to your heirs. That’s doubly true if you give assets directly to your grandchildren—or anyone else who’s at least 37.5 years younger than you. That’s because of the so-called generation-skipping transfer tax (GSTT), which in 2019 is an additional 40%—on top of the estate tax.

Why are assets that skip a generation taxed differently? Because the IRS wants to collect its share as wealth passes from each generation to the next. So when assets are transferred directly to, say, grandchildren, the IRS imposes the GSTT to make up for the difference it would have collected had the assets passed to the children and then the grandchildren.

“In cases like this, your estate’s biggest beneficiary could end up being...
the U.S. Treasury rather than your grandchildren,” says James Madden, a Schwab wealth strategist based in Phoenix.

To be sure, the GSTT affects only the largest estates, particularly since the federal estate tax exemption was doubled in 2017. Even so, nearly 2,000 estates paid a total of $14.93 billion in federal estate taxes in 2018, according to the nonpartisan Tax Policy Center.

How much of that was because of the GSTT is anybody’s guess. But if you have a large estate and plan to leave at least part of it to your grandchildren, it pays to understand how the tax works and how trusts can be used to help minimize the tax hit.

The tax trap
According to Hayden Adams, CPA and director of tax and financial planning at the Schwab Center for Financial Research, there are several ways to transfer assets to someone without getting hit with gift, estate or generation-skipping transfer taxes:

■ Throughout your life, you can use the annual gift tax exclusion to give up to $15,000 per person (as of 2019) to as many people as you like without eating into your lifetime federal gift, estate and generation-skipping transfer tax exemption.

■ You can also make direct payments to certain education and health care providers for qualified tuition and medical expenses on behalf of someone else without affecting your lifetime federal gift, estate and generation-skipping transfer tax exemption. Your $15,000 annual gift tax exclusion.

■ As of 2019, you can gift or bequeath up to $11.4 million tax-free to the next generation—or anyone else who’s up to 37.5 years younger than you—after which the 40% gift and estate tax and 40% GSTT generally kick in.

■ Alternatively, you can give or bequeath up to $11.4 million tax-free to grandchildren—or anyone else who’s 37.5 years (or more) younger than you—aft er which the 40% gift and estate tax and 40% GSTT generally kick in.

The $11.4 million exemption is actually two separate exemptions—one for gifts and estates, the other for the GSTT—however, when you use a portion of one exemption, an equal amount is automatically subtracted from the other.

Here’s an example of how these taxes and exemptions work. Imagine you wanted to make direct gifts of $7.7 million each to your adult daughter and grandson, for a total of $15.4 million. The most tax-efficient way to do this would be to apply the GSTT exemption to the grandson’s $7.7 million gift, thereby avoiding both the 40% gift and estate tax and the 40% GSTT.

That would reduce your remaining exemption to $3.7 million, which you could use to cover a portion of your daughter’s gift. The remainder of that gift—$4 million—would then be subject to just the 40% gift and estate tax.

The GSTT may not seem like much of an issue for most estates, but the lifetime federal estate tax exemption could be cut roughly in half (adjusted for inflation) come 2026, unless Congress acts before then to extend the provision—meaning many more estates could face the GSTT at some point in the future. “Dramatic changes to tax policy are always possible, depending on the outcome of any given election, so it pays to think far into the future when creating your estate plan,” Hayden says.

The trust solution
“If you’re likely to face the GSTT, it can help to talk with a financial advisor about strategies, which can include gifting assets while alive and/or making charitable contributions in order to remain within the federal estate tax exemption,” James says.

Another potential solution is to set up a specialized trust.

One such trust is a generation-skipping trust, in which assets are subject to the estate tax only once: when they’re transferred to the trust. Any cash, investments or property must remain in the trust as long as the skipped generation is alive; however, the assets will pass tax-free to the subsequent generation once the skipped generation has passed on. In the meantime, any income generated by the trust can be enjoyed by both the skipped generation and/or the subsequent generation, depending on the terms of the trust. Such trusts can also protect against claims by creditors of the estate.

A similar trust, called a dynasty trust, functions like a generation-skipping trust, only it can be extended indefinitely to subsequent generations. As with a generation-skipping trust, the beneficiaries of a dynasty trust can enjoy the income from the trust, however, they never gain control over the assets themselves.

Setting up a generation-skipping or dynasty trust involves careful consideration. Once a grantor transfers assets to the trust, for example, he or she no longer controls them, and it’s irrevocable, meaning the grantor can’t claw the assets back once they have been placed in the trust. This can become an issue should a recession or other setback eat into the funds needed to maintain the grantor’s retirement.

Be that as it may, generation-skipping and dynasty trusts can help estate holders avoid being taxed more than once as assets pass from generation to generation.
many clients I work with appreciate having equity as part of their compensation packages. In fact, a recent Schwab survey found that more than a third of employees say it’s a big part of why they took their jobs.1

When managed effectively, stock options can be a great tool for building long-term wealth. However, there’s often confusion regarding how stock options work and whether it makes sense to keep or sell the underlying shares.

Here are answers to the three most common questions I get about employer stock options.

1. Should I keep or sell my shares?

First, determine whether your employer’s stock complements your investment strategy. As with any prospective stock, you should research the fundamentals to understand its long-term potential and risk characteristics.

If you exercise your options and keep the stock, presumably it’s because you believe it will rise; needless to say, that’s not always the case. To help ensure you’re not overexposed, you may want to limit your employer’s stock to no more than 20% of your overall portfolio.

There’s also another kind of overexposure to consider: If your employer gets into financial trouble, you could end up losing money on the stock and losing your job. If that level of exposure makes you uncomfortable, it may make more sense to sell your eligible shares.

That said, there are circumstances under which you may need to hold on to an inordinately large amount of your employer’s stock. Some companies impose holding requirements, for example, or you may have trading windows that limit your ability to sell. Conversely, some employees like having larger allocations to their employer’s stock because they like having skin in the game and are confident of their company’s prospects. Whatever your reason, make sure to consider the risk to your overall investment strategy.

2. What are my stock options worth—and how do I capture their value?

Stock options allow you to buy stock at a specific price during a certain time period. The value lies in the spread—the difference between the exercise price and the market price.
For example, say you have 2,000 options with an exercise price of $40 and a market price of $50. Your potential profit is $20,000 (the $10 spread times 2,000 options)—and you commonly have three choices when it comes to realizing their value:

**A. Exercise and hold:** In the example above, you’d buy the stock and hold it, spending $80,000 up front for $100,000 in stock, after which the entire amount would be subject to changes in market value (see table).

**B. Exercise and sell:** This is the opposite scenario—you’d buy the stock and immediately sell it. (Some companies permit a cashless exercise, in which employee stock options are exercised without making any cash payment using a broker-assisted short-term loan.) Based on the numbers above, you’d realize $20,000 in profit, minus taxes and transaction costs (see table).

**C. Sell to cover:** In this middle ground, you’d buy all the stock and sell just enough of it to cover what you spent ($80,000), plus taxes and transaction costs. In other words, instead of realizing your $20,000 profit in cash, you’d realize it in stock (see table).

**How are stock options taxed?**

Employees are generally granted one of two types of options—incentive stock options (ISOs) or nonqualified stock options (NSOs)—and the main difference lies in how the spread is taxed. We’ll focus on federal taxes here, but applicable state taxes should also be a consideration.

With ISOs, you are not typically taxed when you exercise your options, but the spread will always be taxed when you sell your shares. If you hold the shares for more than one year past the exercise date and more than two years past the original grant date, the sale of the stock becomes a so-called qualifying disposition and any realized profit is typically taxed at the long-term capital gains rate. If you sell earlier, the spread will be taxed at your ordinary income rate, which for high earners can be as much as 37% at the federal level.

With NSOs, on the other hand, the spread is taxed as ordinary income in the year in which you exercise the options—even when you hold on to the shares—and companies usually withhold some of the proceeds to help pay applicable Medicare, Social Security and other taxes.

Unfortunately, the typical withholding rate is often too low, especially for high earners. Therefore, the smart move is often to pay estimated taxes or set aside additional money to cover any gap between the federal withholding rate and your estimated liability.

Work with a qualified tax advisor for greater clarity.

On the surface, ISOs might seem like they offer employees more favorable tax treatment, but they come with a hidden risk: Regardless of when you sell, the spread will count as taxable income when calculating the alternative minimum tax (AMT) in the year you exercise your options, which could result in a larger overall income tax liability. Calculating your AMT is tricky, so be sure to consult an accountant or tax advisor before exercising your ISOs.

**Do your homework**

Equity compensation is an opportunity for you to participate in the future of the company you work for. It can also be a great way to get into the market—so long as you understand the tax ramifications of exercising your options and the effect the shares could have on your overall investment strategy. When in doubt, consult a financial advisor before making any decisions.

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*Does not reflect fees or taxes. Unrealized profit is the difference between the exercise price and the current market value of any unsold shares. Some companies may not allow “sell to cover,” but rather allow tendering shares back to cover the cost (often called “net exercise”). The example is hypothetical and provided for illustrative purposes only.

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**Table:**

<table>
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<th>Number of shares exercised</th>
<th>Purchase price per share</th>
<th>Number of shares sold</th>
<th>Market price per share</th>
<th>Out-of-pocket cost</th>
<th>Realized/unrealized profit*</th>
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<td>2,000</td>
<td>$40</td>
<td>0</td>
<td>$50</td>
<td>$80,000</td>
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<tr>
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<td>2,000</td>
<td>$40</td>
<td>2,000</td>
<td>$50</td>
<td>$0</td>
</tr>
<tr>
<td><strong>C. Sell to cover</strong></td>
<td>2,000</td>
<td>$40</td>
<td>1,600</td>
<td>$50</td>
<td>$0</td>
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*The September 2017 survey, conducted by Koski Research for Schwab Stock Plan Services, is based on interviews with respondents 25–70 years old who participated in their employer’s equity compensation plan. Koski Research is neither affiliated with, nor employed by, Schwab Stock Plan Services.

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See page 46 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. (1119-9VY)

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**LET’S TALK**

Your Schwab financial consultant can help you think through the details of exercising your employer stock options. Call today to schedule an appointment.
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Barron’s ranked American Funds the #1 fund family of 2018.
Based on relative performance of 57 fund families across a range of categories for the one year ended 12/31/18.*

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* Returns are calculated before any 12b-1 fees, fund loads or sales loads are deducted. Each fund’s performance is measured against all of the other funds in its Lipper category. The result is then weighted by asset size, relative to the fund family’s other assets in its general classification. To qualify for the ranking, firms must offer at least three mutual funds or actively managed exchange-traded funds in Lipper’s general U.S. stock category, one in world equity, one in mixed asset (such as a balanced fund or target date fund), two taxable bond funds and one national tax-exempt bond fund. All funds must have a minimum track record of one year. As of last year, the ranking excludes index funds, but does include actively managed ETFs and “smart-beta” ETFs — which are run passively but built on active investment strategies. Of the 869 asset managers in Lipper’s database, 57 met this criteria. In the Barron’s ranking of the best fund families over five and 10 years for the period ended 12/31/18, American Funds ranked 6th and 17th of 55 and 49 fund families, respectively. Past results are no guarantee of results in future periods. For more details, visit http://webreprints.djreprints.com/55985.pdf.
The Case for Actively Managed Bond Funds

Why their higher fees can sometimes be worth it.

By Colin Martin

When you’re looking to invest in a bond fund, cost is probably top of mind. Indeed, that’s often what attracts fixed income investors to bond index funds, which tend to be much less expensive than actively managed funds.

However, when it comes to the mainstream U.S. bond market—to say nothing of riskier emerging-market and high-yield issues—having a manager handpick a fund’s portfolio can make sense.

Here are three reasons why actively managed bond funds may be worth the extra fees.

Flexibility

Many of the biggest and most popular U.S. bond funds track the performance of the Bloomberg Barclays U.S. Aggregate Bond Index. But recent market changes have eroded some of the benefits of this broad benchmark, including:

- **Treasury overload:** Due largely to the flood of federal bonds issued in the wake of the 2008–2009 financial crisis, the index has a significantly higher allocation to Treasuries than it did a decade ago. In 2007, U.S. Treasuries represented just 22% of the index’s holdings. In 2018, that number jumped to 59%.

- **Corporate bond weight:** In the index, corporate bonds are few and far between—just 5% of the index’s holdings are corporate bonds as of year-end 2018. Non-dollar-denominated bonds, a common feature of emerging market bond funds, are not included.

Given today’s anemic Treasury yields, such overexposure can come at a cost to investors in such funds.

Expertise

When you invest in a bond index fund, the rules of the index dictate which bonds are included. An active fund manager, on the other hand, can use her or his expertise to select the bond that best fits the fund’s stated goals or offers the most attractive yields at a given moment.

This matters because a single issuer could have dozens—if not hundreds—of different bonds available in the market. Consider General Electric Company (GE). While there are only a handful of GE bonds available to trade, there are more than 200 varieties of GE bonds, with coupons ranging from as little as 2% to more than 7% and maturities ranging from a few months to more than a decade. What’s more, some are highly liquid, while others rarely trade. An active manager can sift through all available options to find the ideal holding.

Returns

Although actively managed bond funds typically command higher fees than passively managed bond index funds, there are three categories of bond funds tracked by Morningstar—intermediate-term, corporate and high-yield—that hold the promise of positive returns for the difference in fees, according to Morningstar (see “Active beats passive,” above). In other words, sometimes you really do get what you pay for.

Active beats passive

<table>
<thead>
<tr>
<th>Time frame</th>
<th>Asset-weighted net returns</th>
</tr>
</thead>
<tbody>
<tr>
<td>3 years</td>
<td>2.5% 2.0%</td>
</tr>
<tr>
<td>5 years</td>
<td>2.6% 2.4%</td>
</tr>
<tr>
<td>10 years</td>
<td>4.6% 3.4%</td>
</tr>
</tbody>
</table>

Source: Morningstar. Returns are net of fees. Past performance is no guarantee of future results.

Know your fund

Credit quality and duration can impact the appeal of a bond fund. Here’s how you can research both by yourself.

- **Credit quality:** To find information about the average credit quality of a fund’s holdings, log in to schwab.com/research, search for its ticker symbol, click the Portfolio tab and then scroll down to the Credit Ratings section. Given the deteriorating trend in the credit ratings of corporate bonds, it’s worth making sure the rating of a given investment matches your risk tolerance.

- **Duration:** Check the average duration of a given fund under the same Portfolio tab; it’ll be listed under Fixed Income Statistics at the bottom. All things being equal, you should select a fund whose average duration matches your investing time horizon.

See page 46 for important information. Fixed income securities 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 of underlying securities, default, liquidity, prepayment, early redemption, corporate events, tax ramifications and other factors. Lower rated securities are subject to greater credit risk, default risk, and liquidity risk. [1119-9WKG]
Hidden ETF Fees

When “low cost” could be higher than you think.

By Emily Doak

There’s little debate that exchange-traded funds (ETFs) have democratized investing. In addition to offering access to previously hard-to-reach parts of the market (think commodities and precious metals), ETFs have helped drive down investing costs in many areas of the market.

However, even relatively low fees and expenses can add up over time. So here are three costs to consider when investing in ETFs, and how to keep them to a minimum.

Commissions

When you buy and sell ETFs, your brokerage company may charge a trading commission, which covers the costs associated with executing and clearing a trade. Some brokerage firms offer commission-free trades on certain ETFs, while Schwab offers them on all ETFs. But if you’re paying a commission to trade ETFs, there are a few things to know:

- The more often you trade, the more you’ll pay in total commissions.
- Most firms charge a flat fee, so the percentage cost will be larger for smaller trades than for larger ones.
- If you’re buying in person or over the phone, you’re likely to pay a higher commission than if you trade online.

Commissions are important for everyone to consider. But because commissions will play a more significant role in your total cost of ownership if you trade frequently or in small dollar amounts, active traders, in particular, should pay attention to the cumulative cost of commissions.

Expense ratios

The expense ratio is the annual rate a fund charges to cover its operating costs. Fund managers collect a small portion of the total annual expense from the ETF each day. As a result, the longer you invest in a fund, the higher the cumulative cost of this fee will be.

Also, be sure you understand the difference between an ETF’s net expense ratio and its gross expense ratio. The former is what shareholders pay as a result of the temporary fee waivers some ETF managers have introduced to attract new investors. The latter is what shareholders pay if and when those waivers expire. So, if you see a fee waiver in the prospectus, look for the expiration date and know that the fund could have paid you more in the future.

Bid/ask spread

When you research ETFs, it’s easy to overlook the bid/ask spread, which is the difference between the market price at which a market maker is willing to buy an ETF (the bid) and the price at which the market maker is willing to sell it (the ask). It’s not a fee, per se, but rather a cost of investing.

Bid/ask spreads are often a reflection of an ETF’s liquidity. Popular, highly liquid ETFs, such as those that track the S&P 500® Index, tend to have very small bid/ask spreads. That’s because there’s enough demand for both the ETF and the underlying securities it holds that the market maker assumes little risk in facilitating transactions.

But with less-liquid ETFs—ones that access niche areas of the market, for example—market makers may have a harder time finding buyers and sellers, which increases their risk of facilitating a trade. To make up for this risk, the market maker charges you a higher ask when you buy the ETF and offers a lower bid when you’re ready to sell it, effectively eating into your potential profit. The more frequently you trade and the larger the spread on each transaction, the more relevant this cost becomes.

Greater transparency

Despite the fact that fund fees have plummeted over the past two decades, it still pays to do your homework. Spending a few extra minutes to evaluate the true cost of an ETF can help you make sure that headline fee you’re paying isn’t too good to be true.
Are your international investments missing something?

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**Grin and Bear It**

**Market downturns are inevitable. Your response is not.**

Why are bear markets so difficult to stomach? Because the pain investors feel from a loss is roughly twice as powerful as the pleasure they receive from an equivalent gain— which can lead to panic selling and locking in losses on investments that otherwise might have recovered.

To help you keep your cool in the heat of the moment, here are three do’s and three don’ts to consider before, during and after the next bear market.

**NEXT STEPS**

Is your portfolio prepared to weather a downturn? Call 888-486-5340 to discuss your investment strategy with a Schwab investment professional.

See page 46 for important information. All examples herein are hypothetical and provided for illustrative purposes only (1119-9UCN).

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**THE BIG PICTURE**

**Do: Rebalance**

A portfolio that drifted from 50% stocks and 50% bonds to 60% stocks and 40% bonds over the five years leading up to the Great Recession would have lost less if it had been rebalanced regularly.

![Portfolio rebalancing chart](chart)

**Annualized returns**

<table>
<thead>
<tr>
<th>Average stock mutual fund</th>
<th>Average stock mutual fund</th>
</tr>
</thead>
<tbody>
<tr>
<td>6.6% 5-year</td>
<td>7.5% 10-year</td>
</tr>
<tr>
<td>11.6%</td>
<td>12.6%</td>
</tr>
</tbody>
</table>

**Don’t: Panic**

By repeatedly buying and selling—as opposed to remaining invested in good times and bad—the average stock mutual fund investor consistently underperformed the average stock mutual fund over the past 10 years.

**Do: Ignore the noise**

Despite five major market disruptions between 1997 and 2017, the diversified portfolio of a steadfast investor would have more than tripled in size.

**Do: Stick to your plan**

In a study of Americans over 50, those who created and maintained a financial plan achieved an average total net worth three times higher than those who didn’t.

**Don’t: Miss the boat**

The early days of a recovery often see the greatest gains. And the longer you sit it out, the further behind you may find yourself.

<table>
<thead>
<tr>
<th>2002</th>
<th>2007</th>
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<tbody>
<tr>
<td>50%</td>
<td>60%</td>
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<tr>
<td>50%</td>
<td>40%</td>
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<tr>
<td>Stocks</td>
<td>Bonds</td>
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</table>

**Cumulative returns**

<table>
<thead>
<tr>
<th>Stayed fully invested through bear market</th>
<th>Moved into cash for 1 month</th>
<th>Moved into cash for 3 months</th>
<th>Moved into cash for 6 months</th>
</tr>
</thead>
<tbody>
<tr>
<td>70%</td>
<td>46%</td>
<td>29%</td>
<td>20%</td>
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<tr>
<td>85%</td>
<td>46%</td>
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<tr>
<td>4%</td>
<td>50%</td>
<td>50%</td>
<td>50%</td>
</tr>
<tr>
<td>13%</td>
<td>42%</td>
<td>42%</td>
<td>42%</td>
</tr>
</tbody>
</table>

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**Daniel Kahneman and Amos Tversky, “Prospect Theory: An Analysis of Decision Under Risk,” Econometrica, 03/1979 | Schwab Center for Financial Research and Morningstar. The example is hypothetical and provided for illustrative purposes only. The portfolio was composed of 50% stocks and 50% bonds from 12/31/2002 and was not rebalanced through 12/31/2007. Stocks performance represented by the S&P 500 Index and bond performance represented by the Bloomberg Barclays U.S. Aggregate Bond Index. Returns assume reinvestment of dividends and interest. Indices are unmanaged, do not incur management fees, taxes, costs and expenses, and cannot be invested directly. A portfolio cannot ensure a profit or protect against a loss in any given market environment. Rebalancing may cause investors to incur transaction costs and, when rebalancing a nonretirement account, taxable events may be created that may affect your tax liability | Schwab Center for Financial Research and Morningstar. Fund return is the average time-weighted return of all active funds in the Morningstar domestic equity, international and global ex-U.S. equity categories. For the period ending 12/2017, the S&P 500® Index is represented by the S&P 500 Index; 15% small-cap stocks (Russell 2000® Index); 10% large-cap stocks (S&P 500 Index); 5% REITs (S&P SmallCap 6000 Index); 10% international stocks (MSCI EAFE Index [adjusted for taxes]); 5% bonds (Bloomberg Barclays US Aggregate Bond Index) and 5% cash (Bloomberg US Treasury Bills 3-Month). Only funds with the fund return and the investor return are included in the analysis. | Schwab Center for Financial Research and Morningstar. The chart illustrates the growth of a $100,000 portfolio invested in 35% large-cap stocks (S&P 500 Index), 10% small-cap stocks (Russell 2000® Index), 5% international stocks (MSCI EAFE Index [adjusted for taxes]), 35% bonds (Bloomberg Barclays US Aggregate Bond Index) and 5% cash (Bloomberg US Treasury Bills 3-Month). The portfolio was composed for illustrative purposes only. The chart is hypothetical and provided for illustrative purposes only. The historical performance of the S&P 500 Total Return Index, and bond performance represented by the Barclays US Aggregate Bond Index. Returns assume reinvestment of dividends and interest, and reflect the average return on all dollars invested based on active asset allocation strategies that do not ensure a profit and cannot protect against losses in a declining market | Schwab Center for Financial Research. Data from 12/31/2007 through 12/31/2017 | Vanguard Group, Inc. "Financial Literacy and Planning: Implications for Retirement Wellbeing," p. 7, National Bureau of Economic Research, 03/2011. All rights reserved. | Schwab Center for Financial Research and Morningstar. Data analyses the five periods from 01/1970 through 12/2017 during which the S&P 500 Index fell 25% or more. Market returns are represented by the S&P 500 Total Return Index, and bond returns are represented by the Barclays US Aggregate Bond Index. The circles illustrate the total returns of the S&P 500 and 30-Day Treasury Bill Index. Cumulative returns are calculated using the simple average of returns from each period and scenario. The historical performance of the charts shown herein is no guarantee of future results.
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¹ Investment professionals as of 12/31/18.

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Bollinger basics

Bollinger Bands consist of three elements:

- **The central band** is formed by a stock’s moving average—measured over a period of hours or days. (I typically rely on a 20-day moving average.)¹
- **The upper band** is commonly set two standard deviations above the moving average.
- **The lower band** is commonly set two standard deviations below the moving average.

The upper and lower bands together generally contain around 90% of the price action, which is what makes a move outside the bands significant.

When the bands are relatively horizontal and the stock’s price repeatedly tags the upper band, technical analysts may take that as a sign the stock is overbought and therefore ripe for a reversal. Conversely, when the stock bumps along the lower band, it could be a sign the stock is oversold and poised to move higher.

However, some traders make the mistake of treating any contact with either the lower or upper bands as a trigger, when in fact the price will often “walk” the band, without a clear indication of precisely when to act. Therefore, traders would be wise to look for one of the following three signals.

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1. H ave you ever gotten burned when a winning trade suddenly reversed course? The technical-analysis tool known as Bollinger Bands can help you evaluate short-term price movements. Here’s how the bands function—and three ways to put them to work.

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Band Aids

**How Bollinger Bands® can help predict a stock’s next move.** By Lee Bohl

---

THE UPPER BAND

THE CENTRAL BAND

THE LOWER BAND
1 The Squeeze

When the gap between the outside bands narrows significantly—seemingly squeezing the price—it signals low volatility (see “Trading a squeeze,” far right).

If this persists for an extended period of time, it sets the stage for an increase in volatility and a decisive price move in either direction.

In that event, I set a buy order just above the upper band and a sell-short order just below the lower band, so I’m taking a position whichever way the price moves. Once I’m in the trade, I also use stop orders to help manage my risk, usually just over or under the opposite band. You could also use a trailing-stop order, which will adjust the stop price up or down once your predetermined percentage or point change occurs. If the stock changes direction, the stop price will freeze at its new level—and if the stock then hits the new stop price, it becomes a market order.2

Before you trade the squeeze, though, be sure it’s persisted for a reasonable amount of time. If you’re using a 20-day moving average, for example, you’ll want to see the squeeze hold up for at least four weeks. Otherwise, there might not be enough pent-up volatility to lead to a decisive price move.

Also, check to see if there is any news that could explain the squeeze, such as a company being acquired. In such cases, the stock could be range-bound for months pending the completion of the deal, and thus your time might be better spent on more immediately actionable trades.

2 The Double Bottom

The classic double-bottom pattern resembles a W, because the stock sells off to a low, rallies, then tests the previous low before rising to a new short-term high (see “Trading a double bottom,” left). While double bottoms typically occur at the end of a downtrend and signal the beginning of a potential uptrend, they’re hard to identify as they’re happening—unless you use Bollinger Bands, which can help identify double bottoms in real time by charting where the two lows reside relative to the lower band.

If the first low touches or dips below the lower band and the second low is above the lower band, it could signal a good time to buy—but consider having an exit strategy in place, such as a stop order placed below the W’s bottom.

3 The Breakout

When a stock breaks higher, the upper band may increase too since price and volatility are both increasing. The lower band moves in the opposite direction—again, because volatility is expanding—and will continue to do so as long as there is strong momentum behind the breakout (see “Trading a breakout,” far right).

When the momentum starts to wane, the lower band will turn back up. It doesn’t mean the stock will reverse, but it does create some uncertainty. At that point, I tend to take some initial profit and let the rest ride to capture any continued growth. However, I’ll also initiate a trailing stop under the current price to close out my position if it turns lower.

These three signals are just a few of the ways Bollinger Bands can be used to inform your trading, so be sure to investigate additional ways to use this and other trading strategies to your advantage (see “Subscribe,” left).
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<table>
<thead>
<tr>
<th>Interest Rate Discount</th>
<th>Qualifying Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>1/4%</td>
<td>$250k - $999k</td>
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<tr>
<td>1/2%</td>
<td>$1M - $4.9M</td>
</tr>
<tr>
<td>3/4%</td>
<td>$5M+</td>
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</tbody>
</table>

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Q+A

Living Your Best Financial Life

Founder and Chairman Charles R. Schwab on creating a sustainable financial future.
By capitalizing on the changing investing landscape, Charles Schwab turned the then-unheard-of idea of cutting costs for Main Street investors into a brokerage with $3.7 trillion in assets under management today.1

Onward recently sat down with Chuck to discuss his new book, Invested: Changing Forever the Way Americans Invest. In a wide-ranging conversation at his office in San Francisco, he elaborated on his secrets to success, the power of equities and the ongoing evolution of the company that bears his name.

Why did you write the book and what do you hope readers take away from it?

I thought it was necessary to record our history through my eyes. The book provides a 40-year portrait of how we operated, how it developed and what our purpose is as a company. I hope the book will explain the foundation for what our company is today—and also what it will look at in the future.

Early on, our firm was much more transactional. There were everyday people who wanted to make their own investment decisions outside the conflicted brokerage business, and we facilitated easy, inexpensive transactions.

Today, we are much more about our clients’ total financial life. We’re trying to forge a long-term relationship and commitment because, frankly, your financial life starts when you’re very young, and as you grow older, your needs change. We want to be there for every step of that process.

In your book you write about what it takes to be a successful investor. What are some of the key principles of investing you need to understand in order to find success?

I think one big thing is having an actionable and dynamic plan that reflects your unique circumstances, and that changes over time as your financial life evolves. It’s not much of a secret: consistency and diversification.

The most successful investors don’t try to predict the market’s ups and downs. Instead, they save and invest regularly through good and bad times, because they know stocks tend to rise over extended periods.

And you want to make sure you have a diversified portfolio so that you don’t end up putting all your money into, say, a hamburger chain, only to find that somebody else comes along and makes a better hamburger.

If you need more proof of the value of diversification, just look at market stocks, which outperformed all other major asset classes in 2017—but came in dead last in 2018.2 Because it’s rare that the same asset class will generate the best returns year after year, I believe in spreading your investments across a range of asset classes. It’s like a financial shock absorber. It helps dampen the impact of any one investment on your overall portfolio.

Finally, you want to make sure you’re in for the long term. That’s important because there are all kinds of things that work against you: you’re constantly buying in and out of companies—from poor market timing to taxes and transaction costs. Time in the market is more important than timing the market.

Where would you recommend investors put their hard-earned savings?

I’m a big believer in stock investing. Companies are made to grow. I’ve been on several boards of directors, and investing’s management has ever come before a board and said, “We don’t have a plan to grow.” That’s a fundamental thing, but it’s often overlooked.

But when you have companies giving a chance to be a part of that growth. So, unless you need all your money in the very near future, the question isn’t whether to own stocks; the question is which stocks to own and in what proportion. And that’s a different conversation altogether. Even seasoned professionals have a difficult time picking the right stocks repeatedly. That’s what makes index mutual funds and exchange-traded funds so appealing. They offer a mix of investments and often have very low management fees. And unlike actively managed funds, whose individual managers’ stock picking skills can make or break returns, index funds track established benchmarks such as the S&P 500® Index or the Schwab 1000 Index®.

What would you say is the best way to deal with turbulent times?

Crashes are always hard to stomach, but it’s important to remember that they don’t last forever. If you look back, even the most bearish markets have eventually turned into bulls. Just think of the 2008 crisis: U.S. stocks fell more than 40% in a matter of months, and some days it felt like the bottom would never arrive. But of course it did. Had investors in a fund that tracked the S&P 500® simply remained invested, their portfolios would have regained all that lost ground in about three years.

So look at the market. The S&P 500 has grown something like 140% since the start of the financial crisis.3 Every market cycle is unique, but I believe the best course of action is to stay focused on the long term and remain invested even when markets get rough.

How do you see Schwab evolving as it approaches its 50th year in business?

We’ve always been dedicated to making investing accessible to everyone. How do you Own Your Stockbroker, back in 1984, at a time when trustworthy investment guidance was difficult to come by and self-directed investing was considered a novelty? Since then, we’ve created the Schwab Center for Financial Research, whose experts write many of the articles you see in this magazine; launched Schwab Equity Ratings® to provide an independent analysis of stocks; and introduced dozens of investment solutions and online tools in an effort to provide transparent guidance and education. The Schwab 1000 Index is a float-adjusted market capitalization weighted index that includes the 1,000 largest stocks of publicly traded companies in the United States, with size being determined by market capitalization (total market value of all shares outstanding). Schwab will modify the index as necessary to account for stock splits, spinoffs or bankruptcy filings (made because of a company’s inability to continue operating as a going concern). As a result of corporate actions, the index may comprise more or less than 1,000 securities. Schwab may also change the Schwab 1000 Index inclusion criteria if it determines that doing so would cause the index to be more representative of the domestic equity market. • The Schwab 1000 Index is the property of Charles Schwab & Co., Inc. (Schwab). The Schwab 1000 Index is a float-adjusted market capitalization weighted index that includes the 1,000 largest stocks of publicly traded companies in the United States, with size being determined by market capitalization (total market value of all shares outstanding). Schwab will modify the index as necessary to account for stock splits, spinoffs or bankruptcy filings (made because of a company’s inability to continue operating as a going concern). As a result of corporate actions, the index may comprise more or less than 1,000 securities. Schwab may also change the Schwab 1000 Index inclusion criteria if it determines that doing so would cause the index to be more representative of the domestic equity market. • The Schwab 1000 Index is the property of Charles Schwab & Co., Inc. (Schwab). The Schwab 1000 Index is a float-adjusted market capitalization weighted index that includes the 1,000 largest stocks of publicly traded companies in the United States, with size being determined by market capitalization (total market value of all shares outstanding). Schwab will modify the index as necessary to account for stock splits, spinoffs or bankruptcy filings (made because of a company’s inability to continue operating as a going concern). As a result of corporate actions, the index may comprise more or less than 1,000 securities. Schwab may also change the Schwab 1000 Index inclusion criteria if it determines that doing so would cause the index to be more representative of the domestic equity market.
Financial Fault Lines

Seven faulty assumptions that could derail your savings goals—and how to avoid them.
Even the most disciplined planners can face unexpected hurdles. Your career takes a turn for the worse or your child’s education is costlier than you’d expected and, just like that, your savings goals can be in jeopardy. “People often operate under the presumption of control,” says David Jamison, a CERTIFIED FINANCIAL PLANNER® professional with Schwab Intelligent Services. “Unfortunately, failing to expect the unexpected can leave you far short of your desires.” Here, then, is the reality behind seven assumptions savers often make—and solutions that can help keep you from being caught short.

Goal: Retirement

Assumption 1: My expenses will be lower in retirement.

→ Reality check: “Many retirees find they spend just as much money in retirement as they did while they were employed and were still working. Plus, most want to travel and pursue other passions, and those things cost money,” David says. You’ll also need to account for unexpected expenses and other costs, such as health care, not all of which will be covered by Medicare (see Assumption 2, below). What’s more, average life expectancy in the U.S. increased by roughly eight years between 1970 and 2017, so your money may simply need to last longer than that of previous generations.

→ Course correction: When estimating your retirement savings goal, assume your current expenses will remain the same, minus the amount you’re saving annually toward retirement. From there you can calculate your target portfolio size, as well as how much you’ll need to save each year in order to reach your goal. Also tally up any surprise expenses from the past several years and incorporate into your annual average into your final projection.

Finally, factor in inflation and life expectancy. (You can run the numbers using an online calculator like the one at schwab.com/retirementcalculator) If any of the outcomes give you pause, consider revisiting your savings rate or strategizing now on potential cutbacks.

Assumption 2: Medicare will cover my health care costs.

→ Reality check: Medicare doesn’t cover many of the health care expenses retirees will encounter, including most dental, vision and hearing care. Perhaps more important, you have to pay out of pocket for any long-term care, unless you obtain supplemental insurance. “The gap is real and potentially—hence their ability to afford backup planning—has already cost many of our clients,” says Matthew Besich. 

→ Course correction: Review what’s covered at medicare.gov and estimate what your annual out-of-pocket health care liability might be. Also consider contributing to a health savings account (HSA), if your employer offers one. Contributions to HSAs are tax-deductible, their assets typically grow tax-free, and withdrawals are tax-free, too, so long as they’re used for qualified medical expenses.

You may want to investigate long-term care insurance options—not only since the number of Americans needing long-term services and support is expected to nearly triple, from 10 million in 2010 to 27 million by 2050.1

Assumption 3: I’ll be able to work as long as I want or need to.

→ Reality check: Nearly 8 million older Americans are in search of work or stuck in low-quality jobs, according to a 2018 analysis by The Wall Street Journal.

→ Course correction: Rerun your savings projections assuming early retirement and/or relatively low-wage work in retirement. “Many people take as a given that they’ll be able to work as long as is necessary or desirable,” David says. “But your health or circumstances may not allow for the level of earnings you were counting on, so be careful not to be overly reliant on work when it comes to your financial projections.”

Assumption 4: I should play it safe with my investments in retirement.

→ Reality check: Although a conservative retiree’s portfolio might be 20% equities and 80% cash/fixed income, “a greater allocation to stocks can help offset the risk of outliving your finances,” says Rob Williams, CFP® and vice president of financial planning at the Schwab Center for Financial Research (SCFR).

Indeed, an analysis by SCFR found that a retiree with a 60% allocation to stocks was able to take larger withdrawals than a retiree with a 20% allocation to stocks while still maintaining the same degree of confidence that her money would last 20 years.

→ Course correction: “A 60% allocation to stocks in retirement isn’t for everyone,” Bob says. “But you do need some exposure to stocks if you want to generate income and maintain growth potential. Holding a mix of assets with varying risk levels can help support those goals.”

A financial planner can help you create a financial plan that accounts for multiple rates of return and retirement scenarios. He or she can also help you assess how much risk makes sense for your specific situation.

Goal: College

Assumption 5: I can deduct the interest on my mortgage.

→ Reality check: Because of recent changes to the tax code, you can deduct the interest only on up to $750,000 of mortgage debt, and interest paid on a home-equity loan (HELOC) is deductible only if the proceeds were used to purchase or substantially improve your primary or secondary residence.

→ Course correction: Be realistic about your mortgage-interest deduction when evaluating the total annual cost of your home—especially if you’re counting on it when calculating the amount of tax that’s withheld from your paycheck. Also be sure to double-check the IRS’s rules on eligibility if you’re expecting to deduct the interest on your HELOC.

Assumption 6: Real estate is always a safe investment.

→ Reality check: Like any asset, home prices can go down as well as up. In October 2008, for example, home prices fell 18% over the year, as measured by the Case-Shiller 20-city composite index.3

As a result, many borrowers suddenly owed more than they could hope to recover in a sale. And many had to wait years for the market to recover before they could consider selling their homes, which may have compromised their ability to accept lower offers. 

→ Course correction: First and foremost, view your home as a place to live—not primarily as an investment to be sold at a profit. “We recommend using an online calculator like the one at Schwab.com/retirementcalculator to find out how much you might need to save to make it safe with your investments.”

→ Reality check: “Many retirees find their income stream—either from work or Social Security—will be lower in retirement. With less income, you may be less able to afford any unforeseen expenses from health or circumstances that weren’t part of your plans,” David says. 

→ Course correction: When estimating your retirement earnings, factor in inflation and other potential living expenses. Also know that your income may simply need to last longer than your assumptions. “For many, the goal might be for it to last 20 years or longer,” David says.2

Assumption 7: Education debt is always worth it.

→ Reality check: Mounting student debt has been cited as one of the main reasons why so many young adults today can’t afford to buy homes or start families. Moreover, a record 8.9 million federal student loan borrowers were in default in 2017, with a million borrowers expected to default every year.4

“College debt is a growing problem for parents, too—especially if it comes at the expense of their retirement savings,” David says. Indeed, 14% of families who borrowed to pay for college in 2018 used parent loans exclusively, according to Sallie Mae.5

→ Course correction: Higher education isn’t all about returns on investment, but you should nevertheless discuss with your child what her or his choice of major could mean in terms of salary potential and how much you’re willing to contribute. 

When it comes to your own planning, it’s important to revisit your assumptions on a regular basis—at least annually, and ideally with a financial advisor who can bring a fresh perspective to your assumptions.

“Time is your friend when it comes to saving money,” David says. “So the earlier you can spot a potential flaw in your planning assumptions, the easier it is to make the necessary course corrections.”

Prepared for change

When it comes to your own planning, it’s important to revisit your assumptions on a regular basis—at least annually, and ideally with a financial advisor who can bring a fresh perspective to your assumptions.

“Time is your friend when it comes to saving money,” David says. “So the earlier you can spot a potential flaw in your planning assumptions, the easier it is to make the necessary course corrections.”

Need help with your planning assumptions? Call your Schwab financial consultant today to schedule an appointment to review your financial plan.

FINANCIAL FAULT LINES
Tax reform upended the incentives for charitable giving. Here’s how to keep making a difference.

Give and …

... Ye Shall (Still) Receive
Taxpayers who routinely make annual donations to charity face a new hurdle: They may no longer be able to deduct their gifts.

Why not? Because the number of taxpayers who itemize their deductions—including charitable donations—is expected to decrease by roughly two-thirds as a result of the Tax Cuts and Jobs Act of 2017 (TCJA), which doubled the standard deduction to $12,100 in 2019 for individuals and $24,400 for married couples filing jointly.

The effects may already be taking hold. The percentage of households that itemized their charitable contributions declined from 21% in 2017 to just 9% in 2018, according to estimates from the nonpartisan Tax Policy Center.1

“Tax benefits are a secondary motivation for many donors—but they’re still a motivation,” says Kim Laughton, president of Schwab Charitable, the nonprofit donor-advised-fund provider sponsored by The Charles Schwab Corporation to facilitate client giving (see “Giving Made Easy,” page 48).

The good news is that for many the tax advantages to charitable giving remain—albeit in a different form. For gifts other than cash and publicly traded securities in excess of $5,000 ($10,000 for closely held stock), the donor must also obtain a qualified appraisal.

To offset the loss of their charitable tax deduction, they decided to hold off on their 2018 cash contribution and bundled two years’ worth of charitable donations—$20,000—in 2019. Adding in their $5,000 in other deductions will exceed the standard deduction of $24,400 in 2019, allowing them to itemize and capture a significant tax savings.

Of course, bundling multiple contributions into a single year can feel daunting if you’re not sure how much you want to give and to whom. So to build some flexibility into your plan, you may wish to set up a donor-advised fund account, which allows you to donate a lump sum in the current tax year, invest the funds for future growth and parcel out the money to qualified charities over time.

The joys of bundling

“Most people who give don’t do so in order to get something in return—they’re philanthropically inclined,” Kim says. Even so, how can taxpayers continue to benefit from the new tax law as long as they go about it in a slightly more methodical way?

The upside

Several provisions in the TCJA make charitable giving considerably less advantageous from a tax perspective. In addition to the doubling of the standard deduction, tax rates have been lowered for five of the seven income brackets—and brackets have also shifted, meaning in many cases more income will be taxed at a lower rate. Both of these developments mean taxpayers will have less tax savings from their charitable contributions.

What’s more, a $10,000 cap on the deduction of state and local taxes (SALT) has resulted in a higher tax bill for many residents of high-tax states such as California and New York. This not only reduces their disposable income but also makes it much harder to exceed the standard deduction and therefore itemize their charitable contributions. Even those who do itemize are unlikely to see as significant a tax savings as they did in the past, because many deductions—including alimony payments and unreimbursed business expenses—were reduced or eliminated as part of the TCJA.

That said, many taxpayers subject to the standard deduction can still benefit from their charitable donations, so long as they go about it in a slightly more methodical way.

The downsides

For example, imagine a couple who earn $100,000 for charity in 2018. That plus the rest of their deductions added up to $19,000—far more than the standard deduction of $12,700 in 2017 but far less than the post-TCJA standard deduction of $24,000 in 2018.

The joys of bundling

How can taxpayers benefit from the new tax law and get back some of the tax advantages of their charitable contributions? One word: Bundling.

Maximum control

Of all the itemized deductions available to taxpayers, the charitable deduction is perhaps the most flexible. Donors can control the amount, timing and type of donations in order to maximize their impact—to both the charity and themselves: “To give may be better than to receive.” Kim says, “If it doesn’t mean you shouldn’t take full advantage of the tax code.”

Learn more about maximizing your charitable impact with Schwab Charitable’s donor-advised fund account at schwabcharitable.org.

See page 46 for important information. • This article addresses gifts of appreciated non-assets that have been held for more than a year. The tax deduction, for those who itemize, for noncash gifts to a public charity or donor-advised fund account may be used to offset up to 30% of adjusted gross income and can be carried forward for five years. The donor must file IRS Form 8283 when claiming an itemized deduction for contributed securities valued at greater than $500. For gifts other than cash and publicly traded securities in excess of $5,000 ($10,000 for closely held stock), the donor must also obtain a qualified appraisal. • Donors should consult with their tax advisor to determine the appropriate holding period. Under the Tax Cuts and Jobs Act of 2017, carried interest income from investments held for less than three years may be taxed as a short-term capital gain. • Gifts of appreciated property can save the donor the tax costs associated with capital gains analysis and advanced planning. The above article is meant only to be a general overview of some of the considerations and is not intended to provide tax or legal guidance. Please consult with your tax advisor. • Schwab Charitable is the name used for the combined programs and services of The Charles Schwab Foundation, an independent nonprofit organization. The Schwab Charitable Fund has entered into service agreements with certain affiliates of The Charles Schwab Corporation. [119-NHCH]

GIVE AND YE SHALL (STILL) RECEIVE
Redefining Retirement

Leveraging a lifetime of experience can spell success for older entrepreneurs. Here are five steps to get you started.

Illustration by Jun Cen
If you’re funding the business even partially out of your own pocket, make sure you have a clear plan for balancing your personal expenses with your business expenses.

Julia Aker, a financial advisor at Schwab Private Client Investment Management who’s based in Phoenix, suggests dividing existing assets into buckets. “Carve out a portion to support the business, but make sure you’re protecting those funds earmarked for retirement and any legacy you hope to leave behind,” she says.

A financial planner can help you determine how much you can afford to invest in a new business without spending your near- and long-term savings. Financial planners can also help clients assess the potential tax consequences of working in retirement. Medicare and Social Security, for example, both have income thresholds above which either additional premiums or increased taxes must be paid.

Step 2: Fund

Some prospective business owners may consider selling real estate or drawing upon savings for startup capital. Others may contribute cars, securities or other assets directly to the business itself.

If you’re not planning to tap your savings or don’t have sufficient resources to fund your business, you might need to consider borrowing. Taking on new debt in retirement has its risks, so it’s important to explore all of your options, fully understand the terms of the loan and have a solid plan for paying it back.

For example, will you pursue traditional financing, such as a home equity line of credit (HELOC) or a personal loan, or will you try to qualify for a small-business loan? Traditional financing is typically easier to secure because it doesn’t require a formal business plan or a specific use case, but it can be riskier because it ties your personal finances to the health of your business. Small-business loans, on the other hand, can be separate from your personal finances and undergo a less rigorous approval process and may be limited to established businesses.

A third option is to pursue a nontraditional line of credit, such as a pledged asset line, which lets you borrow against the value of your non-retirement assets while keeping your investment strategy on track.

“A pledged asset line may be a good fit for someone who requires access to capital but doesn’t want to sell any investments,” Ken says. “It’s a flexible, borrowing solution that can be used for just about any purpose related to the business, from paying monthly expenses to purchasing land.” (For more, see “Schwab Bank’s Pledged Asset Line,” above right.)

Step 3: Protect

“A lot of people think setting up a business is just a matter of hanging out a shingle—and that can be a big mistake,” says Hayden, the Financial Planning specialist at the Schwab Center for Financial Research. “You should consider filing documents that treat your business as a separate legal entity.”

For example, many small businesses begin as a sole proprietorship, but that could lead to your personal assets being used to settle business debts or even a lawsuit. “If somebody sues your business and it’s not structured properly, you can lose your house or car, lose the value of your business, or to support the outstanding loans, Schwab Bank may demand immediate payment of all or any portion of the outstanding obligations, or require additional cash or securities to be added to the Pledged Account maintained or to support the outstanding loans, Schwab Bank may demand immediate payment of all or any portion of the outstanding obligations, or require additional cash or securities to be added to the Pledged Account maintained at Schwab Bank & Co., If a demand is not addressed, the pledged securities may be immediately liquidated without further notice to you, which may result in tax consequences. This offer is subject to change or withdrawal at any time and without notice. Nothing herein or should be interpreted as an obligation to lend. Schwab Bank’s credit and collateral approval decisions are subject to change and collateral approval decisions are subject to change and collateral approval decisions are subject to change and collateral approval decisions are subject to change. Schwab Bank is a member of the FDIC and an Equal Housing Lender, member of the Financial Industry Regulatory Authority, Inc. (“FINRA”). You should consult your personal advisor regarding advice and even best business practices, while pointing you toward other specialists—including an accountant and an attorney—who can handle the nitty-gritty. “Many times a new business will try to cut corners by going it alone, but that can expose you to unforeseen risks and cost you down the road,” Hayden says. Translating a lifelong dream into a successful enterprise can be tricky, to be sure, but it often starts with the right advice. “We can help to provide framework for success,” Hayden says. “Experience, the more focused an older entrepreneur’s vision and mission are, the more successful her or his business will likely be.”

Schwab Bank’s Pledged Asset Line

Leveraging the value of your assets rather than liquidating them can be a smart strategy.

“If you need access to capital but are hesitant to liquidate part of your portfolio because of tax consequences, concerns about selling during a temporary market decline or other considerations, it might make sense to borrow against your asset to fund your goal.”

A Pledged Asset Line from Schwab Bank is a flexible, nonpurpose line of credit that lets you leverage the value of your portfolio while helping maintain your investment strategy.

The nonpurpose line of credit is secured by assets held in a Schwab Pledged Account and required to be maintained at Schwab Bank & Co., Inc. You can use your line of credit to fund a wide range of business expenses, such as new equipment, startup costs, payroll and more. Line amounts start at $50,000 (with a required minimum initial advance of $70,000), or more.

To learn more about Schwab Bank’s Pledged Asset Line, turn to page 42 or call your regional banking manager at 888-577-7040.

Entering into a Pledged Asset Line and pledging securities as collateral involves a high degree of risk. Before you decide to apply for a Pledged Asset Line, make sure you understand the risks.

Schwab Bank, in its sole discretion, will determine at any time the eligible collateral criteria and the loan value of collateral.

See page 46 for important information.

Further information about Schwab Bank’s Pledged Asset Line is available at Schwab.com/assetline.

Pledged Asset Lines are subject to credit and collateral approval. Other conditions and restrictions may apply.

See page 46 for important information.
Looking for a Smarter Way to Borrow?

Schwab Bank’s Pledged Asset Line® is a flexible line of credit that allows you to borrow against the assets in your portfolio.

In a world of bills and financial opportunities, flexibility is a must. Whether you’re buying a new home, investing in your business or paying a tuition or tax bill, you don’t want your ambitions to get stuck in a bottleneck.

With a Schwab Bank Pledged Asset Line you may be able to avoid some of the challenges that can arise when you need funds quickly—from the time and effort that can go into securing a traditional loan, to the potential tax consequences of selling assets—by borrowing against the value of your portfolio.

These non-purpose¹ lines of credit are:

- **Flexible.** Line amounts from $100,000 (required minimum initial advance of $70,000).
- **Convenient.** Quick lending decisions, whether applying online or with a representative.
- **Affordable.** Competitive rates with no set-up fees or pre-payment penalties.

Collateral for your flexible line of credit may include:

- Marginable equity securities valued at or above $3/share at the time of funding and closing.
- Most mutual funds and exchange-traded funds.
- Certificates of deposit and cash.
- Many corporate, Treasury, municipal, and government agency bonds.

Retirement assets are not eligible.

Entering into a Pledged Asset Line and pledging securities as collateral involve a high degree of risk. At any time, including in the event that the loan value of collateral is insufficient to satisfy the minimum loan value of collateral or to support the outstanding loans, Schwab Bank may demand immediate payment of all or any portion of the outstanding obligations, or require additional cash or securities to be added to the Pledged Account maintained at Charles Schwab & Co., Inc. If a Demand is not addressed, the pledged securities may be immediately liquidated without further notice to you, which may result in tax consequences.

Schwab Bank requires that the assets pledged as collateral for the Pledged Asset Line be held in a separate Pledged Account maintained at Charles Schwab & Co., Inc. (Schwab). Schwab Bank, in its sole discretion, will determine at any time the eligible collateral criteria and the loan value of collateral.

¹A non-purpose line of credit may not be used to purchase securities, pay down margin loans, or be deposited into any brokerage account. Proceeds must be used for a lawful personal, commercial, or business purpose under state, federal, or other applicable law.

LET’S TALK
To learn more, talk with your Schwab financial consultant or call 888-725-3630.
Get a roadmap for your financial future with planning guidance from Schwab Intelligent Portfolios Premium™.

Everyone has financial goals. Maybe it’s making sure you have enough income for a long retirement or setting up an estate plan that provides for your family. Maybe it’s leaving a legacy for your alma mater. Maybe it’s all three.

But regardless of your goals, properly investing your assets in a cost-conscious way can help ensure you get there. And here’s where Schwab Intelligent Portfolios Premium can make a difference. Our robo-advisor builds, monitors and automatically rebalances a diversified portfolio based on your goals. Plus, you’ll receive planning and unlimited 1:1 guidance from a Certified Financial Planner™ professional.

Planning guidance at your fingertips

Your Schwab Financial Consultant will connect you with a Schwab CFP® professional who will work in partnership to establish a financial plan customized to your financial situation and needs. With their guidance, you’ll get recommendations for a low-cost investment strategy that can work both now and in the future. By staying engaged and updating your financial plan as your life changes, you’ll better position yourself to meet your goals.

Backed by our commitment to keeping costs low

You’ll pay a one-time planning fee of $300 for an initial consultation with a CFP professional, which includes a customized financial plan with portfolio recommendations.

After 90 days, you pay a $30 per month advisory fee, billed quarterly, to receive ongoing access to a team of planning consultants to address updates to your plan and answer questions as needs arise—as well as interactive online tools.

You’ll invest in a portfolio of low-cost exchange-traded funds. Just as if you’d invested on your own, you will pay the operating expenses on the ETFs in your portfolio, which includes Schwab ETFs™.

What else you should know

We believe cash is a key component of an investment portfolio. Based on your risk profile, a portion of your portfolio is placed in an FDIC-insured deposit at Schwab Bank. Some cash alternatives outside of the program pay a higher yield. See more information below.*

Brokerage Products: Not FDIC-Insured • No Bank Guarantee • May Lose Value

See page 46 for additional 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. (1119-9RV5)
Get the Help You Need With Schwab Advisor Network

Whether as a result of the steady accumulation of wealth over time or a sudden windfall such as an inheritance, there can come a point when your wealth management needs become so complex that you would prefer personalized attention from a financial advisor. But how to find the right mix of specialized expertise, investment management philosophy and personal connection that are so essential to a successful advisor relationship?

Schwab can help by referring you to third-party professionals in the Schwab Advisor Network.

Experienced advisors dedicated to helping you grow and preserve your wealth

Schwab Advisor Network is a select group of approximately 200 independent advisory firms nationwide, whose advisors we have pre-screened for investment management experience, assets under management and professional education. Advisors in the network have 20 years of experience, on average, and many hold advanced professional certifications, such as CERTIFIED FINANCIAL PLANNER™, Chartered Financial Analyst® or Certified Public Accountant, among other designations.

Before referring you to an advisor, your Schwab financial consultant will talk with you about your needs and identify advisors who can bring the right kind of expertise to bear for your situation. Your Schwab financial consultant will continue to be your main contact at Schwab even after you’ve established a relationship with a third-party advisor.

Building a personalized plan for your total financial picture, not just your investments

Once you’ve decided on a Schwab Advisor Network advisor, they will develop a customized plan for you that addresses your individual needs. These advisors can provide professional guidance in areas such as:

- Investment management
- Financial planning
- Insurance
- Tax strategies
- Estate planning
- And other areas, depending on your needs

Schwab Advisor Network advisors can take over day-to-day management of your investment portfolio and broader wealth management needs, and as fiduciaries, they are committed to helping you accomplish your goals. They’ll also check in with you periodically to update you on your progress and discuss any adjustments you need to make. After all, life happens, and your plans have to change accordingly.

But the support doesn’t stop there. Your independent advisor can also work with your lawyer or accountant, and, depending on the third-party firm, bring in-house specialists on taxes, estate planning and other areas—that means you can have access to an entire wealth management team working on your behalf.

See page 46 for important information. Schwab Advisor Network (“SAN”) member advisors are independent and are not employees or agents of Charles Schwab & Co., Inc. (“Schwab”). Schwab prescreens advisors and checks their experience and credentials against criteria Schwab sets, such as years of experience managing investments, amount of assets managed, professional education, regulatory licensing and business relationship as a client of Schwab. Advisors pay fees to Schwab in connection with referrals. Schwab does not supervise advisors and does not prepare, verify or endorse information distributed by advisors. Investors must decide whether to hire an advisor and what authority to give the advisor. Investors, not Schwab, are responsible for monitoring and evaluating an advisor’s service, performance and account transactions. Services and fees may vary depending on which advisor an investor chooses. (1219-9ALL)
The information provided here is for general informational purposes only and should not be considered an individualized recommendation or personalized investment advice. The investment strategies mentioned here may not be suitable for everyone. Each investor needs to review an investment strategy for his or her own particular situation before making any investment decision.

All expressions of opinion are subject to change without notice in reaction to shifting market conditions. Data contained herein from third-party providers is obtained from what are considered reliable sources. However, its accuracy, completeness or reliability cannot be guaranteed.

Examples provided are for illustrative purposes only and not intended to be reflective of results you can expect to achieve.

Pg. 8: Fixed income securities 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. ● Charles Schwab Investment Advisory, Inc. (“CSIA”) is an affiliate of Charles Schwab & Co., Inc. (“Schwab”).

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The impact our clients have made over the years is profound. Since Schwab Charitable’s inception, donors have given $13 billion to 150,000-plus charities worldwide. If you’re looking for a simple, tax-smart approach to your philanthropy, learn more about Schwab Charitable at schwabcharitable.org. We’d be happy to help you define your charitable mission and support the causes you care about most.

Charles R. Schwab
Founder & Chairman
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