A better approach to rebalancing
Page 9

To refi or not to refi?
Page 13

Learning from your losses
Page 23

Extend Your Savings
Tax-smart strategies for keeping more of your money.
Pages 6, 15 & 26
Dear Client,

As you accumulate wealth, making tax-smart investment decisions becomes increasingly important—especially for those in the highest income tax brackets. To that end, we’ve rounded up some timely tax-related topics, including what to know about income payouts from ETFs (page 6), why municipal bonds may be the new darlings of high-income earners (page 15), and how making tax-smart withdrawals in retirement can help extend the life of your savings (page 26).

Elsewhere in this issue, you can find insights on a variety of other subjects, including how the newly passed SECURE Act could affect you (page 20), how to decide if you should manage your own finances or bring in a professional (page 30), and what to know about buying, renting, and selling a second home (page 38).

If you have questions about how these topics apply to your own finances, I encourage you to reach out to us at 877-297-1126. We welcome every opportunity to help you achieve your goals.

Sincerely,

Joseph Vietri
Senior Vice President, Investor Services
DEPARTMENTS

2 SCHWAB ORIGINALS
Listen, read, and learn.

3 CEO’s NOTE
Tackling retirees’ biggest challenge.
By Walt Bettinger

THE BOTTOM LINE

5 Does your fund’s age matter?

7 States that tax Social Security.

8 Dividend-paying stocks.

9 A better approach to rebalancing.

11 FAMILY MATTERS
Why giving unequal inheritances can sometimes make sense.

PERSPECTIVES

13 To refi or not to refi?
By Rob Williams

17 Drowning in debt.
By Liz Ann Sonders

20 THE BIG PICTURE
7 SECURE Act takeaways.

23 TRADING
Learning from your losses.
By Joanna Payne

42 SPOTLIGHT
Schwab Live | Schwab Bank Visa® debit card | 1099 Dashboard.

48 ON YOUR SIDE
A helping hand.
By Charles R. Schwab

ON THE COVER

30 DIY vs. Pro
When to take financial matters into your own hands—and when to ask for help.

34 Worth Their Weight
Alternatives to ubiquitous capitalization-weighted index funds can help diversify your portfolio.

38 Home Sweet Homes
Your guide to buying, renting, and selling a second home.

EXTEND YOUR SAVINGS

6 Tax-efficient ETFs.

15 Municipal bonds’ tax-free income.

26 How smart tax planning can help extend the life of your savings.

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Tax season is upon us. Find tips for lowering your tax bill, maximizing deductions, and effectively managing your taxes throughout the year at schwab.com/taxstrategies.

Do you know someone who’s just getting interested in investing? At schwab.com/how-to-invest, they can find a primer on key concepts, as well as tips on how to start and where to turn for guidance.

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Walt Bettinger
President & CEO
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Own your tomorrow.
When comparing actively managed mutual funds for your portfolio, how much attention should you pay to a fund’s age?

On the one hand, research has shown that, on average, younger funds outperform older funds, perhaps because advances in technology give new fund managers an advantage over existing managers. As one might predict, this advantage dissipates over time as new funds enter the fray.1

On the other hand, it’s very difficult to assess whether a new fund will go the distance. “Investing in a brand-new active strategy is pretty risky, because you’re basing your entire investment on the promise of strong returns without a track record to back it up,” says Michael Iachini, vice president and
head of manager research for Charles Schwab Investment Advisory.

That’s why, when selecting funds for inclusion on Schwab’s Mutual Fund OneSource Select List®, Michael and his team exclude those with less than three years of performance history. “We’re looking for funds with consistently strong performance relative to their peers,” Michael says. “Otherwise, we have no way of knowing whether their strategies have staying power or are just flashes in the pan.”

When it comes to index funds, however, age isn’t really a factor. “These funds are passively managed, meaning their entire strategy is to replicate a market benchmark rather than outperform it,” Michael says. “As a result, investing in a new index fund generally doesn’t carry as much risk as investing in a new actively managed fund, so long as it’s from a reputable source using an established approach.”

See page 46 for important information. ◆ Investors should consider carefully information contained in the prospectus, including investment objectives, risks, charges, and expenses. You can request a prospectus by calling 800-435-4000. Please read the prospectus carefully before investing. ◆ Charles Schwab & Co., Inc., Member SIPC, receives remuneration from fund companies participating in the Mutual Fund OneSource service for recordkeeping and shareholder services and other administrative services. Schwab also may receive remuneration from transaction fee fund companies for certain administrative services. ◆ Charles Schwab Investment Advisory, Inc. ("CSIA") is an affiliate of Charles Schwab & Co., Inc. ("Schwab"). (0220-925Y)

How Tax-Efficient Is Your ETF?

Income from exchange-traded funds plays by different rules.

Because ETFs are structured and traded differently than mutual funds, ETFs typically realize fewer capital gains, making them one of the more tax-efficient investments you can own.

If you invest in ETFs that generate significant income from payouts, however, taxes might be of greater concern. “Dividends and interest are treated differently and should therefore be a factor when selecting funds for your portfolio,” says Emily Doak, CFA and managing director of ETF research at Charles Schwab Investment Advisory.

For example, most dividends from ETFs holding U.S. stocks are considered “qualified” for federal tax purposes, meaning they’re taxed at the long-term capital gains rate of 0%, 15%, or 20%, depending on your income.1 (By contrast, nonqualified dividends are treated as ordinary income, meaning they could be taxed as much as 37% for high-income earners.) But to qualify for the long-term capital gains rate, you must meet certain holding period requirements; if you don’t, your dividends will be subject to ordinary income tax rates.2

Interest payouts from taxable bond ETFs, on the other hand, are always taxed as ordinary income, irrespective of how long you’ve held the fund. So, if generating tax-efficient income is one of your goals, you might instead want to consider municipal bond ETFs, which are tax-free at the federal level (and sometimes at the state level, depending on where you reside).

Of course, taxes are only one consideration among many when selecting investments for your portfolio. Regardless of how their payouts are taxed, funds also need to support your investment goals or income needs. Fortunately, ETFs remain one of the most tax-efficient ways to reach your long-term objectives.

1 An additional 3.8% surtax may apply for high-income earners with significant investment income. 2 Payments from securities-lending revenue and income from options strategies are not eligible for qualified tax treatment. For more details, see IRS Publication 550, “Investment Income and Expenses,” at irs.gov/pub/irs-pdf/p550.pdf.

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. Shares of ETFs are not individually redeemable directly with the ETF. Shares are bought and sold at market price, which may be higher or lower than the net asset value (NAV). All ETFs are subject to management fees and expenses. (0220-929L)
Social (In)Security

Here’s when—and where—the tax man could take a bite out of your benefits.

Contrary to popular belief, some Social Security recipients may owe taxes on their benefits—at the state and federal levels.

“The majority of states won’t take a piece of your Social Security check,” says Hayden Adams, CPA, CFP®, and director of tax and financial planning at the Schwab Center for Financial Research. “But some do, and they vary in their methods for determining taxability, making it all the more confusing to figure out what you owe.” (You can check your state’s rules using the directory at taxadmin.org/state-tax-agencies.)

Even if you live in a state that doesn’t take a bite out of your Social Security benefits, the federal government still might: More than 40% of current beneficiaries pay income taxes on a portion of their benefits.1 “Depending on your combined income—which is the sum of your adjusted gross income, tax-free interest, and half your Social Security benefit (or benefits, if you’re married)—up to 85% of your benefits could be taxable as ordinary income,” Hayden says.

If you’re worried your Social Security payouts will increase your tax bill—or perhaps even push you into a higher tax bracket—a bit of tax management can go a long way, Hayden says. “Taxes can often be offset by, say, strategically selling assets from various accounts or making charitable donations, so reach out to your tax advisor to talk through all the available options.”

1 Summary: Actuarial Status of the Social Security Trust Funds, ssa.gov, 04/2019.

Unlucky 13
If you live in one of these states, your Social Security benefit could be taxed.

For more tax-related insights, visit schwab.com/taxes.

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THE BOTTOM LINE

Stocks That Pay

Adding dividend-paying stocks to your portfolio can help boost returns over time.

With bond yields hovering near historical lows, stocks that offer quarterly payouts may have renewed allure for income-seeking investors.

Nearly half (48.8%) of the stocks in the S&P 500 Index offered a dividend yield of at least 1.90%, as of December 16, 2019. Meanwhile, 10-year U.S. Treasuries offered a yield of 1.87% on that same day—though of course payouts from Treasuries are guaranteed while those from dividend-paying stocks can be reduced or eliminated at any time and without notice.

Dividend-paying stocks can be especially important to retirees. “As health care costs continue to rise and bonds offer nominal yields, retirees need a way to help offset inflation and rising expenses,” says Bill McMahon, a senior vice president at Charles Schwab Investment Advisory. “Dividend-paying stocks can help.”

That said, dividend-paying stocks aren’t only about the dividends. “In addition to helping boost portfolio income, companies that increase their dividends send a positive signal about the business’s health,” Bill says. Indeed, over the past four decades, equities with strong and rising dividends have significantly outperformed their low- and non-dividend-paying counterparts in terms of total returns, which include price appreciation (see “The dividend dividend,” right).

By the same token, companies facing economic hardship may slash their dividends to help preserve capital or meet other obligations. And when a company cuts its dividends, its stock price often declines, potentially compounding the impact on your portfolio.

Investing in dividend-paying stocks via an exchange-traded fund or a mutual fund can help manage this risk. “Fund managers have the time and expertise to research businesses that seem poised not only to sustain their current payouts but also to grow their dividends in the future,” Bill says.

“Schwab Center for Financial Research.

The dividend dividend

The stocks of companies that grew their dividends over time have historically outperformed all other stocks.

Historical total returns, 1980–2019

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Rebalance, Rebalance, Rebalance

How regularly rebalancing your portfolio can help reduce risk.

What if there were a way to consistently buy low and sell high? As it happens, there is—if you take a disciplined approach to rebalancing your portfolio.

Because some of your holdings will invariably do better than others as the market rises and falls, your portfolio can drift away from its target asset allocation over time. If you commit to regularly selling assets that have become overweighted in your portfolio and buying those that have become underweighted, you’ll effectively be buying low and selling high.

Unfortunately, many people do the opposite. “When you have new money to invest or are making changes to your portfolio, the common urge is to put more money into the stocks or funds that have been doing the best recently,” says Mark Riepe, head of the Schwab Center for Financial Research. “Instituting a disciplined rebalancing strategy can help remove those emotions from the decision-making process.”

Practically speaking, you can approach rebalancing in a number of ways. Some people like to follow a strict schedule, realigning their portfolio to their target asset allocation monthly or quarterly. Others—including Mark—find it more useful to set a threshold past which it’s time to act.

“One approach would be to use a five-percentage-point departure in any one area of your target allocation as a prompt to rebalance,” he says. For example, if your target allocation calls for 60% stocks, you might choose to rebalance when that allocation rises to 65% or falls to 55%. (To see if your portfolio is in line with your target allocation, log in to schwab.com/portfoliocheckup.)

However you choose to approach rebalancing, the important thing is to have a reasonable rule—and to stick to it, regardless of what the market is doing.

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* Source: Morningstar, “FundInvestor: The Terrific 28,” by Russel Kinnel, May 2019. Morningstar’s criteria for the “Terrific” list include: expense ratio in the cheapest quintile, 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 for a minimum of five years, must be a share class accessible to individual investors, and no funds of funds. Each fund’s results were evaluated based on share classes that were accessible to individual investors. Morningstar evaluated American Funds’ Class A shares because they are most widely held by individual investors. According to Kinnel’s report, American Funds’ “institutional and clean share classes would have gotten more funds through the tests.” The list’s criteria have changed over the years.

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To Each Their Own

Why dividing your estate unequally among your heirs can sometimes make sense.

The five fingers are not all equal,” goes a Persian proverb, and the same can be true of your heirs. “Most families distribute assets equally in the name of fairness,” says Marianne Hayes, a CPA and senior wealth strategist with Schwab Private Client in Denver. “But unequal distributions are increasingly common, because, well, fair doesn’t always mean equal.”

For example, children who serve as the primary caregiver to their aging parents might conceivably earn less—and therefore receive more—than siblings who were free to pursue their careers unencumbered. By the same token, children who’ve borrowed
FAMILY MATTERS

Call today to schedule an appointment.

A couple Marianne worked with had one child who was a successful attorney and another who did charity work in Africa. “My clients initially wanted to create a trust whose distributions would be commensurate with each child’s income, in order to perpetuate their respective lifestyles,” Marianne says. “However, after thinking through the consequences of that approach—with the child who will likely need more help in retirement receiving the smaller inheritance—they reversed course to reach what they felt was a more equitable solution.”

Special circumstances
Blended families can require a similarly nuanced approach, particularly when it comes to offspring from multiple marriages. For example, the children of a first marriage may have careers and families of their own, while those from a second marriage may still be facing college—and all the costs higher education entails. In each case, the inheritance’s structure and even its size can be substantially different.

That also may be true when a family business is involved. If one child is effectively running the business, for example, he or she might receive ownership upon the parents’ passing. In such cases, some parents might consider taking out life insurance policies equal to the value of the business, naming the children outside the business as beneficiaries. For example, if the business is valued at $1 million, the life insurance policy per child might also be valued at $1 million.

Life insurance also can be useful in covering the costs of caring for a child with disabilities. “Of course, many families will wholeheartedly endorse a disproportionate amount of an estate going toward the care of a special-needs child,” Marianne says. “But when that’s not the preferred approach, a life insurance policy can help support that care while still allowing for an equitable distribution of assets.”

When bequeathing assets for the care of special-needs heirs, make sure you understand that such gifts may affect federal or state benefits. In such cases, many also consider incorporating a special-needs trust, which can be used to pay housing, qualified education, equipment, insurance, and medical expenses not covered by government benefits without reducing or eliminating eligibility.

Don’t go it alone
Whatever approach you take to the distribution of your estate, a good first step is to partner with a seasoned financial planner or wealth strategist—many of whom have already been down this road with other clients.

That can help avoid what Marianne says is a common challenge for those struggling to establish an equitable estate plan: avoiding the issue altogether and thus leaving the distribution of your estate to others. “If you don’t have a will, the state in which you reside will settle your estate for you—and it may not distribute your assets in the way or to the people you’d prefer,” Marianne says.

In all instances, it’s critical that you be up front with your heirs in advance. “When someone passes away, it’s often not the dollar value of an inheritance that matters, it’s the emotional value that’s attached to it—which is why it’s so important to communicate your intentions while you’re still in good health,” Marianne says. “After all, the last thing you want is for your generous bequest to be seen as a bad thing.”

Let’s Talk
Your Schwab financial consultant can help you think through the details of your estate plan and connect you with other Schwab specialists who can help implement it. Call today to schedule an appointment.

Fair play
Five factors to consider when divvying up assets among your heirs.

1. Age
Heirs at different life stages can have radically different financial needs. Older adult children, for example, may be looking to finance a first home, while younger kids might need help with college or graduate school costs.

2. Family business
If the family business goes to the child or relative responsible for running it, bequests of similar value—such as the contents of a savings account or the proceeds from a life insurance policy—might make sense for your remaining heirs.

3. Income level
Heirs with hefty incomes may need less help securing their financial futures than, say, an adult child caring for an aging parent.

4. Number of grandchildren
The number of children each of your children has can also influence the distribution of assets. “There’s an argument to be made for this approach,” Marianne says. “The important thing is to share your thinking beforehand to help head off any hurt feelings.”

5. Special circumstances
From a child with a disability to an heir who’s taken an advance against her or his inheritance, your bequests need not be equal to be equitable.

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hen the Federal Reserve began cutting interest rates in July 2019, homeowners jumped at the chance to refinance their mortgages, with such activity reaching a three-year high in August.\(^1\)

But locking in a lower interest rate won’t always save you money in the long run. Here are four common reasons to refinance—and what to consider about each.

**Reason 1: Cut your interest rate**

In September 2019, more than half of all borrowers with 30-year fixed-rate mortgages could have saved at least three-quarters of a percentage point on their interest rate by refinancing, according to mortgage-analytics firm Black Knight.\(^2\)

However, locking in a lower rate may not be enough, especially if you plan to move in the next few years. If you can’t make back what you paid in closing costs and other expenses by the time you sell, refinancing probably isn’t worth it.

Even if you plan to remain in your home, you need to think about how far along you are in your current loan. For example, if you’re 10 years into a 30-year loan and you refinance with another 30-year loan, you’re potentially adding 10 years to the time it will take to pay off your home. To justify that extra decade, you’d have to save a significant amount of money on your monthly mortgage payments (see “Loan vs. loan” on the following page). Either that or you’d need to commit to paying off the loan far more quickly than required.

**Reason 2: Replace an adjustable-rate mortgage**

Today’s rates don’t have much room to go lower, but they have plenty of room to rise. Although we don’t expect rates to increase significantly anytime soon, the benchmark 30-year fixed-rate mortgage did rise in mid-December to 3.93% from 3.90%, according to Bankrate’s weekly survey of large lenders. And it was 5.04% only a year earlier.\(^3\)

Hence, refinancing might make the most sense for borrowers with an adjustable-rate mortgage (ARM), which is susceptible to rate hikes once the loan’s initial fixed-rate period expires.
Loans vs. loan

Even a 0.75 percentage point cut to your current loan wouldn’t be worth it over the life of your new 30-year deal.

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<td>Some lenders allow borrowers to “recast” their mortgages by paying a lump sum against the principal owed. The loan’s interest rate and term remain the same, but the lender sets up a new amortization schedule based on the smaller principal balance, thereby reducing monthly payments for the remainder of the loan.</td>
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This strategy can increase cash flow right away without extending the life of the loan, but generally requires borrowers to have cash on hand to cover the lump sum and any possible fees. Veterans Affairs (VA) and Federal Housing Administration (FHA) loans typically are not eligible.

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Mortgage recasting

Another way to reduce payments. Some lenders allow borrowers to “recast” their mortgages by paying a lump sum against the principal owed. The loan’s interest rate and term remain the same, but the lender sets up a new amortization schedule based on the smaller principal balance, thereby reducing monthly payments for the remainder of the loan. This strategy can increase cash flow right away without extending the life of the loan, but generally requires borrowers to have cash on hand to cover the lump sum and any possible fees. Veterans Affairs (VA) and Federal Housing Administration (FHA) loans typically are not eligible.

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Mortgage recasting

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continue to drive demand and bolster returns for tax-advantaged munis for the foreseeable future.

- The muni market’s overall credit health remains strong, and issuers should be able to continue making timely interest and principal payments. Indeed, from 1970 through 2017, the default rate among muni issuers was less than 1%—compared with 6.7% for corporate bonds during the same period.\(^1\)

- Because of their tax-free status, munis may also offer higher after-tax yields than corporate bonds of similar maturity (see “A leg up,” right). That said, individuals in lower tax brackets or those who reside in low-tax states may find better after-tax yields from taxable bonds, including corporates.

### Shopping around

If you’re looking to add munis to your portfolio, we suggest keeping three factors in mind:

1. **Geographic diversification:** Despite a positive credit outlook for the muni market overall, some regional pockets, such as areas of the Rust Belt, suffer from heightened risk. Investors should stick to issuers in economic regions with stable or growing populations, which generally have stronger financials than those in areas experiencing slow growth or outmigration.

   Furthermore, it’s generally wise for most investors to diversify across multiple U.S. municipalities. Investors who live in California or New York, however, may want to consider an all-in-state portfolio in order to shelter as much income as possible from their state’s high taxes. Both states issue a wide variety of munis each year, making a home-state portfolio fairly easy to implement.

2. **Bond classification:** Broadly speaking, munis fall into one of two categories:
   - General obligation (GO) bonds, which are backed by a specific tax source or the full taxing power of a state or local government.
   - Revenue bonds, which are supported by the revenue from a specific project or public service, such as a sports stadium or utilities.

   Revenue-bond issuers vary in terms of credit quality and are therefore generally viewed as less secure than issuers of GO bonds, but it’s important to evaluate the risks and benefits of both options. You should ideally look to combine different muni types to build a well-diversified portfolio.

3. **Credit rating:** Recently, investors have been scooping up hundreds of millions of dollars in munis from lower-rated issuers in the hopes of earning higher yields. Because such bonds have a much higher risk of default than investment-grade issues, we recommend sticking with higher-rated issuers (AA/Aa and above), which comprise about two-thirds of the $3.6 trillion muni market.\(^5\)

### Pick and choose

Munis are a great way to earn competitive yields while protecting income from taxes. Before you join the fray, however, be sure to do your homework and consider the regions and municipalities that make the most sense for your needs and tax situation.


### A leg up

The higher the federal marginal income tax rate, the more valuable muni bonds’ tax-free income becomes in comparison to corporate bonds and U.S. Treasuries.

![A leg up graph](image-url)

Source: Bloomberg Barclays Indices, as of 12/16/2019. Corporate bonds assume an additional 5% state income tax and U.S. Treasuries assume an additional 3.8% surtax for the 32%, 35%, and 37% tax brackets.
Drowning in Debt

How might the country’s rising tide of red ink affect your portfolio?
By Liz Ann Sonders

The debt bubble may have burst during the 2008–2009 financial crisis, but the United States has been in an ongoing, if subtler, debt crisis ever since.

In fact, the current economic expansion, although the longest, is also the weakest since WWII—due in no small part to the ever-growing debt problem plaguing corporations and the U.S. government. And as debt rises, it tends to crowd out more productive investments and leave the economy vulnerable to a slowdown.

Let’s take a look at the depth of our debt—and how investors might prepare for any repercussions.

In the red

To illustrate the magnitude of U.S. debt, let’s look at total credit market debt (TCMD), which includes all debt from financial and nonfinancial corporations, governments, and households. TCMD is considered high if it exceeds 320% of gross domestic product (GDP) and low if it falls below 160%.

Prior to the financial crisis, the debt-to-GDP ratio rose as high as 380%, fueled in large part by the unmanageable debt loads of financial institutions and households. Although there’s been a significant decrease in such debt since 2009, the debt-to-GDP ratio remains only slightly lower—at 350%—thanks to government and nonfinancial corporate debt (see “Down and up,” upper right).

The problem, according to Ned Davis Research, is that economic output becomes severely stunted when the debt-to-GDP ratio surpasses that 320% threshold (see “Diminished by debt,” lower right).

Down and up

While the debt of households and financial institutions has decreased since 2009 ...

... government and nonfinancial corporate debt have climbed.

Diminished by debt

Historically, economic activity—as measured by the growth of a variety of indicators—has been slower when the debt-to-GDP ratio has surpassed normal levels.

<table>
<thead>
<tr>
<th></th>
<th>High debt-to-GDP levels (&gt; 320%)</th>
<th>Normal debt-to-GDP levels (160%–320%)</th>
<th>Low debt-to-GDP levels (&lt; 160%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nominal GDP</td>
<td>3.7%</td>
<td>6.3%</td>
<td>7.5%</td>
</tr>
<tr>
<td>Real GDP</td>
<td>1.8%</td>
<td>3.2%</td>
<td>3.6%</td>
</tr>
<tr>
<td>Nonfarm payroll</td>
<td>0.9%</td>
<td>1.5%</td>
<td>2.3%</td>
</tr>
<tr>
<td>CPI inflation</td>
<td>2.0%</td>
<td>3.7%</td>
<td>3.9%</td>
</tr>
<tr>
<td>Real nonresidential investment</td>
<td>3.5%</td>
<td>5.2%</td>
<td>9.0%</td>
</tr>
<tr>
<td>Nonfinancial productivity</td>
<td>0.9%</td>
<td>2.3%</td>
<td>2.3%</td>
</tr>
</tbody>
</table>

Source: Charles Schwab, FactSet, and Ned Davis Research, Inc. Data from 12/31/1951 through 09/30/2019. Nominal GDP refers to growth in gross domestic product, measured in current prices. Real GDP refers to growth in gross domestic product after adjustments for inflation. Nonfarm payroll refers to growth in the number of U.S. workers, excluding farm workers. CPI inflation is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services. Real nonresidential investment refers to investments by businesses. Nonfinancial productivity refers to labor productivity at nonfinancial corporations. ©2020 Ned Davis Research. Further distribution prohibited without prior permission. All rights reserved. See Ned Davis Research disclaimer at ndr.com/copyright.html. For data vendor disclaimers refer to ndr.com/vendorinfo.
And if you think the government debt problem, in particular, is going to ease up anytime soon, think again. Over the next decade, the Congressional Budget Office expects net interest payments on outstanding federal debt to increase nearly 150%,1 potentially crowding out more productive investments such as infrastructure and research.

**Fear not**

Until policymakers can come up with a viable solution to ballooning debt, we may be in for an era of weak economic growth and increased volatility. Given that possibility, investors should consider taking the following actions to help offset those risks:

1. **Look abroad:** U.S. equities may not continue to deliver strong relative returns over the coming decade, so all but the most risk-averse investors should consider having exposure to international and even emerging markets for diversification purposes. Of course, international investing comes with its own risks, including currency weakness and geopolitical turmoil, which is why Schwab suggests that:

   - Conservative investors allocate no more than 5% of their portfolios to international equities—including both developed- and emerging-market companies.
   - Moderate investors who can stomach a bit more risk allocate no more than 15% to international equities.
   - Aggressive investors allocate no more than 25% to international equities.

2. **Play defense:** As debt crises persist and we near the end of the current economic cycle, bond and stock markets are likely to turn choppy. If you haven’t already done so, consider adding defensive assets to your portfolio, such as low-volatility stocks and precious metals. U.S. Treasuries, too, remain a good defensive choice; it would take much more than the current debt problem to jeopardize the security of federally backed bonds.

   - **Rebalance regularly:** During periods of volatility, your portfolio may deviate from your target asset allocation more dramatically than usual—resulting in undue risk. Adopting a disciplined rebalancing strategy can keep your investments on a more even keel.

3. **To learn more about the benefits of rebalancing, see “Rebalance, Rebalance, Rebalance,” page 9.

In short, investors are right to be concerned about historically elevated debt levels, whether from the private or public sectors. But with a little planning, you can reposition your portfolio to help weather the uncertainty.

1. Updated Budget Projections: 2019 to 2029, 05/02/2019.

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### Liz Ann Sonders (@lizannsonders) is a senior vice president and chief investment strategist at Charles Schwab & Co., Inc.

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The policies and politics coming out of Washington move markets and affect every aspect of our personal finances, from the taxes we pay to how our portfolios perform. For example, Congress has temporarily suspended the debt ceiling—meaning the federal debt can grow unfettered until July 31, 2021, at which point it’s projected to reach $25 trillion.

“That number is indisputably outrageous, and yet few Americans understand just how profoundly the federal debt can affect their lives,” says Mike Townsend, host of **WashingtonWise Investor** and Schwab’s D.C.-based vice president of legislative and regulatory affairs. “And that lack of understanding means a lack of pressure on politicians to do anything about this crisis.”

In each episode, Mike tackles such issues, while his expert guests suggest what to do (and not do) in response.

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<table>
<thead>
<tr>
<th>Fund Name</th>
<th>Schwab Annual Operating Expenses</th>
<th>Industry Average Annual Operating Expenses*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Schwab® 1–5 Year Corporate Bond ETF</td>
<td>SCHJ 0.05%</td>
<td>0.11%</td>
</tr>
<tr>
<td>Schwab® 5–10 Year Corporate Bond ETF</td>
<td>SCHI 0.05%</td>
<td>0.18%</td>
</tr>
<tr>
<td>Schwab® Long-Term U.S. Treasury ETF</td>
<td>SCHQ 0.05%</td>
<td>0.14%</td>
</tr>
</tbody>
</table>

*Category average expense ratio from Morningstar Direct as of 12/13/2019.

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7 SECURE Act Takeaways

New legislation aims to help Americans save more for the future—and manage costs in the present.

The SECURE (Setting Every Community Up for Retirement Enhancement) Act includes provisions that can help new parents, retirees, savers, and students. But these potential new benefits could come at a cost to some taxpayers. Here are seven key changes—and what they could mean for you.

1. **RMDs kick in at 72**
   - IRS-mandated required minimum distributions (RMDs) from tax-deferred retirement accounts now begin at 72 for anyone who turns 70½ after December 31, 2019.
   - **THE FINE PRINT**
     - If you turned 70½ in 2019, the old law still applies and you must take your first RMD by April 1, 2020. If you turned 70½ before 2019, you must continue to take your RMDs by the end of each calendar year. Failure to take RMDs on time results in a 50% penalty on the portion not withdrawn.

2. **IRA contributions aren’t restricted by age**
   - Contributions to traditional IRAs are now permitted no matter your age, so long as you have earned income.
   - **THE FINE PRINT**
     - Whether you’re working or not, you’ll still be subject to RMDs at either 70½ or 72 (see “RMDs,” left).

3. **Inherited IRAs must be depleted within a decade**
   - Other than a spouse, a minor child, and certain other “eligible designated beneficiaries,” inheritors of retirement accounts must now deplete those assets within 10 years.
   - **THE FINE PRINT**
     - The new withdrawal schedule could generate significant taxable income for inheritors, potentially pushing them into a higher tax bracket. If assets remain after 10 years, inheritors face a penalty equal to 50% of the undistributed amount.

4. **401(k)s are available to more part-time workers**
   - Employers are now required to offer their 401(k)s or other workplace retirement plans to employees with three consecutive years of service of at least 500 hours per year in addition to employees with more than 1,000 hours of service within a 12-month period.
   - **THE FINE PRINT**
     - Newly qualified part-time employees can save money on a pretax basis—and capture the employer match, if offered—once they’ve accrued the requisite work history starting in 2021.

5. **405(b)s can be used to pay back student loans**
   - Account owners can now use up to $10,000 from a 529 college savings account to repay student loans—so long as it’s for the account’s primary beneficiary or the beneficiary’s siblings or stepsiblings.
   - **THE FINE PRINT**
     - Those with excess 529 assets now have another penalty-free way to use them—though such funds should be used to pay the beneficiary’s college tuition first, all things being equal.

6. **Retirement savings can be used for adoption and birth costs**
   - Account owners can now withdraw up to $5,000 from a 401(k) or an IRA to pay for qualified adoption or birth expenses without penalty.
   - **THE FINE PRINT**
     - Parents may be able to avoid taking on debt to cover such expenses; however, tapping retirement funds early could put your long-term savings goals at risk.

7. **Late tax returns trigger a bigger fine**
   - If your tax return is 60 or more days late, you will now incur a penalty of the lesser of $400 or 100% of taxes owed.
   - **THE FINE PRINT**
     - Although the new penalty is at most only $200 more than the previous one, every dollar you lose to penalties is one you can’t invest for future growth.

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As traders, we’re often so enamored of our winning trades that we ignore our losers. But it’s our losers from which we stand to learn the most. Here are four ways to learn from the trades that didn’t pan out.

### 1. Calculate your performance

First things first: Gather your gain and loss data so you can begin to assess the factors affecting your overall performance. Instead of simply looking at total gains or losses, I like to display it as a ratio so I can dig deeper into where my profits and losses are coming from:

<table>
<thead>
<tr>
<th># Profitable trades</th>
<th>Average gain</th>
<th>Total gains</th>
</tr>
</thead>
<tbody>
<tr>
<td># Unprofitable trades</td>
<td>Average loss</td>
<td>Total losses</td>
</tr>
</tbody>
</table>

For example, let’s say I had 17 profitable trades with an average $150 gain per trade and eight unprofitable trades with an average $225 loss per trade:

<table>
<thead>
<tr>
<th># Profitable trades</th>
<th>Average gain</th>
<th>Total gains</th>
</tr>
</thead>
<tbody>
<tr>
<td>17</td>
<td>$150</td>
<td>$2,550</td>
</tr>
<tr>
<td># Unprofitable trades</td>
<td>Average loss</td>
<td>Total losses</td>
</tr>
<tr>
<td>8</td>
<td>$225</td>
<td>$1,800</td>
</tr>
</tbody>
</table>
If I looked just at the net gain/loss ratio ($2,550 vs. $1,800), I might think I’d been doing pretty well with $750 in net profit and 17 profitable trades out of 25. Looking more closely at my average gain versus my average loss, however, I can see that I lost 1.5 times more money than I gained ($225 vs. $150), on average.

The average gain versus average loss per trade also tells you how effectively you’re managing and closing out your positions. If your average loss is uncomfortably close to your average gain, ask yourself:

- Do I generally stick to my original trade plans or diverge from them?
- When trades are profitable, what influences my decision to exit?
- When trades are unprofitable, do I exit within my planned risk parameters or hold on too long?

Answering these questions can help you identify weaknesses and build better trading habits over time.

2. Drill down on your losers

When it comes to learning from my past mistakes, I pay extra attention to my average losses because I have the most control over them.

Even when you do your homework, a position can move against you without notice, turning a once-profitable trade into its inverse. It’s how you control those situations that can make or break your success as a trader. If you’ve experienced a similar about-face with one or more of your trades, take a look at how long you allowed the position to fall before you acted.

Focusing on my average losses helped me identify a bad habit in my own trading that was contributing to lackluster results: hanging on to unprofitable trades too long. Simply by exiting each losing trade before it reached my average loss, I noticed an immediate improvement in my performance.

Indeed, you can be wrong more than you’re right and still come out ahead—so long as you keep your average loss to a minimum.

3. Look at your expectancy

Expectancy is the average dollar amount you expect to gain or lose per trade based on previous performance. It combines your percentage of profitable trades and average gain per trade with your percentage of losing trades and average loss per trade:

\[
\text{Expectancy} = \left( \frac{\% \text{ Winning trades} \times \text{ Average gain}}{\% \text{ Losing trades} \times \text{ Average loss}} \right) = \left( \frac{40\% \times \$500}{60\% \times \$250} \right) = \$50
\]

For example, let’s say 40% of your trades in the past six months were profitable and your average gain was $500 per trade, while 60% of your trades were unprofitable with an average loss per trade of $250. Using the calculation above, you could reasonably expect an average gain of $50 per trade.

You should aim for an increasingly positive outcome with each trade. If the opposite is happening, revisit your losers to see where the breakdowns might be occurring.

4. Examine other variables

Finally, it can be helpful to see if any patterns emerge by dividing your trades into categories, such as:

- Fundamental vs. technical analysis techniques
- Investment types
- Order types
- Time frames
- Trade size

Do you find less success with longer-term trades, for example? Or when you choose exchange-traded funds versus stocks? Breaking down your positions in this way can help identify which strategies tend to work for you and which you may want to improve upon—or avoid altogether.

Taking control

Examining your trading performance on a regular basis can help you better understand the behaviors and other factors that may be influencing your outcomes. Paying particular attention to losses is a great way to identify shortcomings—and to up the ante on your trading approach. ■

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Going the Distance

Smart tax planning can help extend the life of your retirement savings.

For many current and future retirees, one question is paramount: How can I ensure I don’t burn through my savings too quickly?

“Most retirees don’t have enough invested to live off the interest alone—even when combined with Social Security, pensions, and other nonportfolio income—so at some point they’ll need to start liquidating their investment assets,” says Hayden Adams, CPA, CFP®, and director of tax planning at the Schwab Center for Financial Research.

Selling investments generally triggers taxes, however, which can undercut such sales and further eat into your nest egg.

“Fortunately, not all investments are subject to the same tax treatment,” Hayden says, “and if you liquidate them in an efficient way you may be able to extend the life of your savings.”

With that in mind, here’s a step-by-step approach to making tax-smart withdrawals in retirement.
1 Take your RMDs
If you turned 70½ in or before 2019, start by taking the required minimum distributions (RMDs) from your tax- deferred retirement accounts. Failure to do so means getting hit with a 50% penalty on the difference between what you withdrew and what was required. Those who turn 70½ in 2020 or later can now wait until age 72 to begin taking RMDs (see “SECURE Act Takeaways,” page 30).

“Because of the penalty, RMDs should be your first stop when tapping your retirement portfolio,” Hayden says. (Most financial institutions—including Schwab—can help you calculate your RMDs when the time comes, or you can estimate them ahead of time using an online calculator like the one available at schwab.com/RMDcalculator.) Whatever you withdraw will be taxed as ordinary income, so if you don’t need this money to cover your living expenses, consider depositing it into a taxable brokerage account, where you could potentially generate gains.

2 Tap interest and dividends
Don’t realize any interest or dividends—but not the original investment—from your taxable accounts. “If you have a capital gain investment untouched means it can continue to grow and potentially yield more dividends and/or interest in the future,” Hayden says.

Interest is taxed as ordinary income—unless it’s from a tax-free municipal bond or municipal bond fund (see “Mad for Munia,” page 15). Dividends, on the other hand, are often taxed at the lower capital gains rate of 0%, 15%, or 20%, depending on how long you’ve held the account. For more information, pricing, and disclosures related to the Schwab Intelligent Portfolios® disclosure brochures, visit schwab.com/retirement.

3 Collect principal from maturing bonds and CDs
Many retirees rely on bonds and certificates of deposit (CDs) to generate regular income. Laddering such investments—that is, buying bonds and/or CDs with staggered maturity dates and reinvesting the principal as each comes due—can help provide a steady stream of income while evening out your portfolio’s yields over time. However, should you need cash after exhausting RMDs and your inter- est and dividends, the principal from a maturing bond or CD can often be the next place to turn—particularly if interest rates have declined and you won’t earn as much by reinvesting the proceeds. Generally speaking, you won’t owe any taxes on your original principal, so long as you hold on to a bond or CD until it matures; an early sale will trigger capital gains taxes if you earn a profit on the sale.

4 Sell additional assets as needed
If the income generated from Steps 1 through 3 isn’t enough to cover your expenses, you’ll need to sell additional assets to close the gap. But which accounts should you tap first—and in what proportion?

If you have significant tax-deferred savings, it’s possible that the size of your RMDs could push you into a higher tax bracket once you kick in, especially after accounting for Social Security, pensions, and other income. If you suspect this to be the case, you may want to consider drawing down your tax-deferred accounts alongside your taxable savings.

With this approach, you take withdrawals from both your tax-deferred and taxable accounts in amounts proportionate to their balances. For example, say you have $800,000 in traditional IRA and $200,000 in a brokerage account for a total of $1 million in savings. If you require an additional $50,000 in income, you’d take $40,000 (80%) from your tax-deferred IRA and $10,000 (20%) from your taxable brokerage account.

“This strategy can help smooth out the potential spike in income caused by RMDs, which may reduce your total taxes paid in retirement,” Hayden says. Distributions from your tax-deferred accounts are taxed as ordinary income, so the order in which you sell them doesn’t matter from a tax perspective, however, you should still draw them down in a way that maintains your target asset allocation.

If you have modest tax-deferred savings or your RMDs aren’t likely to push you into a higher tax bracket, depleting your taxable brokerage account first leaves your tax-deferred assets to potentially grow until RMDs kick in. To tap your taxable accounts most efficiently:

First, part with investments that have lost value. Your losses can be used to offset any gains you may realize—a strategy known as tax loss harvesting (see “Using a tax loss to get a tax break,” left). “And if you don’t realize any capital gains, you can use those losses to offset up to $3,000 of your ordinary income per year until all your losses have been used up,” Hayden says. Just be sure you don’t violate the wash-sale rule by repurchasing the same or “substantially identical” securities within 30 days before or after the sale, lest your losses be disallowed.

Next, focus on selling investments you’ve held for more than a year to take advantage of lower long-term capital gains tax rates. You can sell these appreciated investments as part of your regular portfolio rebalancing, using whatever’s necessary to meet your spending needs and reinvesting the remainder in under-weight areas of your portfolio.

5 Save Roth accounts for last
“It’s in your interest to hold off on tapping Roth assets for as long as possible,” Hayden says. That’s because:

Roth IRAs are subject to RMDs—you can leave those assets to grow indefinitely during your lifetime.

Roth IRAs are also tax-free for your heirs. “The laws could always change, but at least for now it’s one of the best assets you can pass on to the next generation,” Hayden says.

Unlike Roth IRAs, Roth 401(k)s are subject to RMDs—which is why it might make sense for some people to roll over any existing Roth 401(k)s into a Roth IRA. Be aware, however, that converting a Roth 401(k) to a Roth IRA could create the five-year holding requirement—unless funds are rolled into an existing Roth IRA, in which case they benefit from the holding requirement. Whether it’s deciding which Roth you’d like to use, or managing your tax liability, this can be an effective way to help keep more money in your pocket and potentially extend the life of your savings.

Creating tax-smart withdrawals during retirement

Schwab Intelligent Income™—a feature of Schwab Intelligent Portfolios®—is an automated investing solution that generates a predictable, tax-smart, monthly paycheck from your investments. Whether it’s deciding which accounts to draw from, harvesting your losses, or prioritizing required minimum distributions, Schwab Intelligent Income can help make withdrawals in a tax-efficient manner.

Schwab Intelligent Income can handle that complexity for you. Using sophisticated algorithms, Schwab Intelligent Income considers owned assets across your taxable, tax-deferred, and tax-free retirement accounts and makes withdrawals in a tax-efficient manner.

To learn more or get started, visit schwab.com/intelligentincome.
When to take financial matters into your own hands—and when to ask for help.

There’s never been a better time to take charge of your own finances. Fund fees and other expenses are lower than ever, and the proliferation of digital tools has put the power of planning firmly in the hands of consumers. Even novice do-it-yourselfers can set financial goals for themselves, select investments, and designate beneficiaries for their accounts.

But everyone has their limits. Some investors lack the discipline, interest, or time required to achieve optimal results. Others face financial circumstances too complicated for any one person to reasonably handle alone. “Today’s tools...
The goal-setting aspect of financial planning can help bring that peace of mind. "And working with a professional can help bring that peace of mind," says. "But these days you can get top-level research—this is key."}

David says. "In the past, you had to have considerable expertise to understand the complexities of financial planning. Now, with the help of Schwab's financial planners, you can get the same level of expertise in a more accessible format. Schwab's financial planners are qualified and experienced professionals who can help you craft a financial plan that's tailored to your specific needs.

One of the most important aspects of financial planning is setting goals. Setting goals is the foundation upon which all financial planning is built. Without clear goals, it's easy to get sidetracked, waste money, and feel like you're making no progress. Setting goals helps you stay focused and motivated, which is crucial for achieving financial success.

To create an investment portfolio that supports your goals, first you need to consider your risk tolerance and time frame, which will help determine the appropriate mix of assets for your needs. After determining your target asset allocation, it's time to start researching and selecting investments. This is often the step where people stall out. Says. "With so many investments to choose from, it's hard to know where to start or how to evaluate comparable choices." Fortunately, there are a variety of investment options that can help build and monitor your portfolio, from investing in set-and-forget it-target-date funds and using a portfolio builder to employing a professional investment manager and an algorithm-based robo-advisor. "In the past, you had to have considerable savings to get quality advice." Says. "But these days you can get top-level portfolio management at a low cost. Even those who've successfully managed their own investments during their working lives may feel the need for outside help as they approach retirement, when income generation (as opposed to wealth accumulation) takes center stage (see "Going the Distance," page 26). When you reach those inflection points in your investing life, you want to know you're making the right decisions," David says. "The challenge for many investors is knowing what it is, you're doing and how to implement them effectively. A financial planner can help you assess your total tax situation and may recommend working with a tax advisor, who can help with everything from financial planning to tax-loss harvesting—giving strategy to timing the sale of your investments to managing the required minimum distributions (RMDs) from your tax-deferred retirement accounts mandated by the IRS. (For more information on RMDs, see "7 SECURE Act Takeaways," page 20.) A lot of people make costly mistakes that are perfectly avoidable." Says. "Working with a tax pro can help you make the most of the tax code and keep more of your money, both before and during retirement."

People tend to think estate planning is only for the very wealthy, but that's not necessarily true. Many people have complex estates—no kids, no house, no assets outside of their retire-ment accounts—you're probably better off working with someone who can tailor your estate documents to your specific circumstances," Rob says. "Of course, attorneys typically charge by the hour, which is why both David and I recommend doing some of the legwork before you meet with one. "The most important thing is to figure out in advance who you want to inherit what—no small task—you're not running up a tab working through questions only you can answer," David says.

The goal-setting aspect of financial planning is a perfect do-it-yourself task, because only you can decide what you want out of life. Maybe you plan to retire at 62, fully finance your child's college education, or purchase a second home. That said, "having a general sense of where you want to end up is just as important as making a concrete plan to get there," says. "Too often we end up saving what we can and hoping for the best, without any real sense of whether it's actually enough."

So start by articulating your financial goals, listing them in order of priority, and assigning a dollar amount and due date to each. If you need help prioritizing your goals or estimating your savings targets, there are a number of online calculators and tools available to help. Once you've sorted out your goals, it's time to figure out how much you need to save each month to achieve them. If the prospect of juggling multiple goals feels daunting, a financial planner can help you establish a savings strategy and timeline, as well as provide an honest assessment of what is and isn't possible. Of course, a financial plan is only as good as its execution—which means sticking to your plan through good times and bad.
Alternatives to ubiquitous capitalization-weighted index funds can help diversify your portfolio.

One alternative methodology—called equal weighting—is to hold all the stocks in an index in equal amounts; hence, as some companies rise in value, a portion of their shares are sold and the money reinvested in other companies in the index to maintain equal weighting. Other approaches focus on growth or value or volatility. These alternative weighting methodologies—known collectively as “strategic beta”—account for about 17% of U.S. equity index fund investments. “Strategic beta is where we’re seeing some of the largest growth in the ETF industry,” Steve says.

Beyond cap weighted

Individual stock pickers rarely beat the market over the long term—but which can make a compelling case for investing in index mutual funds and exchange-traded funds (ETFs). What’s more, a single index fund can provide exposure to hundreds if not thousands of stocks, ensuring you’re not overexposed to the ups and downs of any one security.

Be that as it may, many broad-market index funds—including those that track the S&P 500® Index—aren’t necessarily diversified as you might think. That’s because their underlying indexes are often capitalization weighted, meaning they weight each stock according to the total market value of its outstanding shares. In other words, if the total market value of Microsoft’s outstanding shares were 10 times that of Nike’s, the technology company would have 10 times more influence on the index’s performance than the activewear company.

Thus, the capitalization-weighted approach contains a hidden risk: A few large companies can come to dominate an index’s overall value (and hence its performance). The top 10 companies in the S&P 500, for example, represent only 2% of the stocks in the index but approximately 22% of its value (see “Outsize influence,” far right).

This potential for overexposure to a handful of market behemoths has helped give rise to alternative weighting methods, which determine a company’s influence on an index using metrics other than market capitalization. “Investors are recognizing that there are drawbacks to investing proportionate to market cap alone,” says Steve Greiner, senior vice president of Schwab Equity Ratings®.

One alternative methodology—called equal weighting—is to hold all the stocks in an index in equal amounts; hence, as some companies rise in value, a portion of their shares are sold and the money reinvested in other companies in the index to maintain equal weighting. Other approaches focus on growth or value or volatility.

These alternative weighting methodologies—known collectively as “strategic beta”—account for about 17% of U.S. equity index fund investments. “Strategic beta is where we’re seeing some of the largest growth in the ETF industry,” Steve says.

Most strategic-beta funds may offer some degree of diversification and complement the cap-weighted funds many investors tend to hold, but investors might find certain strategic-beta funds more suited to their investment goals than others.

So, how can you determine which alternative indexing methodologies are right for you? Let’s break down seven common strategic-beta approaches—and the investors to whom they may appeal.

1. Dividend

What it is: A mix of stocks weighted by the highest-dividend payers, typically based on the aggregate dollar amount of each company’s dividends or other approach tied to payouts.

Who it’s for: These funds are often favored by investors who are nearing retirement and shifting their focus from growth to income generation. Because equities with strong and rising dividends have in recent decades outperformed their low- and non-dividend-paying counterparts (see “Stocks That Pay,” page 8), they might also appeal to any investor looking to maximize her or his returns.

2. Fundamental

What it is: These funds screen and weight stocks based on various financial metrics—such as their underlying companies’ cash flow, dividends, and sales. Fundamental strategies tend to outperform during the middle to late stages of an economic expansion, when growth becomes scarce and value becomes more important.

Who it’s for: Because they are likely to be less volatile in down markets, say, momentum funds (see next entry), fundamental funds may appeal to investors who want less exposure to the downward pressure of highfliers that often dominate capitalization-weighted indexes. Even in appreciating markets, however, fundamental funds can complement traditional cap-weighted approaches because of their differentiated performance.

3. Momentum

What it is: These funds look to capitalize on an upward market trend by favoring stocks with the strongest price movements while avoiding those with the weakest price movements. Managers of momentum funds rebalance at regular intervals to reflect the latest price changes in their underlying indexes, which can generate a high degree of turnover in the fund’s holdings and hence ordinate capital gains.

Who it’s for: Momentum funds might be right for investors looking to potentially boost their returns over the short term, especially during rising markets. That said, “momentum can change direction quickly, leaving investors who invested and with high turnover in their portfolios, which could trigger unexpected taxes,” Steve says. “For this reason, it’s wise to incorporate these funds in moderation.”

4. Growth

What it is: Growth funds seek to amplify returns by giving more weight to stocks that exhibit superior growth.
characteristics. They score their component companies by such growth metrics as rapidly rising earnings and sales—irrespective of price trends.

**Who it's for:** This strategy may be appropriate for investors looking for better potential returns than those typically provided by traditional cap-weighted funds—and who are comfortable with the increased risk. Because you’re betting that the fastest-growing companies are going to continue to outperform the market, such funds could suffer if growth slows.

### 5. Value

**What it is:** Essentially the opposite of growth, these funds incorporate prices in determining how much of a discount a stock is trading at relative to fundamental characteristics such as book value, earnings, and sales. The bigger the discount, the greater the weight in the index.

**Who it's for:** Value funds can be especially attractive to those in or nearing retirement because they can provide steady returns without overexposing investors to high-flying, highly volatile growth stocks.

### 6. Quality

**What it is:** A fund that favors companies that have historically delivered higher returns on equity, lower debt burdens, and steadier earnings.

**Who it's for:** Quality funds are mainly geared toward investors who want exposure to stable companies with a proven track record of stronger profits and prudent financial management, and who favor consistent performance over the potentially greater returns—and risk—of high-growth stocks.

### 7. Low volatility

**What it is:** Funds in this category give more weight to stocks that have historically generated smaller price swings than the market as a whole over previous periods.

**Who it's for:** Because of their orientation toward lower-volatility stocks, such funds may be particularly appealing to those nearing retirement or who are otherwise concerned about their ability to wait out a market downturn. Be aware, however, that investing in low-volatility funds may also mean sacrificing potentially bigger returns during rising markets.

**Stay diversified**

While momentum and pure growth funds can boost performance when growth stocks are leading the way, pure value and low-volatility funds may offer better protection when stocks slump. But does that mean you should use strategic-beta funds to respond to prevailing market conditions? “Only if you can accurately predict when to shift between styles—which is a tall order even for professional money managers,” says Mark Riepe, head of the Schwab Center for Financial Research.

Instead, Mark suggests a diversified approach—incorporating strategic beta as a complement to the cap-weighted funds many already hold. The good news, he says, is that “given the number and variety of methodologies available, most investors are sure to find one that fits their risk appetite and investment objectives.”

*See page 46 for important information.  
Investors should consider carefully information contained in the prospectus or, if available, the summary prospectus, including investment objectives, risks, charges, and expenses. Please read it carefully before investing.  
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.  
Diversification and asset allocation strategies do not ensure a profit and cannot protect against losses in a declining market.  
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. Shares of ETFs are not individually redeemable directly with the ETF. Shares are bought and sold at market price, which may be higher or lower than the net asset value (NAV). All ETFs are subject to management fees and expenses.  
Indexes are unmanaged, do not incur management fees, costs, and expenses, and cannot be invested in directly.  
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Brokerage Products: Not FDIC Insured • No Bank Guarantee • May Lose Value
Home buying has gone plural.

According to the National Association of Realtors, one in eight home buyers is shopping for a second home—a majority with rental income in mind. In fact, more than two-thirds of those surveyed were looking for a second home to rent it out for at least part of the year, up from 20% in 2000, according to Savills.

One securities-based lending option you could consider is Schwab Bank’s Pledged Asset Line®, a flexible, nonpurpose line of credit.* This let’s you leverage the value of your nonretirement assets while helping maintain your investing strategy. The line of credit is secured by assets held in a separate Pledged Account that is required to be maintained at Charles Schwab & Co., Inc. and is a required minimum initial advance of $70,000. To learn more about Schwab Bank’s Pledged Asset Line, 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.

*A nonpurpose line of credit may not be used to purchase securities or pay down margin loans, and can’t 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.

- A traditional mortgage: The most popular types include fixed-rate loans—typically for 15 or 30 years (generally speaking, the shorter the loan, the lower the interest rate)—and adjustable-rate mortgages (ARMs), whose interest rates reset after a fixed period of time and adjust in response to prevailing market rates. Jumbo loans—or those that exceed $484,350 in most counties in the United States—may require higher down payments and have higher interest rates, closing costs, and fees. Under the Tax Cuts and Jobs Act of 2017, you can deduct the interest on up to $750,000 worth of such loans for married couples filing jointly, and $375,000 for individuals or separate filers.

- A home equity line of credit (HELOC): You may not be able to borrow against the equity in your existing residence—and the interest may be deductible if the funds are used to purchase, build, or substantially renovate a primary or secondary residence, up to the limits mentioned previously.

- A cash-out refinance: This refi approach replaces your existing mortgage with one that carries a larger balance (To Refi or Not To Refi, page 13). The difference between the two loans is distributed as cash, which can be especially useful if you have house-related expenses over and above the new property’s purchase price.

- Securities-based lending: These nonpurpose lines of credit can allow you to borrow against the value of your nonretirement assets while helping keep your investment strategy on track (see “Another way to borrow,” below).

Important risk information: At any time, including in advance of the loan value of collateral or to support the outstanding loans, Schwab Bank may require immediate payment of all or any portion of the outstanding loans in accordance with the terms of 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.

This offer is subject to change at any time and without notice. Schwab reserves the right to withdraw at any time and without notice. If the Demand is not addressed or is not addressed within the period to lend, Pledged Asset Lines are subject to credit and collateral approval. Other conditions and restrictions apply. See “Another way to borrow,” page 13.

Important: This is not an offer to open an account. Schwab Bank, Member FDIC and an Equal Housing Lender. Charles Schwab Bank is not acting or registered as a securities broker-dealer or investment advisor.

You also need to decide up front whether you’ll rent out your second home, be it occasionally or on an ongoing basis.

A rental property can provide not only income but also potential tax benefits. For example, you may be able to deduct certain expenses, such as depreciation, from your annual rental income.

Keep in mind, however, that you’ll likely face a host of tax obligations as well. Apart from property taxes, any rental income could potentially push you into a higher tax bracket. Also, if you use a second home as both a rental property and for extended personal use, you may not be eligible for all the deductions and credits that a rental property would provide. A tax advisor can help you maximize the available deductions while helping you fulfill your tax obligations. Some people think of a rental property as a hobby, but it’s not—it’s a business,” Hayden says. “That’s certainly how the IRS sees it, and how you should see it, too.”

Another question to tackle in advance: How will you interact with renters? Some owners take a hands-on approach, more than others. Are you willing to rent to making repairs, while others hire handymen and even full-service property managers who can find suitable renters, help refurbish the property between tenants, and do everything in between. Such white-glove service comes at a cost, but it can be especially helpful with a property in a distant locale.

Also be sure to check with a real estate agent and/or your homeowner’s association regarding local rental laws. These can vary by municipality and even by neighborhood and are evolving rapidly in response to the rise of vacation rentals through companies such as Airbnb. In New York City, for example, you may not rent out an entire apartment or home to visitors for fewer than 30 days, even if you own or live in the building.

Owners should also strongly consider setting aside emergency funds to avoid selling securities in a down market to pay for any unexpected expenses. Finally, Hayden urges those planning to rent out a second home to treat it as a separate business entity. “If your rental isn’t structured properly, any renter who brings a lawsuit could potentially take your car, house, or hard-earned savings,” he says. For example, registering a business as a limited liability company (LLC) can help protect your assets in the event you’re sued—as can liability insurance.

Your Schwab financial consultant can help you think through financing options, the process and eventual sale. Finding a reliable team of professionals—an accountant, an attorney, a real estate agent, and possibly a property manager—can help. “More so than your primary home, a successful second-home ownership is a team effort,” says Hayden.

And of course, an experienced financial advisor or wealth strategist can help you to realize your dream of second-home ownership to begin with.


See page 40 for important information. * Investing involves risk, including loss of principal. ** This information is not intended to be a substitute for specific individualized tax, legal, or investment planning advice. When specific advice is necessary or appropriate, you should consult with a qualified tax advisor, CPA, financial planner, or investment manager. (0220-9190)
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Market insights, economic analysis, and fresh perspectives—straight to you.

Want to better understand what’s moving the market—and why? Whether you’re a frequent trader or an investing novice, Schwab Live Daily offers shows on a range of topics matched to your experience level:

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- Develop a better understanding of how market news could impact your investments.
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Sharpen your skills by tuning in to more than 10 segments, like “Liz Ann Live” with Schwab Chief Investment Strategist Liz Ann Sonders. Every other Monday at 4:30 p.m. Eastern time, Liz Ann and host Joe Mazzola discuss timely topics from her Market Commentary column and update you on relevant topics that could impact the investing landscape, like these:

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- Fed interest rate cuts and what could happen next
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About Liz Ann Sonders

As chief investment strategist at Charles Schwab, Liz Ann analyzes and interprets the economy and markets on behalf of Schwab’s clients. She is a regular guest on CNBC, CNN, Fox Business, PBS NewsHour, and more, and is regularly quoted in financial publications, including The Wall Street Journal, The New York Times, and Barron’s.

FOLLOW LIZ ANN @lizannsonders
and watch “Liz Ann Live” on Schwab Live Daily every other Monday at 4:30 p.m. Eastern time.

See page 46 for important information. (0220-99ZL)
Schwab Bank Visa® Platinum Debit Card

Security features for your Schwab Bank Debit Card

Schwab Bank’s Visa Platinum Debit Card offers a variety of security features to help you control and monitor activity in your account.

<table>
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<th>Security feature</th>
<th>How to set it up</th>
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**In the app:** Tap More > Client Service > Manage Cards > Set Up Debit Card Alerts. |
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See page 46 for important information. (0320-923N)
Schwab’s 1099 Dashboard Brings Transparency to Tax Season

Find out when your 1099 tax forms will be available on schwab.com or via the Schwab Mobile app.

Tax season can be fraught enough on its own, without the added stress of having to track down tax documents for your various accounts or wondering when they’ll become available.

That’s why we’ve eliminated some of the guesswork.

Log in to schwab.com/1099dashboard to view your 1099 Dashboard (above). There, you can access tax forms for all of your Schwab accounts and see when new forms become available.

You can also access the 1099 Dashboard on the Schwab Mobile app. Just tap More at the bottom of the screen, then tap Client Service, and then select the special 1099 Tax Forms menu.

On the 1099 Dashboard, you’ll find:

- Expected availability dates for 1099 Composite forms for brokerage accounts that had taxable activity.
- Other tax forms as they become available:
  - Retirement accounts (Form 1099-R)
  - Bank accounts (Form 1099-INT)
  - Employer Sponsored Account forms (Form 1099-B, Form 1099-DIV)
- Educational resources, including filing dates and other tax-related information.
- Quick links to easily manage paperless and security preferences.

See page 46 for important information.

◆ 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.◆ The expected availability date for your account(s) applies to the original Form 1099 Composite and may change if all necessary information to complete your Form 1099 Composite has not been received from the issuers of securities in your account.◆ Schwab sends all necessary tax forms by the regulatory filing due date. We provide 1099 Composite information during the month of February. In early February 2020, 1099s will be sent out for accounts that hold investments for which we have all necessary tax information, including stocks, options, and money market funds/cash deposit interest. We expect these 1099s to be available on schwab.com on Friday, December 31. Mailings of paper 1099 Composites will take place from February 1 through February 15. In mid-February 2020, 1099s will be sent out for accounts that contain at least one investment for which the issuer can’t provide information on time for the earlier mailing. Examples include ETFs and mutual funds, fixed income, REITs, UITs, WHFITs, and U.S. and foreign stocks that have been reclassified in the past. We expect these 1099s to be available on schwab.com on Friday, February 14. Mailings of paper 1099 Composites will take place from February 15 through February 28.◆ Requires a wireless signal or mobile connection. System availability and response times are subject to market conditions and your mobile connection limitations. Functionality may vary by operating system and/or device.◆ Independent investment advisors are not owned by, affiliated with, or supervised by Schwab.◆ This general information is not intended to be a substitute for specific individualized tax, legal, or investment planning advice and is not intended to be construed as tax advice. This information cannot be used for the purpose of avoiding penalties that may be imposed under the Internal Revenue Code or applicable foreign tax authority provisions. Where specific advice is necessary or appropriate, Schwab recommends consultation with a qualified tax advisor, CPA, financial planner, or investment manager.

(0220-92L5)
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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.

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Pg. 6, 25–29: 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 Alternative Minimum Tax (AMT). 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.

Pg. 7, 9, 13–14, 15–16, 38–41: The Schwab Center for Financial Research is a division of Charles Schwab & Co., Inc.

Pg. 8: Indexes are unmanaged, do not incur management fees, costs and expenses, and cannot be invested in directly.

Pg. 15–16: Diversification and asset allocation strategies do not ensure a profit and cannot protect against losses in a declining market.

Pg. 15–16, 17–18, 25–29, 34–36: 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. Lower rated securities are subject to greater credit risk, default risk, and liquidity risk.

Pg. 25–29: A bond ladder, depending on the types and amount of securities within the ladder, may not ensure adequate diversification of your investment portfolio. This potential lack of diversification may result in heightened volatility of the value of your portfolio. You must perform your own evaluation of whether a bond ladder and the securities held within it are consistent with your investment objective, risk tolerance and financial circumstances. • A rollover of retirement plan assets to an IRA is not your only option. Carefully consider all of your available options which may include but not be limited to keeping your assets in your former employer’s plan; rolling over assets to a new employer’s plan; or taking a cash distribution (taxes and possible withdrawal penalties may apply). Prior to a decision, be sure to understand the benefits and limitations of your available options and consider factors such as differences in investment related expenses, plan or account fees, available investment options, distribution options, legal and creditor protections, the availability of loan provisions, tax treatment, and other concerns specific to your individual circumstances.

Pg. 34–36: Dividend-focused funds may underperform funds that do not limit their investment to dividend paying stocks. Stocks held by the fund may reduce or stop paying dividends, affecting the fund’s ability to generate income. • International investments involve additional risks, which include differences in financial accounting standards, currency fluctuations, geopolitical risk, foreign taxes and regulations, and the potential for illiquid markets. Investing in emerging markets may accentuate these risks. • All corporate names shown above are for illustrative purposes only and are not a recommendation, offer to sell, or a solicitation of an offer to buy any security.

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S&P 500® Index measures the performance of 500 leading publicly traded U.S. companies from a broad range of industries. It is a float-adjusted market-capitalization weighted index.

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Charles R. Schwab
Founder & Chairman

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