Heads Up

Five unexpected expenses that can befall your retirement—and how to avoid them. Page 22
Dear Client,

If 2020 has taught us anything, it's that life can quickly change in ways we don't anticipate. That's why it's so important to create a financial plan that's built to withstand the unexpected—especially where retirement is concerned. On page 22, we outline five surprise expenses that could derail your retirement budget and provide helpful tips for getting ahead of them.

Elsewhere in this issue, we look at four common mistakes people make when creating trusts (page 11), explain how preferred securities could be an attractive option for income seekers (page 17), offer tips for maximizing your charitable giving during times of crisis (page 30), and more.

If you need help preparing for or navigating the unexpected, I encourage you to reach out to us at 877-297-1126. We welcome the opportunity to speak with you about your financial needs and goals.

Sincerely,

Joseph Vietri
Senior Vice President, Investor Services
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Sincerely,

Walt Bettinger
President & CEO

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Do Hold Back

It might be time to revisit your W-4.
Putting Your HSA to Work

Health savings accounts are for more than just routine medical expenses.

Health savings accounts (HSAs) are particularly prized for their triple tax advantages: Contributions are tax-deductible,1 earnings are tax-free, and withdrawals are tax-free when used for qualified medical expenses.

However, roughly 95% of HSA holders keep their accounts entirely in cash, according to the Employee Benefit Research Institute. Account holders who don’t invest their HSA contributions could be missing an opportunity to earn tax-free returns.2

“We generally recommend keeping two to three years’ worth of routine medical expenses in cash,” says Rob Williams, vice president of financial planning at the Schwab Center for Financial Research. But any funds in excess of that could be invested for potential growth—for two reasons:1

Given the likelihood that health care costs will be even higher in the future, it may be wise to do all that you can to get ahead of them. Indeed, a 65-year-old couple retiring today can expect to need as much as $363,000 in savings to cover Medicare premiums and out-of-pocket costs.2

If you use HSA funds for things other than health care expenses after age 65, you’ll pay only ordinary income tax with no other penalty—putting the funds on par with withdrawals from 401(k)s and IRAs, with the added advantage that HSAs aren’t subject to required minimum distributions. (Nonqualified withdrawals made prior to age 65 are subject to ordinary income tax plus a 20% early withdrawal penalty.)3

To contribute to an HSA, you must participate in an eligible high-deductible health care plan. You can contribute up to $3,550 in 2020 ($7,100 for families), plus an additional $1,000 in catch-up contributions if you’re 55 or older. Once you have sufficient funds in the account—most require you to maintain a minimum cash balance—you can start to invest additional funds based on your risk tolerance, your time horizon, and the choices offered by your HSA administrator.

Likewise, if you recently got married, you both work, and you plan to file jointly, you’ll likely need to modify your withholding to account for higher household income.

Your dependents changed: If you welcomed children to your family this year, you may be eligible for a child tax credit of up to $2,000 per child under the age of 17. Those with other qualifying dependents—such as children between the ages of 17 and 23 who are full-time students—may be eligible for a child tax credit of up to $500 per child.

The IRS Tax Withholding Estimator (irs.gov/w4app) can help you calculate whether you should increase or decrease your withholding based on changes in income or other factors.

“In general, I recommend reviewing your withholding at the start of the year and then again halfway through,” Hayden says, “particularly when there are changes to tax law or your personal circumstances.”

See page 42 for important information. ■ This information does not constitute and is not intended to be a substitute for specific individualized tax, legal, or investment planning advice. Where specific advice is necessary or appropriate, Schwab recommends consultation with a qualified tax advisor, CPA, financial planner, or investment manager. (1120-0WL2)
There’s a New ETF in Town

A new breed of exchange-traded fund offers less transparency—in ways good and bad.

The Securities and Exchange Commission recently approved a new kind of exchange-traded fund: the semi-transparent ETF.

Unlike transparent ETFs, whose managers are required to report their holdings daily, semi-transparent ETFs must disclose their holdings only monthly or quarterly—which allows fund managers to roll out actively managed strategies without fear of copycats or predatory traders following their every move.

“Some active managers have avoided traditional ETFs because they believe the requirement for daily disclosure would allow others to steal their ‘secret sauce,’” says Emily Doak, CFA and managing director of ETF research at Charles Schwab Investment Advisory.

“This new breed of ETF allows fund managers to offer the kinds of proprietary strategies formerly reserved for active mutual funds.”

That said, less frequent disclosure of holdings could involve trade-offs. Because they often shield their holdings using proxy portfolios that resemble but aren’t identical to the fund’s actual holdings, semi-transparent ETFs may be harder to value than regular ETFs.

This could cause their shares to trade with wider bid-ask spreads, particularly during periods of heightened market volatility.

“The bottom line is, it’s too soon to know how semi-transparent ETFs will stack up against their traditional peers and each other,” Emily says, “so I suggest approaching them with an abundance of caution until they have a track record to back them up.”

See page 42 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. You can request a prospectus by calling Schwab at 800-435-4000. Please read it carefully before investing. ◆ Active semi-transparent ETFs operate differently from other ETFs. Unlike other ETFs, an active semi-transparent ETF does not publicly disclose its entire portfolio composition each business day, which may affect the price at which shares of the ETF trade in the secondary market. Active semi-transparent ETFs have limited public trading history. There can be no assurance that an active trading market will develop, be maintained, or operate as intended. There is a risk that the market price of an active semi-transparent ETF may vary significantly from the ETF’s net asset value and that its shares may trade at a wider bid/ask spread and, therefore, cost investors more to trade than shares of other ETFs. These risks are heightened during periods of market disruption or volatility.

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Borrowing Trouble

Early, penalty-free withdrawals from certain retirement accounts are easier than ever. But that doesn’t mean they’re good for you.

For Financial Research, “but early withdrawal penalties were put in place to help preserve your savings for their true purpose: funding retirement. Tapping the money early may help in the short term but could have the opposite effect in the long term.”

Of course, there may be times when withdrawing retirement funds early is the right—and possibly only—course of action. Even so, here are three tips to consider as you weigh your options:

1. Exhaust the alternatives: Your retirement savings may be a tempting target, but other options might make more sense in the long run. For example, borrowing against the equity in your home or your brokerage assets could provide the short-term cash flow you need without undermining your long-term goals.

2. Keep your withdrawal to a minimum: The legislation allows you to withdraw up to $100,000 across eligible accounts—but just because you can withdraw that amount doesn’t mean you should. After all, every dollar you withdraw now is a dollar you’re taking from your future self (not to mention any gains it might produce if you were to leave it invested).

3. Pay it back ASAP: If you do decide to take a withdrawal, make a plan for getting your retirement savings back on track as quickly as possible, particularly since you won’t owe taxes on those funds if you pay them back within three years.

If you’re thinking of taking a coronavirus-related distribution, be aware that the provision is set to expire at the end of 2020, unless Congress votes to extend it. Also be sure to check with your employer’s plan administrator before taking a withdrawal, as employers are not required to amend their plans to provide for such distributions and/or loans. And finally: “Speaking with a financial advisor before taking action is always a good idea,” Rob says.

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At its core, the purpose of estate planning is to ensure your assets transfer to your heirs as efficiently and effectively as possible. And that’s where trusts come in.

Not only do they bypass probate—the often-lengthy legal process of validating your will—but they also leave behind precise, legally binding instructions for how to distribute and potentially maintain your assets. This can be especially critical if you have a beneficiary with special needs or one who is otherwise ill-equipped to manage an inheritance, or you’re bequeathing complex assets that will require ongoing attention after you’re gone.

That said, “establishing your own trust can be a minefield,” says Kimberly Frank, a Schwab senior wealth strategist. Here, Kimberly and her colleague George Pennock, director of trust services consulting for Charles Schwab Trust Company, share four common missteps people make when setting up a trust—and how to avoid them.

Mistake No. 1: Failing to fund the trust

According to Kimberly, the biggest and most costly mistake she has seen people make when creating a trust is failing to fund it. “You’d be surprised how many people go through the effort and cost of meeting with an attorney
to formalize their wishes, only to leave the trust empty,” she says.

Once you’ve done the paperwork, you must follow up by retitling the appropriate assets in the name of the trust as instructed by your attorney. In the case of insurance policies and retirement accounts, retitling may be as easy as updating your beneficiary designations online. For bank accounts and nonretirement investment accounts, you’ll need to reach out to your financial institutions. And for real estate or business interests, you may need to work with your attorney to properly transfer such assets into the trust.

“Any assets that aren’t appropriately retitled may have to go through probate, which can be a very lengthy process,” Kimberly says. And don’t assume a so-called pour-over will—in which you decree that the property in your estate should be distributed to the trust upon your passing—will help your estate avoid probate. “It will simply make sure the assets eventually end up in the trust once the probate process has concluded,” she says.

**Mistake No. 2: Choosing the wrong trustee**

Whether or not you’re able to act as the trustee of your own trust during your lifetime, you’ll eventually need someone else to manage the assets and execute transactions, including distributions, after your passing.

“Older adults often want to lean on their kids to fill these roles, but you have to think about whether family dynamics could get in the way,” Kimberly says. “I’ve also seen grantors name their adult children and new spouse as co-trustees, which can lead to all kinds of conflict if they have competing interests or don’t see eye to eye.” In such cases, it may make more sense to appoint a close family friend or corporate trustee instead. You might also consider combining the two approaches, naming an individual and a corporate trustee as co-trustees.

Where the trustee resides may matter, as well. Some states, including California and New York, tax the income from trusts administered in their states. Certain states may also offer better protection from creditors than others based on where the trustee resides. “Depending on the size and complexity of your estate, where a trustee is located could matter significantly,” George says. An estate-planning attorney can help you think through such considerations as part of the trust-creation process.

**Mistake No. 3: Underestimating financial needs**

When designing a trust, many people concentrate more on portioning out what they have rather than assessing what their beneficiaries might actually need. “I’ve seen people put $1 million into a trust thinking that will maintain their spouse’s lifestyle,” George says. “But what if that person lives another 10, 15, or 20 years? Part of your process should be understanding the assumptions that underpin your planning—and accounting for different scenarios. You don’t want your loved ones to run out of funds.”

In addition, think about the costs your beneficiaries might incur when maintaining cherished but potentially burdensome nonfinancial assets, such as property. Most houses, for example, require repairs and general upkeep, and those costs can be considerable for higher-priced or second residences.

**Mistake No. 4: Failing to update your trust**

Unless you’re working with an irrevocable trust—which, once established, generally can’t be modified or revoked—you may want to periodically make changes to your trust should circumstances, such as death or divorce, require it.

Kimberly recommends meeting with an estate-planning attorney at least every three to five years to address any such changes. It also makes sense to stay on top of changes in tax laws that could affect how trust assets are treated. The Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019, for example, requires certain nonspouse inheritors of individual retirement accounts to deplete those assets within 10 years, rather than over their lifetimes.

**Trust in the process**

When designed correctly, a trust can help your heirs bypass the costs, delays, and headaches that often arise from probate proceedings. “The difference between a well- and poorly designed trust is usually the quality of the counsel you’re getting,” George says. “After all, your wishes are only as good as the trust designed to implement them.”

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Thanks to decades-long trends that have lowered costs for trading and increased access to the markets, it’s now easier than ever to become an investor.

Some of the latest innovations include commission-free online stock trading and the introduction of fractional shares, which allow investors to buy smaller, more affordable “slices” of otherwise prohibitively priced stocks.

While these developments are indeed wonderful, they don’t change a fundamental aspect of investing—namely, that investing is all about balancing the potential for making money with the possibility of losing it.

Whether you’re a new investor or an experienced one, have a little bit of money or a lot, managing risk is key to success. With that in mind, here are four risk-management principles to get you started—and to stick with throughout your investing career.

1. **Align your risk with your goals**

What are you investing for and how are you going to achieve it? To create a successful plan, you first need to identify what your goal is: a comfortable retirement, the down payment on a...
house, a trip you hope to take in the next few years? Once you know your goals, ask yourself how quickly you want to achieve each and how much risk you’re willing to take—financially and psychologically—to get there. Could you afford to lose much of the money you’re investing? How would you react? If the answers are “no” and “poorly,” it doesn’t mean you shouldn’t invest; it just means you should invest in ways more in line with your risk tolerance and time horizon.

If you’re saving for something you’ll want or need soon—such as a down payment on a new house—you’ll probably want to invest in something relatively stable, like a money-market fund or U.S. Treasuries. If you’re saving for a retirement that’s still decades away, you may be comfortable with a larger portion of your savings in stocks—which have historically come with more risk but also delivered higher returns—since you’ll have much longer to potentially recover from a downturn.

Diversify

Diversification means spreading out your investments—both across different asset classes (such as stocks and bonds) and within them (such as U.S. stocks and international stocks).

Each asset class plays a unique role in your portfolio. Stocks provide the potential for growth and could make up the majority of your portfolio when you’re young and have many decades to benefit from compound growth. Bonds, on the other hand, can help preserve your capital, which becomes all the more critical as you approach retirement. What’s more, asset classes don’t always move in tandem, so when one is doing poorly, another may be doing well. Holding a healthy mix of assets can help reduce the impact of any single investment on your portfolio’s performance.

After a long bull run, equities could account for a much larger chunk of your overall portfolio than you’d planned—leaving you exposed to unwanted risk.

That said, diversification still matters even if you’re investing solely in stocks. A portfolio of 20 equities in a variety of industries, for example, is generally far less risky than a portfolio of just two.

Rebalance

Achieving long-term investing success isn’t just a matter of creating a portfolio with the right mix of investments for your goals and time frame. As the markets rise and fall, the investments in your portfolio will grow and shrink in value—so much so that, over time, your portfolio could become either less or more aggressive than you’d intended. After a long bull run, equities could account for a much larger chunk of your overall portfolio than you’d planned—leaving you exposed to unwanted risk.

This is what makes rebalancing so important. By regularly selling positions that have become overweight in relation to the rest of your portfolio and moving the proceeds to positions that have become underweight, you can bring your portfolio back to its original target allocation. It’s a good idea to do this at least once a year, and more frequently if markets are making big moves.

Again, even if you invest only in a handful of individual stocks, don’t let any single name or type of stock represent too big a portion of your overall portfolio. Ask yourself what would happen financially and psychologically if your biggest position significantly declined or got wiped out altogether. If that scenario is troubling even to contemplate, then your position probably needs to be trimmed back.

Watch out for leverage

Leverage is a strategy that uses borrowed money to increase an investment’s potential return—often through products like leveraged exchange-traded funds, futures contracts, margin loans, or options. While such products can amplify returns, they can also disproportionally magnify risk, making it especially easy to get into financial trouble. Indeed, some of the saddest stories involve investors who suffered catastrophic losses because leverage worked against them.

Ultimately, if you don’t understand leverage, it’s best to steer clear of it altogether. Even relatively sophisticated investors should proceed with caution, lest their desire for outsized gains deliver outsized losses instead.

Go slow

Investing is a lifelong endeavor replete with plenty of trial and error. You can learn as you go, and explore different approaches as your interests and goals change. The important thing is to diversify, rebalance regularly, and take a cautious approach to riskier practices in order to get where you’re going without undue turbulence.

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Uncovering the complexities of commodity ETFs.

By Emily Doak

What Lies Beneath

Does it hold physical assets or futures?

Some precious-metal ETFs actually purchase the physical commodities—such as bars of gold or silver—and warehouse them in secure vaults. These funds tend to closely track the spot price of the commodity in question because the metals can be retrieved and sold on the spot market at any time. However, most commodities—including livestock, oil, and wheat—are too costly or cumbersome for an ETF to transport and store. Instead, ETFs typically invest in these commodities via futures contracts, which are agreements to buy a commodity on a future date for a specified price, with the intention of selling the contract before it expires rather than taking possession of the commodity in question.

As a result, ETF managers must regularly sell expiring contracts and purchase new ones with later expiration dates—with two potential consequences:

• When contracts approaching expiration have higher prices than those with expiration dates further out, ETFs are effectively selling high and buying low with every contract rollover—a condition known as backwardation. This happens when the current demand for a commodity is higher than investors expect it to be in the future, relative to its supply.

• Conversely, when contracts approaching expiration have lower prices than those with expiration dates further out, ETFs are effectively selling low and buying high with every contract rollover—a condition known as contango. This happens when the current demand for a commodity is lower than investors expect it to be in the future, relative to its supply.

While contango obviously isn’t ideal, fund managers often invest in futures contracts of various durations to help mitigate its effects.

• A fund’s prospectus will tell you whether the ETF relies on physical assets or futures contracts. Log in to schwab.com, search its ticker symbol, and click the Prospectus link.

How volatile is it?

Commodity ETFs are notoriously volatile because of the supply-and-demand characteristics of their underlying holdings, which can be dramatically impacted by certain events. Unseasonably cold or wet weather, for example, can be catastrophic to some agricultural commodities, while OPEC (to say nothing of COVID-19) can unduly influence oil prices.

One solution to this potential problem is to consider ETFs that track a broadly diversified commodity index. That said, the degree of diversification will vary by index. For example, 61.7% of the S&P GSCI Commodity Index is allocated to the more-volatile energy sector,1 while the Bloomberg Commodity Index’s allocation is roughly a third of that, at 23.4%.2

• To search for commodity ETFs, log in to schwab.com/ETFs/research, select Fund Category under the Basic Criteria menu, and then select Commodities.

• Check a commodity ETF’s volatility characteristics by logging in to schwab.com, searching its ticker symbol, and clicking Risk & Tax.

Know your fund

Investing in commodity ETFs can be a low-cost way to add diversification and inflation protection to your long-term portfolio. However, if you’re looking to make shorter-term tactical moves, be sure you understand how the ETF you’re considering is constructed, since a fund’s volatility, in particular, can have an outsize impact on your short-term prospects.3

1S&P GSCI methodology, as of 05/2020. | 2Bloomberg Commodity Index fact sheet, as of 06/30/2020.

What is its tax treatment?

The complexities of commodity ETFs can also create unusual tax issues. Funds with direct ownership of precious metals, for example, are taxed as collectibles under U.S. rules. Depending on your income tax bracket, the tax bill for this investment may be higher than the long-term capital gains rate or even your ordinary income tax rate.

Funds that invest in futures and other derivatives contracts, on the other hand, may be structured as partnerships, meaning you get a K-1 tax form at the end of the year instead of the typical 1099. To avoid the complications and added expense K-1’s can create at tax time, some newer funds pass their investments through an offshore entity, which allows the fund to be taxed like a traditional mutual fund. However, it’s important to note that such funds are actively managed and may offer less visibility into their underlying holdings.

• You can check whether an ETF distributes K-1 tax forms by logging in to schwab.com, searching its ticker symbol, and clicking Risk & Tax.

preferential securities

Preferred securities may offer attractive yields—but don’t discount their risks.

By Collin Martin

It’s been a tough year for income-focused investors, as the economic fallout from COVID-19 has helped push yields to historic lows. When the pickings are so slim, preferred securities could prove an attractive alternative. They offer higher yields than investment-grade corporate bonds, though they tend to come with more risk. Let’s take a look at how preferreds work and why you should understand their finer points before adding them to your portfolio.

What are preferred securities?

Prefereds are corporate issuances that blend the characteristics of bonds and stocks:

• Like bonds, prefereds make scheduled coupon payments and have par values (typically $25) that are paid back at maturity. They’re usually issued with maturities of 30 years or more—indeed, some never mature—but are generally callable within 10 to 15 years, meaning the issuer can redeem the shares for a fixed value before maturity. Many shares also carry a credit rating from a recognized rating agency.

• Like stocks, prefereds tend to be more volatile than bonds, and a company can suspend dividend payments on certain types of prefereds without triggering default, just as they can with dividends on common shares. (Note that some prefereds are structured as debt and pay interest rather than dividends, meaning they could, in fact, trigger a default.) Additionally, they’re lower than traditional bonds on an issuer’s priority of payments—but more
senior in the payment hierarchy than common stock (hence the “preferred” moniker)—meaning, in the event the issuer is unable to meet all of its liabilities, preferred shareholders will be paid after traditional bondholders but before common stock shareholders.

Because they’re lower in the payment hierarchy, preferreds carry higher credit risk than some corporate bonds and thus offer higher yields to compensate for that risk. That said, if you can find preferreds from an investment-grade issuer, they’re generally less risky than junk bonds but may offer similar yields.

**Should you consider preferreds now?**

Low interest rates make preferreds particularly attractive now, but their unique attributes could subject them to additional risk in today’s market for two reasons:

1. **The Fed could restrict dividends**
   
   The Federal Reserve has been flexing its regulatory authority amid the pandemic. As part of its annual stress tests, in June the Fed instructed large banks to suspend stock buybacks and to keep common stock dividends flat in the third quarter to ensure firms had enough capital to keep lending during the pandemic. Preferred dividend payments weren’t affected by the Fed’s actions this summer, but if the economic picture worsens, banks might need to halt capital distributions—limiting common stock dividends first, then preferred dividends if the Fed deems it necessary.

   Suspending dividends not only eliminates a predictable income source for investors but can also severely erode a preferred security’s value. For example, during the Great Recession one preferred security suspended dividends for a staggering 18 months, and its share price fell more than 50% as a result.

2. **Your securities could be called**
   
   With interest rates near rock bottom for many fixed income securities, investors have bid up prices on higher-yielding preferreds. This raises concerns for investors in callable preferreds, which allow issuers to repurchase the securities at par value prior to their maturity date. If you buy a callable security at a premium, be aware that the issuer could buy it back at par, potentially forcing you to realize a loss by buying high and selling low.

**How should investors proceed?**

There are three moves investors can make to help mitigate these risks:

- **Opt for quality:** There’s no telling how the next year will shake out, but issuers of higher-rated securities are generally in a better financial position to satisfy their liabilities. You could also invest via an actively managed preferred fund, whose managers may be able to weed out riskier securities.

- **Diversify:** If the Fed clamps down on bank common stock dividends, preferreds could be next. One way to get ahead of this is by adding preferreds from sectors the Fed doesn’t regulate—such as communications, real estate, and utilities—to your portfolio. Many preferred funds will hold a mix of issuers from multiple sectors.

- **To research preferred funds by sector concentration, log in to schwab.com/fundscreener, select Taxable Bond, then select Preferred Stock. From there, select Sector Exposure under the Choose Criteria menu, then choose a sector.**

- **Pay attention to prices:** If a preferred security is trading above its typical par value of $25, investigate how soon it could be called. Should interest rates stay low for an extended period of time, issuers may choose to call their higher-interest shares early in order to issue newer shares at lower rates. Investing in preferreds via a diversified fund can help reduce this risk.

- **Consult a Schwab fixed income specialist if you need help assessing the prospects of a preferred security by calling 866-893-6699.**

Preferreds can be a good way to supplement a fixed income portfolio, especially during times of low interest rates. Just be sure your allocation matches your risk tolerance. We generally recommend fixed income investors limit their exposure to riskier assets—including preferreds—to no more than 20% of their overall portfolio.

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See page 42 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.* *Examples provided are for illustrative purposes only and not intended to be reflective of results you can expect to achieve.* *Preferred securities are often callable, meaning the issuing company may redeem the security at a certain price after a certain date. Such call features may affect yield. Preferred securities generally have lower credit ratings and a lower claim to assets than the issuer’s individual bonds. Like bonds, prices of preferred securities tend to move inversely with interest rates, so they are subject to increased loss of principal during periods of rising interest rates. Investment value will fluctuate, and preferred securities, when sold before maturity, may be worth more or less than original cost. Preferred securities are subject to various other risks including changes in interest rates and credit quality, default risks, market valuations, liquidity, prepayments, early redemption, deferral risk, corporate events, tax ramifications, and other factors.* (1120-04N5)
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Betting on a Breakdown

The ins and outs of short selling.

By Lee Bohl

any successful traders profit from stocks that rise in value. But some do the opposite, profiting from stocks that decline in value, through a strategy known as short selling.

Short selling involves borrowing a security and selling it on the open market, purchasing it later at a lower price, and pocketing the difference after the initial loan is repaid.

For example, let’s say a stock is trading at $50 a share. You borrow 100 shares and sell them for $5,000. The price promptly declines to $25 a share, at which point you purchase 100 shares to replace those you borrowed, netting $2,500 in the bargain.

Short selling may sound straightforward, but this kind of speculative trading involves considerable risk. Here’s a closer look at how it works—and what to consider before taking the plunge.

Getting started

Because you’re borrowing shares from a brokerage firm, you must first establish a margin account, into which you put eligible bonds, cash, mutual funds, and/or stocks as collateral. As with other forms of borrowing, you’ll have to pay interest on the value of the outstanding shares until they’re returned (though the interest may be tax-deductible).

Once you’ve opened and funded your margin account, you can start to research possible short-sale candidates. Traders typically use one or more of the following approaches to identify short-sale targets:

- **Fundamental analysis:** Analyzing a company’s financials can help determine if its stock may be a candidate for a pullback. For example, a company’s earnings per share (EPS) and sales growth tend to move in the same direction as its share price; hence, when looking for short-sale candidates, traders may consider companies with negative EPS and sales growth trajectories.

- **Technical analysis:** Patterns in a stock’s price movement can also help you determine if it’s on the cusp of a downtrend. One potential sign of a seller’s market is a stock that’s been falling through a series of lower lows while trading at higher volumes. Another is a stock that’s rebounded to the upper range of its trading pattern but appears to be losing steam.

- **Thematic:** This approach involves betting against companies whose business models or technologies are deemed outdated. Think Blockbuster Video, which can be more of a long game but can pay off should your prediction prove correct.

Entering a trade

As with any trade, you should identify your entry and exit points, and a potential stop order before you begin (see “A simple plan,” below). You’ll want to enter a stop order to help limit your losses in the event the trade moves against you. In general, two kinds of stop orders may prove useful:

- **Buy-stop orders** trigger an order to buy back the shares if the stock price rises to or above the stop price.

- **Trailing buy-stops** specify a stop price that follows, or “trails,” the lowest price of a stock by a percentage or dollar amount that you set. If the stock rises above its lowest price by thetrail or more, it triggers a buy market order, at which point the stock is purchased at the best available price. If the price drops, the stop resets at a lower price.

However, neither of these methods guarantees that the order will execute at or near the price you designate—and in fact could lock in losses if the price gaps up.

Understanding the risks

Short selling comes with numerous risks—but these are the big two:

- **Potentially limitless losses:** When you place a standard trade, your downside is limited to 100% of the money you invested. But when you’re shorting a stock, its price can keep rising—which means there’s theoretically no limit to the amount you’d have to pay to replace the shares you borrowed.

For example, if you enter a short position on stock XYZ at $80, but instead of falling it rises to $100, you’ll have to spend $10,000 to pay back your borrowed shares—at a loss of $2,000. Stop orders can help mitigate this risk, but they’re by no means bulletproof.

- **Margin calls:** If the value of the collateral in your margin account drops below the minimum equity requirement—usually 30% to 35% of the value of the borrowed shares, depending on the firm and the particular securities you own—your brokerage may require that you immediately deposit more cash or securities to cover the shortfall.

For example, so long as your 100 shares of stock XYZ remain at $80 per share, you’ll need $2,480 in your margin account, assuming a 30% equity requirement ($8,000 x .30). However, if the stock suddenly rises to $100 per share, you’ll need $3,000 ($10,000 x .30)—requiring an immediate infusion of $600 to your account, which you may or may not have.

If you fail to meet the margin call, your brokerage firm may close out open positions to bring your account back to the minimum requirement.

Proceed with caution

At its most basic, short selling involves rooting against individual companies or the market, and some investors may be opposed to that on principle. However, if you have a firm conviction that a stock price or index is heading lower, shorting can be a profitable way to act on that instinct—so long as you’re aware of the inherent risks.

See page 42 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 assess an investment strategy reflective of his or her own particular situation before making any investment decision.**

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

- **Short selling is an advanced trading strategy involving potentially unlimited risks, and must be done in a margin account. Margin trading increases your level of market risk. For more information please refer to your account agreement and the Margin Risk Disclosure Statement.**

- **Schwab does not recommend the use of technical analysis as a sole means of investment research.**

- **There is no guarantee that execution of a stop order will be at or near the stop price.**

Schwab’s Trading Up-Close video series offers guidance on foundational trading topics. Watch now at schwab.com/trading-up-close.

Lee Bohl, CMT, is a trading services senior manager at Charles Schwab & Co., Inc.
SURPRISE!

Five unexpected expenses that can derail your retirement—and how to get ahead of them.
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| 2020

To help meet the rising costs of health care in retirement, it may make sense to contribute to a health savings account (HSA), which changes each month but generally allows you to contribute debt-free, to lock in a more affordable premium. “Yes, you’re paying for something you might not end up needing, but that’s true of many types of insurance—and you will have turned a potential financial surprise into a predictable expense,” he says.

A child in crisis

Even with Medicare, it’s no secret that having health care coverage can cost you a pretty penny in retirement. “But many retirees don’t fully appreciate just how much, in part because they believe Medicare covers more than it actually does,” says David jamsion, a certified financial planner™ with Schwab’s Schwab Charitable Planning team.

The U.S. Department of Health and Human Services estimates that close to 70% of today’s 65+-year-olds will require some kind of long-term care, for an average of about three years—and the costs can be exorbitant.

For example, the national average cost per year of home health aide in 2019 was $52,624, whereas a private room in a nursing home facility was $102,200.1 “Americans are becoming more aware of these potential expenses but may still not fully plan for them—or even know where to start,” says David.

Some retirees may be able to reduce long-term care costs by turning to their families for help, but those who can’t or don’t want to rely on their loved ones generally cover these expenses in one of two ways:

- **Out of pocket:** One approach is to pay out of pocket if and when the need arises, in which case you’ll need significant savings to cover such costs. The benefit of this approach is that you pay for only what you need, which may be attractive to wealthier individuals who don’t want to pay for insurance they may not use.
- **Long-term care insurance:** For most people, coming up with an extra hundred thousand dollars or more isn’t realistic—in which case, long-term care insurance may allow them to get the quality care they need without having to liquidate their assets to pay for it. David says it’s generally best to purchase a policy in your 50s or early 60s and “the earlier the better” since health changes each month but generally approximates the rate paid by creditors of deposit and savings accounts. If your loan’s rate is below the AFR or your circumstances don’t change, you'll be charged the IRS determines that the loan wasn’t really a loan at all, it may be treated as a gift for tax purposes (and subject to the $15,000 annual gift tax exclusion).

For example, the IRS sets a minimum rate for such loans, called the applicable federal rate (AFR), which changes each month but generally approximates the rate paid by creditors of deposit and savings accounts. If your loan’s rate is below the AFR or your circumstances don’t change, you'll be charged the IRS determines that the loan wasn’t really a loan at all, it may be treated as a gift for tax purposes (and subject to the $15,000 annual gift tax exclusion).

A child in crisis

It’s natural to want to step in when your child needs financial help. But the older you are and the more difficult it can be to recover from such an unanticipated expenditure. In fact, half of all parents financially helping an adult child say it’s putting their retirement savings at risk. “With an adult child falls on hard times, retired parents often feel obligated to help, even when their savings are already stretched too thin,” David says.

Before offering your support, think about how much help you’re able to provide—and for how long. “Are you willing to withdraw a large lump sum from your savings, for example, or would you be more comfortable covering smaller expenses over a longer timeframe while they get back on their feet?” Rob asks.

If you do decide to dip into your retirement assets, Rob suggests you have a pretty penny in retirement. “But many retirees don’t fully appreciate just how much, in part because they believe Medicare covers more than it actually does,” says David jamsion, a certified financial planner™ with Schwab’s Schwab Charitable Planning team.

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If you do decide to dip into your retirement assets, Rob suggests you have
Certified Financial Planner™ professional and three Schwab wealth strategists provide answers to clients’ five most frequently asked questions about the current environment.

1. Should I delay my retirement?  
For those nearing retirement, the final working years are often the most important: Salaries tend to be bigger and contribution limits are higher, helping them in their final push to maximize their savings. But this year’s economic uncertainty resulted in a lot of lost income for the millions of Americans who were laid off, furloughed, or saw a cut in pay—and many near-retirees may be rethinking their retirement date as a result.

“Delaying retirement until the current uncertainty has passed and you are on firmer financial footing is certainly one option, but there are other levers you can pull,” says David Jamison, a Certified Financial Planner™ professional with Schwab’s Centralized Planning Team.

If you’re determined to retire on schedule, reducing your spending now so you can double down on saving is one solid strategy. Collecting Social Security earlier than intended is another. “Taking Social Security early isn’t something we’d typically recommend, but if it allows you to retire on time and keeps you from having to tap your portfolio early, it might be worth it,” David says.

Although you can file for Social Security as early as age 62, you’ll collect 30% less than you’d receive at full retirement age (between 66 and 67 for today’s retirees)—and roughly 75% less than you’d receive at age 70 (after which there is no incremental benefit).

“A lot of people know that waiting to take Social Security increases their benefit,” David says, “but they may not realize how much they’d be leaving on the table by filing before age 70.” (See “Why waiting to collect pays,” below.)

Married couples have another option: the so-called 62/70 split. With this strategy, the lower-earning spouse takes Social Security at age 62 and the higher-earning spouse postpones filing until age 70 to maximize her or his benefit. What’s more, if the older spouse is the higher earner and was born before January 2, 1954, she or he can collect a spousal benefit until they file for their own benefit at age 70.

“Social Security is one of the few truly guaranteed sources of income, so uncertainty has passed and you are on firmer financial footing is certainly one option, but there are other levers you can pull,” says David Jamison, a Certified Financial Planner™ professional with Schwab’s Centralized Planning Team.

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“Social Security is one of the few truly guaranteed sources of income, so
Q&A: THE BIG FIVE CHARLES SCHWAB

Rising market doesn’t always lift all
often means smaller returns. Recent ups and downs have you reconsid-
ered your returns? Is your asset allocation strategy different, but most people would benefit from a comprehensive portfolio review. Is your asset allocation strategy still on track? How risky are your investments? Are the returns you’re getting worth the fees you’re paying? “Big market shocks remind us why good portfolio hygiene is so critical,” Marilin says. Any of your investments have lost value, harvesting some of those losses can help offset taxes owed on your overall capital gains.

It might also be a good time to consider converting your tax-deferred retirement accounts to a Roth IRA. That’s because you have to pay taxes on the value of your account at the time of the conversion—so if your account value is down, you can reduce the upfront tax hit on the conversion.

Likewise, holdings that have declined in value can create unique estate-planning opportunities. For example, if you’re concerned about estate taxes being levied against your heirs, you might consider establishing a grantor retained annuity trust (GRAT) to pass assets to your beneficiaries tax-free. A grantor retained annuity trust (GRAT) can potentially pass to its beneficiaries tax-free. A grantor retains the right to receive a fixed annuity for a term of years, after which the trust’s assets pass to the beneficiaries.

Once the assets are in the Roth account, all withdrawals in retirement are tax-free—and, unlike traditional tax-deferred accounts, Roth has no required minimum distributions mandated by IRS starting at age 72.

Use the Roth IRA Conversion Calculator at schwab.com/calculator/rothcalculator to see if a conversion might make sense for you.

How GRATs work
Any appreciation of assets transferred to a grantor retained annuity trust (GRAT) can potentially pass to its beneficiaries tax-free.

| How can I best help others in need? |

Theripples of widespread economic
shutdowns have been felt by nearly
everyone, prompting many financially
secure clients to look for ways to help
family and friends in need.

Cash gifts are a common way to provide direct assistance. Under current limits, individuals can gift up to $15,000 per recipient per year to an unlimited number of people without eating into the giver’s lifetime gift and estate tax limit of $11.58 million for 2020. (Married couples can give a combined $30,000 per person per year.) Some clients are also taking advan-
tage of the tuition gift tax exclusion, which allows individuals to make tui-
tion payments of any size directly to a college or university on behalf of a loved one. “These gifts are also exempt from the lifetime estate tax limit,” Marilin says. “And because there’s no limit to the size of the tuition payment, it’s a great way for wealthier individuals to reduce their taxable estate.”

Of course, it’s not just family and friends that clients care about. “We’ve heard from dozens of clients who want to adjust their giving strategies to ac-
celerate support to a variety of causes,” says Marianne Hayes, a Schwab wealth strategist. The Coronavirus Aid, Relief, and Economic Security (CARES) Act improved the tax benefit of charitable giving in two key ways:

- A new above-the-line income adjustment allows donors who take the standard deduction to write off up to $300 in annual charitable contributions. (Those who itemize deductions can’t take the new income adjustment but can continue to itemize their charitable gifts.)

- For the 2020 tax year, donors can deduct cash gifts of up to 100% of their adjusted gross income (AGI) for the 2020 tax year—but only 60% thereafter.
Giving in Times of Crisis

Between the COVID-19 pandemic, natural disasters, and social unrest, 2020 has seen its fair share of upheaval—and generous Americans with the means to help have stepped up their charitable giving in response. One study of 32 community foundations reported an 80% increase in donations from March to May, compared with the same period in 2019.1 Despite a growing desire to help, however, many donors and even some seasoned philanthropists

Five steps for maximizing your charitable impact.
are unsure how best to support the causes they care about—particularly given the nearly 2 million IRS-recognized charities and nonprofits in the U.S. and the sheer number of challenges we face.2

“Needs shift, more considerations are making their way onto donors’ radar screens, including which issues to support and how to create an overall giving strategy,” says Kim Laughston, president of Schwab Charitable, an independent public charity and a donor-advised fund created more than two decades ago to help philanthropically minded people donate more strategically. “The challenge for many donors right now is figuring out how to make their charitable dollars go as far as possible.”

With that in mind, here’s how to refine your giving priorities, identify the organizations that align with your philanthropic mission, and give most effectively.

Donating direct
Donating an appreciated asset directly to a charity or donor-advised fund (DAF)—as opposed to selling the asset and donating the proceeds—can allow you to give more and pay less in taxes.

Start with a prospective charity’s goals and approach. Has the organization articulated its strategy and vision for the future? kim asks. “Of course, it doesn’t have to be either-or. The point is to figure out what you care about most so you can start to identify the organizations that match your goals.”

“With COVID-19, for example, do you want to support the global fight against the virus, or would you rather help closer to home to ‘tackle the local’?” Kim asks. “Of course, it doesn’t have to be either-or. The point is to figure out what you care about most so you can start to identify the organizations that match your goals.”

With that in mind, how’s the way to refine your giving priorities, identify the organizations that align with your philanthropic mission, and give most effectively.

Option 1: Sell asset and donate directly

| Current fair market value of stock | $100,000 | $100,000 |
| Long-term capital gains tax | $14,250 | $0 |
| Amount donated to charity | $85,750 | $100,000 |

Option 2: Donate asset directly to charity or DAF

| Deduction for those who itemize | $27,440 | $32,000 |

The example is hypothetical and provided for illustrative purposes only. Assumes investor has held stock for at least one year and a year-end basis of $1,000, and a long-term capital gains rate of 15%. Assumes a 32% federal tax rate and does not reflect state or local taxes, or a potential Medicare net investment income surtax. Note that the value of a charitable deduction may be subject to reduction for taxpayers whose adjusted gross income (AGI) is at or above certain thresholds. In addition, deductions for contributions of appreciated property to public charities are generally limited to 50% of the donor’s AGI. Excess contributions may be carried forward for up to five tax years.

To get started, it can help to reflect on what you hope to achieve with your support:

- What causes, communities, and concerns are most important and relevant to you?
- Do you want to focus locally, nationally, globally, or combination thereof?
- Which, if any, areas of need overlap with your experience and interests?

If you want to provide financial support, that isn’t your only option. Nearly any noncash asset—such as publicly traded stock, real estate, art, or even private business interests—could qualify as a charitable donation. That’s because donating appreciated noncash assets that you’ve held more than one year directly to a charity can potentially eliminate the capital gains tax you would have owed on a sale of the assets (see “Donating direct,” below left).

However, some charities may be interested in managing any noncash donations—especially during an emergency—in which case a one-time or recurring donation may be a valuable tool for giving. With a donor-advised fund, you contribute cash or noncash assets to the account, allow the donor-advised fund sponsor to manage the sale of the assets, where applicable, then make grants to the charities of your choice, either as a one-time or recurring donation.

**Step 1: Pinpoint your priorities**

To get started, it can help to reflect on what you hope to achieve with your support:

- What causes, communities, and concerns are most important and relevant to you?
- Do you want to focus locally, nationally, globally, or combination thereof?
- Which, if any, areas of need overlap with your experience and interests?

Donors who plan to take the standard deduction may want to consider using a donor-advised fund to claim an above-the-line deduction of up to $300 for cash contributions to operating charities (excluding donor-advised funds, private foundations, and so-called supporting organizations). This may be a great option for donors who bunched two or more years of giving in 2019.

**Step 2: Choose your charities**

Once you’ve settled on which causes to support, you may still need to choose from hundreds or even thousands of organizations focused in those areas. “Different charities will approach the problem in different ways,” Kim says. “So do some research to identify groups that help implement the kind of changes you’d like to see.”

Consider bounced ideas off family, friends, and financial advisors—or even taking your cues from prominent philanthropists who share your interests. The Bill & Melinda Gates Foundation, for instance, publishes all the grants it has awarded—searchable by program, issue, and region.

View Schwab Charitable’s list of reputable outside resources to help you identify legitimate, highly effective charities at schwabcharitable.org/explore-charities.

**Step 3: Consider your contribution options**

Next, think about the kind of support you want to offer. Will you contribute money or your time and skills? According to the Corporation for National and Community Service, more than half of all Americans donated money in 2018, and a third volunteered.

If you want to provide financial support, that isn’t your only option. Nearly any noncash asset—such as publicly traded stock, real estate, art, or even private business interests—could qualify as a charitable donation. That’s because donating appreciated noncash assets that you’ve held more than one year directly to a charity can potentially eliminate the capital gains tax you would have owed on a sale of the assets (see “Donating direct,” below left).

However, some charities may be interested in managing any noncash donations—especially during an emergency—in which case a one-time or recurring donation may be a valuable tool for giving. With a donor-advised fund, you contribute cash or noncash assets to the account, allow the donor-advised fund sponsor to manage the sale of the assets, where applicable, then make grants to the charities of your choice, either as a one-time or recurring donation.

“Especially now, long-term support is critical,” Kim notes. “Many charities are reeling from both financial strain and overwhelming demand— and setting up recurring grants and signing up for ongoing volunteer shifts can help organizations maintain their services and reliably fill critical positions.”

**Step 4: Plan your giving**

As you explore your options, don’t forget to consult financial advisors and tax professionals who can help maximize the benefit of your giving—both to your charities of choice and to your own bottom line. You may also want to consult your tax advisor before committing to your giving plan for the year. Donors and organizations that use a donor-advised fund account can help you maximize your charitable impact at schwabcharitable.org.

**Maximum impact**

Tax laws, including an expiring tax provision, provide the opportunity to maximize your giving—and minimize taxes—like never before.

Annual income tax deduction limits for gifts to public charities, including donor-advised funds, are 60% of adjusted gross income (AGI) for contributions of cash, 30% of AGI for contributions of noncash assets held more than one year, and 50% of AGI for blended contributions of cash and noncash assets.

And thanks to a temporary provision in the CARES Act, in 2020 you can elect to use some charitable donations to deduct up to 100% of your AGI. To qualify for the deduction, donations must be made in cash to public charities (excluding donor-advised funds, private foundations, and supporting organizations) and you must itemize these deductions on your tax return. Donors who use a donor-advised fund account each year to provide financial support— including charitable donations—have the option to elect to take advantage of a temporary provision introduced by the Coronavirus Aid, Relief, and Economic Security (CARES) Act that allows individuals to claim an above-the-line deduction of up to $300 for cash contributions to operating charities (excluding donor-advised funds, private foundations, and so-called supporting organizations). This may be a great option for donors who bunched two or more years of giving in 2019.

**Step 5: Just get started**

It’s easy to get bogged down in the details as you identify your goals and vet potential donor recipient charities, but it’s important to remind yourself that there’s no such thing as the “right charity.”

“Don’t let perfect be the enemy of good,” Kim says. “Amid all this uncertainty, you may still need to explore charities.” To get started, it can help to reflect on what you hope to achieve with your support:

- What causes, communities, and concerns are most important and relevant to you?
- Do you want to focus locally, nationally, globally, or combination thereof?
- Which, if any, areas of need overlap with your experience and interests?

Donors who plan to take the standard deduction may want to consider using a donor-advised fund to claim an above-the-line deduction of up to $300 for cash contributions to operating charities (excluding donor-advised funds, private foundations, and so-called supporting organizations). This may be a great option for donors who bunched two or more years of giving in 2019.

**See page 42 for important information.** This information does not constitute and is not intended to be a substitute for specific, individualized tax, investment planning advice. Where specific advice is necessary or appropriate, Schwab recommends consultation with a qualified tax advisor, CPA, financial planner, or investment manager. This summary provided is for illustrative purposes only and is not intended to be a substitute for reflective of results you can expect to achieve. A donor’s ability to claim itemized deductions is subject to a variety of limitations depending on the donor’s specific tax situation. Consult your tax advisor for more information.

Schwab Charitable is a public charity and a donor-advised fund for contributing assets for contribution on a case-by-case basis. Schwab Charitable is the name used by the combined programs and services of Schwab Charitable Fund™, an independent nonprofit organization, which has entered into service agreements with certain charities of The Charles Schwab Corporation. (1120-0004A)
Investors—and with good reason.

If the rapid growth of U.S. borrowing keeps you up at night, you’re not alone. Even before COVID-19, investors had reason to be concerned about the federal debt, which, after a brief period of decline in the 1990s, has been on a steady upward march for most of the 21st century.

Indeed, the federal debt as a percentage of gross domestic product (GDP) reached 100% in the years following the 2008–2009 financial crisis, and this year’s historic pandemic-relief spending has pushed that number much higher (see “Awash in debt,” page 36). As of mid-year 2020, defaults were rising at the fastest pace since the financial crisis, which could ripple through the broader economy if layoffs continue, suppliers go unpaid, and local and state tax revenues continue to shrink.

“Longer term, we might also see significant ramifications associated with running up the federal debt—including stunted economic output,” says Liz Ann Sonders, Schwab’s chief investment strategist.

Let’s look at why federal and corporate debt matters—and how you might adjust your portfolio in response.

Federal debt

In the near term, the soaring federal debt isn’t a major concern for two reasons:

- The Federal Reserve has dramatically lowered the cost of borrowing by reducing the federal funds rate to a range of 0% to 0.25%, down from 2.25% just a year earlier. The fed funds rate influences interest rates on everything from credit cards to U.S. Treasuries, and the lower the rate the less it requires the government to pay to attract outside buyers.

- At least for the time being, the Fed has guaranteed a market for U.S. Treasuries, thereby reducing the yield the government needs to offer to entice outside buyers.

Once the economy recovers, however, the Fed will likely look to raise rates to help stave off inflation. It will also need to pull back on its purchases of Treasuries, which may require the government to pay higher yields to attract traditional big buyers like China.

Over the long run, higher interest payments will eat up more of the federal budget, potentially leading the government to cut back on infrastructure investments and other capital expenditures—which in recent years have contributed about a fifth of U.S. GDP.

“All else being equal, net interest payments over the next 10 years will crowd out government spending elsewhere. And when the government invests less in the economy, growth tends to suffer,” Liz Ann says.

Corporate debt

When the economy is growing, borrowing typically helps businesses expand their production capacity or workforce to meet increasing or anticipated demand. However, many businesses today are turning to the debt markets simply to stay afloat.

“Unfortunately, many companies today aren’t issuing bonds to build new plants or hire new employees—they’re doing so to shore up cash reserves, which can help them weather future economic uncertainty,” says Collin Martin, managing director and fixed-income strategist at the Schwab Center for Financial Research. “As a result, their future growth could be constrained as debt payments crowd out more productive investments, just as with the federal government. It might even make them riskier as they pile on debt in the face of declining profits and weaker economic prospects.”

So far, moves by the Fed to backstop that debt by purchasing corporate bonds have helped sustain demand and provided fresh capital—which has eased investors’ fears and helped to explain why stock prices have continued to rise even as other economic indicators have tanked.

However, there’s a limit to the amount of corporate bonds even the Fed can buy. For example, relatively few individual sub-investment-grade corporate bonds are eligible for purchase by the Fed due to its self-imposed ratings limitations. “Ultimately, the Fed can’t save everyone,” Collin says.

Awash in debt

This year’s historic pandemic-relief spending caused the already-elevated federal debt to jump by more than 25%.

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<thead>
<tr>
<th>Total federal debt as a percentage of nominal GDP</th>
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<td>56%</td>
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<td>63%</td>
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What to do

High levels of federal and corporate debt could impact the near- and long-term outlook of mainstream asset classes such as stocks and bonds. With that in mind, here are some moves that could help fortify three key areas of your portfolio:

- Bonds: With corporate debt balances at record levels and bankruptcies on the rise, there’s greater risk that defaults will increase in frequency. Despite the Fed’s support for the credit markets, that support can’t keep every company afloat; nor will it last forever. For now, a conservative approach may make sense for many investors. In particular:
  - For example, relatively few individual sub-investment-grade corporate bonds are eligible for purchase by the Fed due to its self-imposed ratings limitations. “Ultimately, the Fed can’t save everyone,” Collin says.

Source: Charles Schwab and Federal Reserve Bank of St. Louis. Data from 01/01/1990 through 06/30/2020.
 WHO’S AFRAID OF HISTORICALLY HIGH DEBT?

Avoid overexposure to junk-rated corporate and municipal bonds. As well as those on the lowest rungs of the investment-grade scale. Focus instead on more defensive issuers with lower debt balances or revenue streams that can weather the ups and downs of the recovery.

Limit the average duration of your bond funds. While not an immediate concern, keeping the average duration of bond funds in your portfolio below market benchmarks can help you manage the effects of interest rate risk, or the chances that your holdings will lose value should rates rise. For example, the Bloomberg Barclays Aggregate Bond Index, which is typically used as a proxy for the overall U.S. bond market, has a duration of about 6, so we would suggest keeping the average duration of your U.S. bond funds at 4 or 5.

Cash savings: The Fed has pledged to keep short-term rates near zero for the foreseeable future. That means yields on cash or short-term investments like certificates of deposit and money market funds are likely going to remain quite low. As a result:

- If you’re still working, consider limiting your cash savings to emergency funds that can cover three to six months’ worth of expenses and investing the rest in a diversified mix of assets.
- If you’re a retiree, consider limiting your short-term cash reserves to what you’re going to need for the next two to three years, and investing the rest in higher-income options such as annuities, bonds, and dividend-paying stocks.

Stocks: The early days of the pandemic led to significantly elevated volatility and the fastest 30% stock market decline in history. Thanks in part to the Fed’s aforementioned relief efforts, stocks’ recovery was nearly as swift. Even so, the speed with which a full market cycle of decline and recovery unfolded serves as a reminder that what’s gone up might well go down again. Thus, rather than trying to anticipate market moves, consider:

- Rebalancing your portfolio more frequently, especially after big swings (as opposed to the typical calendar-based portfolio maintenance that brings your asset allocations back in line with your long-term targets).
- Focusing on quality. In the wake of a recession, investors often focus on sectors that look primed for a rebound. However, Liz Ann says it might be better to focus on so-called quality stocks. “You want to look for industry leaders with strong balance sheets, positive cash flows, and management teams that will see them through this crisis,” she says.
- Reducing your expectations for long-term stock returns and increasing your savings to make up for the difference. For example, Schwab estimates the annual return for U.S. large-cap stocks over the next decade will be 7.1%—compared with 10.1% for the five decades prior.

Take control

Investors are right to be concerned about historically elevated debt levels and their effect on the economy. “You may have to put more away if you were counting on a repeat performance from the markets to help you reach your long-term goals,” Liz Ann says. “But with some planning, you can reposition your portfolio to help weather uncertainty.”

<table>
<thead>
<tr>
<th>Q1 2008</th>
<th>Q3 2020</th>
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<tr>
<td>15%</td>
<td>60%</td>
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<tr>
<td>1.5%</td>
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<td>43.0%</td>
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Accessing your investments and finances is now simpler and more intuitive thanks to Schwab’s new Transfers & Payments center. When you log in to schwab.com from any web-enabled device, you can quickly and securely manage your accounts and move money with features like these:

Make a variety of transfers and payments.

1. Transfer funds between Schwab and/or linked non-Schwab brokerage and bank accounts
2. Transfer whole positions between your Schwab brokerage accounts
3. Wire funds to another financial institution
4. Pay bills or schedule automated payments on eligible accounts
5. Move investments from other financial institutions to your Schwab account*
6. Request a check with funds from your enabled accounts

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See page 42 for important information. 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. (0820-00TY)
Get Updates Quickly and Securely With Virtual Assistants

Getting real-time account and portfolio updates is more convenient than ever with Schwab Assistant and Google Assistant. Both recognize voice commands so you can conveniently get up-to-the-minute financial information and answers to your investing questions 24/7.

Schwab Assistant
In the Schwab Mobile app, tap the Schwab Assistant icon at the top-right corner and then ask a question or use Schwab Assistant to:

- View account information and portfolio performance
- Access real-time stock market data
- Get quotes and manage investments
- Lock your debit card
- Check your personal value
- Add to your watchlist
- Find answers to common investing questions
- Access support 24/7

Google Assistant
In your Google Assistant account settings, go to Services, then Finances, then click “Link account” under Charles Schwab. Once connected, you can use Google Assistant–enabled devices like a smart speaker, smart watch, mobile phone, and Google Home to:

- Track portfolio performance
- Review account information
- Get updates on positions

Next Steps
- Try Schwab Assistant today by logging in to the Schwab Mobile app.
- To try Google Assistant, link your Schwab accounts through the Finances section of your Google Assistant account settings.

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Sometimes the smart move might be to borrow in order to achieve your goals, whether you’d like to make additional investments, purchase or refinance a home, or cover a large or unplanned expense. Schwab and Schwab Bank have lending options that may help fit your borrowing needs.

**BORROW AGAINST YOUR SECURITIES WHILE STAYING INVESTED**

**MARGIN LOAN**
Borrow against your portfolio to buy securities or access cash quickly for shorter-term personal or business needs:
- Minimum of $2,000 in cash or marginable securities to start
- Competitive rates and a flexible repayment schedule
- No setup fees or credit checks to add a margin loan to your brokerage account

Margin loans are available through Charles Schwab & Co., Inc.

**PLEDGED ASSET LINE**
Leverage the value of your portfolio for larger, planned expenses like a new home purchase, college, or business needs with this flexible non-purpose line of credit from Schwab Bank:
- Line amounts from $100,000 (required minimum initial advance of $70,000)
- Competitive rates and monthly interest-only payments
- Quick and easy online application

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

**BORROW FOR HOME LENDING NEEDS AND EXPLORE EXCLUSIVE DISCOUNTS**

**MORTGAGE**
Achieve multiple financial and personal goals—such as building home equity and planning for retirement—with a mortgage provided by Schwab Bank’s home loan provider Quicken Loans®:
- Competitive rates
- No prepayment penalties or balance requirements

**HOME EQUITY LINE OF CREDIT (HELOC)**
Tap into your home’s equity to make home improvements, consolidate debt, supplement your emergency fund in a time of need, or achieve other financial goals with a HELOC® provided by Quicken Loans:
- Competitive rates
- Access to a Schwab Bank and Quicken Loans team solely dedicated to serving Schwab clients

**EXCLUSIVE DISCOUNTS**
- Competitive rates on interest rates based on your qualifying assets with Schwab
- Access to Schwab Bank’s Investor Advantage Pricing® with increased potential savings
- Exclusive discounts through Schwab Bank’s Investor Advantage Pricing®

**Make smart debt part of your financial strategy.**

See page 42 for important information.

**Next Steps**
Learn more about how smart debt can be part of your financial strategy at schwab.com/strategic-borrowing.
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Examples provided are for illustrative purposes only and not intended to be reflective of results you can expect to achieve.

Investing involves risk, including loss of principal.

Diversification and rebalancing 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 a nonretirement account is rebalanced, taxable events may be created that may affect your tax liability.

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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.

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Indexes are unmanaged, do not incur management fees, costs, and expenses and cannot be invested in directly. For more information on indexes please see schwab.com/indexdefinitions.

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Pg. 22–25: Health savings account withdrawals that are not used for qualified medical expenses are subject to ordinary income tax and prior to age 65 may be subject to a 20% federal tax penalty.

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4. Investor Advantage Pricing (IAP): Loans are eligible for only one IAP discount per loan. Select mortgage loans are eligible for an interest rate discount of 0.25%–0.75% based on qualifying assets of $250,000 or greater. Discount for ARMs applies to initial fixed-rate period only. Qualifying assets are based on Schwab and Schwab Bank combined account balances, including select brokerage, bank, and retirement accounts. For more information, please visit schwab.com/IAP. 5. Home equity lines have a 10-year draw period followed by a 20-year repayment period. During the draw period, monthly payments of accrued interest are required. Payments will increase if rates increase. At the end of the draw period, your required monthly payments will increase because you will be paying both principal and interest. You may not use this home equity line as a bridge loan, for commercial purposes, to invest in securities, or to repay a margin loan.

7. HELOC Terms: First lien standalone HELOCs are available. Second lien standalone or piggyback HELOCs are available with an eligible Schwab Bank first lien loan. As of 3/16/2020 the annual percentage rate (APR) for a primary residence HELOC opened simultaneously with your first mortgage loan—also known as piggyback loan—is 3.00%. Rates vary for second homes, vacation homes, or HELOCs opened as standalone accounts. The APR on your home equity line of credit is variable based upon the Wall Street Journal Prime Rate plus a margin. The maximum APR that can apply is 18% or the maximum amount permitted by state law, whichever is less. The minimum credit line amount is $50,000 or the minimum amount permitted by state law, whichever is less. The maximum credit line is $1,000,000. Additional terms and conditions apply. Please contact your Schwab Bank representative for assistance regarding eligible loan types.

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(1120-OWL6) ADP111156OW-01 (08/20) 00249633
longtime readers of this magazine know how passionate I am about introducing young people to investing. When you teach kids the importance of saving and the potential long-term benefits of compound growth, you’re giving them the knowledge to take charge of their finances into adulthood.

Schwab MoneyWise® has the tools to help them set goals and keep their finances on track, including a budget planner, cost-of-debt calculator, and spending tracker. Learn more at schwabmoneywise.com.

Another way to make investing feel concrete is by helping kids experience what it’s like to own a piece of a company they care about—perhaps the one behind their favorite app, phone, or sneakers. When you open and fund a custodial account, you can give the gift of ownership with Schwab Stock Slices™, which allows you to purchase any stock in the S&P 500® Index for as little as $5. Learn more at schwab.com/givestockslices.

So, why not consider a more meaningful gift this holiday season? An appreciation of investing never goes out of style—and could give the young people in your life the start they need to build a brighter future for themselves.

Charles R. Schwab
Founder & Chairman

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