Piece of Cake
Five ways to sweeten your tax strategy. Page 22
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Mark Riepe and Financial Decoder™ return for Season 6 with new episodes about the emotional biases that can cloud your financial judgment and cost you money. Listen and subscribe at schwab.com/financialdecoder.

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n times of struggle, investing and planning for the future can feel like abstractions compared with the realities of everyday living.

That’s particularly true today, when so many are concerned about business and job uncertainty, balancing work and home schooling, and the health of themselves and their families. All of us at Schwab know that nothing is more important than the well-being of you and your loved ones.

When confronted with instability, there can be great comfort in focusing on what you can control, and in having tried-and-true principles in place that can help light the way. That’s one reason we distilled our experience in the markets down to what we call our Investing Principles—seven best practices that can help you reach your goals.

These principles start with the importance of creating a realistic plan you can stick to, in good times and bad. They address ways to invest according to your goals and tolerance for risk, so you can sleep easier. And they end with a reminder to ignore as much of the noise out there as possible, because steady progress toward your goals is more important than short-term performance.

Taken together, Schwab’s Investing Principles are a foundation upon which you can build your future—whatever may come. To learn more, visit schwab.com/principles or call us at 888-484-5340 to discuss how to implement these timeless principles in your own plan.

Sincerely,

Walt Bettinger
President & CEO

See page 38 for important information.

Investing involves risk, including loss of principal.

(0321-0S2M)
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When the economy takes a turn for the worse, some companies may pare expenses—including matching contributions to employees’ retirement accounts. It happened when the dot-com bubble burst in 2000, again during the financial crisis of 2008–2009, and most recently during last year’s pandemic-triggered recession.

As of June 2020, more than 11% of large companies had suspended matching 401(k) contributions as a result of the COVID-19 pandemic, according to the Plan Sponsor Council of America. Fortunately, such cuts are often temporary. However, when every dollar counts, they can still take a toll on your retirement savings.

So, what can you do if your employer scales back its contributions to your retirement account? You have a few options:

Raise the stakes: One consequence of the pandemic is that savers are spending a lot less on costs like commuting and dining out. If you've got extra cash that normally goes toward other expenses, consider boosting your contributions to your workplace plan to make up for the loss from your employer—up to a maximum of $19,500 in 2021 ($26,000 for those 50 and over). If you're already maxing out, consider saving more in an IRA or a taxable brokerage account.

---

Missing the Match

What to do if your employer suspends its retirement plan contributions.
THE BOTTOM LINE

2 Keep it up: If you don’t have any surplus cash, at least try to maintain your current contributions. “Money is tight for a lot of people right now, but continuing to make regular retirement contributions is the best way to combat a reduced or suspended employer match,” says Rob Williams, vice president of financial planning at the Schwab Center for Financial Research. “Following your employer’s lead by reducing your own contributions would only compound the issue.”

3 Review your plan: Sometimes we let our retirement plans run on auto-pilot, and that’s never a great idea. “Perhaps the loss of your employer match—even temporarily—can serve as a catalyst to review your goals and savings strategy, and determine if your current style of investing is still suited to your needs,” Rob says.

A Cut Above?
Why stock splits may soon be a thing of the past.

That’s the question many investors may be pondering in the wake of 2020’s high-profile Apple and Tesla splits.

A stock split allows a company to increase the number of shares in circulation with no change to its market value, thereby making shares more affordable to individual investors. In a 2-for-1 split, for example, every share of a stock trading at $400 would be divided into two shares trading at $200.

Such splits often provide a short-term price boost as investors rush to snap up lower-priced shares. Between 2012 and 2018, for instance, large-cap stocks that split outperformed the S&P 500® Index by an average of nearly 5% after one year, according to Nasdaq.

Despite the potential for short-term outperformance, however, investors shouldn’t scramble to purchase shares of a stock just because they’re cheaper. “When a stock splits, it can feel like you’re getting a better value because your money can buy more shares,” says Steve Greiner, senior vice president of Schwab Equity Ratings®. “However, a split doesn’t change a company’s underlying health—or does it tell you anything about its long-term prospects.”

Instead, you should focus on a company’s fundamentals when considering a prospective stock investment. “We suggest looking for companies with low debt balances, lower valuations, and strong earnings growth, which tell you more about a stock’s value than the price tag does,” Steve says.

That said, if your research points you toward particularly pricey stocks, you’ve still got options—namely, fractional shares. With Schwab Stock Slices™, for example, you can buy a fractional share of some of America’s leading companies for as little as $5.

“The emergence of fractional shares all but removes the barrier of lofty share prices—and ultimately might undercut the power of stock splits going forward,” Steve says.

See page 38 for important information. • Schwab Stock Slices is not intended to be investment advice or a recommendation of any stock. Investing in stocks can be volatile and involves risk, including loss of principal. Consider your individual circumstances prior to investing. • All corporate names are for illustrative purposes only and are not a recommendation, an offer to sell, or a solicitation of an offer to buy any security. • Past performance is no guarantee of future results and the opinions presented cannot be viewed as an indicator of future performance. (0321-0UC3)
**BINGO!**

Are you taking the right steps toward a healthy financial future? See how many milestones you can cross off in each category—and which await your attention.

<table>
<thead>
<tr>
<th>THE BASICS</th>
<th>GETTING AHEAD</th>
<th>BUILDING WEALTH</th>
<th>OPTIMIZING RETIREMENT</th>
<th>EXTRA CREDIT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capture the full employer match on your 401(k)</td>
<td>Pay a little extra on your mortgage each month</td>
<td>Max out your 401(k) contributions</td>
<td>Pay off your mortgage before retirement</td>
<td>Research investment options for your health savings account, if eligible</td>
</tr>
<tr>
<td>Name or update beneficiaries on all accounts</td>
<td>Improve your investing knowledge through an online workshop</td>
<td>Contribute to a health savings account, if eligible</td>
<td>Create a budget based on your ideal retirement, including location and lifestyle</td>
<td>Save even more toward your goals with a taxable brokerage account</td>
</tr>
<tr>
<td>Diversify your portfolio to match your goals and risk tolerance</td>
<td>Pay off your credit cards in full each month</td>
<td>Review your Social Security statement for missing income information</td>
<td>Educate the young people in your life about investing</td>
<td></td>
</tr>
<tr>
<td>Create an emergency fund</td>
<td>Contribute to a 529 plan</td>
<td>Contribute to an IRA</td>
<td>Make a plan for long-term care</td>
<td>Gift any individual up to $15,000 annually without triggering the federal gift tax</td>
</tr>
<tr>
<td>Prepare a will</td>
<td>Track your spending and cut back where possible to boost your savings</td>
<td>Create a financial plan</td>
<td>Create a tax-smart income-withdrawal strategy</td>
<td>Make a tax-smart charitable gift of appreciated assets</td>
</tr>
</tbody>
</table>

**How’d you do?**

- **Got a horizontal or diagonal bingo?** Excellent work—you’ve completed at least one task across all five categories. Now drill down into each individual category to add some depth to your plan.
- **Got a vertical bingo?** Great job! You’ve gone deep in a key area of financial planning. Now try to add some breadth with a horizontal or diagonal bingo—or go big and complete the whole card.

Need help getting started or putting your plan into action? Work one-on-one with a Certified Financial Planner™ professional when you enroll in Schwab Intelligent Portfolios Premium™. Learn more at schwab.com/portfoliospremium.

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An Ounce of Prevention

Having a plan in place can help you recover faster from the unexpected.

With all the bad news over the past year, few of us want to entertain the prospect of future disasters. Yet even a little preparation can make a big difference in the face of an emergency—and may even help you sleep a little easier in today’s uncertain world. Here are some practical tips to get you started.

Sock away an emergency fund: Try to have enough cash on hand to cover three to six months’ worth of essential expenses, saved in an account you can access immediately. If you suffer a significant loss, this money can help bridge the gap until you receive an insurance payout or any government assistance for which you may be eligible.

Shore up your cash reserves: If you’re retired, try to avoid tapping investments in the midst of a downturn by having a year’s worth of expenses in relatively liquid investments (a high-yield checking account or a money market fund, for example), plus another two years’ worth of funds in bonds or short-term certificates of deposit. Likewise, if you’ll need money in the coming few years to fund other goals—such as paying for college or purchasing a home—consider investing those funds in a relatively conservative portfolio of bonds and cash, with few, if any, stocks.

Check your insurance: Review your homeowner’s or renter’s policy to see if you’re adequately covered. You also may want to talk to your agent about whether you should consider additional coverage, such as earthquake, fire, or flood—or umbrella insurance for losses not covered by the other policies.

Protect important documents: If the unthinkable happens and your home is destroyed, you’ll need certain documents right away to start the recovery process. Put copies of birth certificates, driver’s licenses, insurance policies, passports, trust documents, wills, and other key financial records in a fire- and waterproof box. Better yet, keep digital copies of important documents in a secure online location so you can recover them from anywhere.

Inventory your valuables: Take extensive photos or video of your home and valuables, then save them securely online or on a thumb drive in a fire- and waterproof box. This will make insurance claims much easier in case of fire, flood, theft, or other damage.
The Basics of Cost Basis

How you sell an investment can seriously affect your tax bill.

A nytime you’re looking to sell an investment, your gain or loss will be determined by calculating the difference between the cost basis—your purchase price plus trading costs and/or commissions—and the current market price. But when you’ve purchased the same investment several times over the years, you’re likely to have a different cost basis for each transaction—and which shares you decide to sell can affect not only your profit or loss but also any taxes you might owe.

When instructing your brokerage firm which shares to sell, you can choose from one of several methods for calculating your cost basis:

- **First in, first out** (FIFO) means your shares will be sold from oldest to newest.
- **Last in, first out** (LIFO) means your shares will be sold from newest to oldest.
- **High cost** means your shares will be sold from highest cost basis to lowest cost basis.
- **Low cost** means your shares will be sold from lowest cost basis to highest cost basis.
- **Specific identification** means your shares will be sold however you see fit.

So, which method is right for you? “Unless you specify otherwise, at Schwab the default method for everything except mutual funds is FIFO,” says Hayden Adams, CPA, CFP®, director of tax and financial planning at the Schwab Center for Financial Research. (For more on mutual funds at Schwab, see “What about mutual funds?” below.) “However, in many cases you’d be better served using specific identification, which allows you to sell particular shares and therefore gives you the greatest control over your tax bill” (see “Case in point,” below left).

“It’s really just a matter of ensuring that whatever method you go with is in line with your specific goals for the sale,” Hayden says. When in doubt, discuss your options with a qualified tax advisor before taking action.

### Case in point

Let’s say you own 200 shares of XYZ stock, which currently have an overall net loss. You decide to sell 100 shares to lock in some losses, which will allow you to offset part of your taxable income for the year. Because you purchased the stock in lots of 50 shares, however, each purchase has its own cost basis—and not all of them are underwater. For example:

If you sell your shares using the default method—first in, first out—Lots 1 and 2 will be sold, resulting in potential gains.

<table>
<thead>
<tr>
<th>Lot</th>
<th>Cost basis</th>
<th>Market value</th>
<th>Potential gain</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lot 1</td>
<td>$11,375</td>
<td>$12,500</td>
<td>$1,125</td>
</tr>
<tr>
<td>Lot 2</td>
<td>$10,425</td>
<td>$12,500</td>
<td>$2,075</td>
</tr>
</tbody>
</table>

On the other hand, if you were to choose last in, first out (or specific identification), you could sell Lots 3 and 4, potentially resulting in your desired losses.

<table>
<thead>
<tr>
<th>Lot</th>
<th>Cost basis</th>
<th>Market value</th>
<th>Potential loss</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lot 3</td>
<td>$15,940</td>
<td>$12,500</td>
<td>$3,440</td>
</tr>
<tr>
<td>Lot 4</td>
<td>$15,995</td>
<td>$12,500</td>
<td>$3,495</td>
</tr>
</tbody>
</table>

What about mutual funds?

At Schwab, the default cost basis method for mutual funds is “average cost,” which is calculated by dividing the total dollar amount invested in a fund by the number of shares held. You can elect to change your cost basis method to specific identification, which allows you to choose which shares to sell.

Be aware, however, that if you’ve previously sold the fund using the average cost method, the new method will apply only to those shares you purchase going forward.

See page 38 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.

◆ Examples provided are for illustrative purposes only and not intended to be reflective of results you can expect to achieve. (0321-066L)

To review or update your default cost basis methods for your Schwab accounts, log in to schwab.com/accountsettings.
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Long-Term Care Insurance

Is it right for you?

Dear Carrie,
I’m 50 years old and starting to plan for retirement. One of my biggest stumbling blocks is whether to purchase long-term care insurance. Do you think it’s worth the cost?

Dear Reader,
This is a great question because it applies to millions of Americans who are approaching their retirement years. At the heart of the issue is the fact that long-term care (LTC) costs can be quite expensive but so can LTC insurance. Add to that the uncertainty of whether you’ll actually need it, when to buy it,
how much coverage you might need, and what type of policy to purchase, and you’ve got some tough decisions to make.

Here are a few important questions to ask yourself as you evaluate whether LTC insurance is right for you.

**Will I need long-term care?**

It’s hard to know for certain whether you’ll need long-term care—assistance with daily activities such as bathing, dressing, and eating for people experiencing physical or cognitive decline—but statistics suggest most of us will.

According to LongTermCare.gov, about 70% of people ages 65 and older will need long-term care at some time in their lives—women more so than men (79% vs. 58%, respectively). For some, this care might be required only for a few months, but others may need it for several years or longer.

**How much does long-term care cost?**

Stats from the Genworth Financial 2020 Cost of Care Survey are pretty sobering. For instance, the current median annual cost for assisted living is $51,600; an in-home health aide is $54,912; and a private room in a nursing home is $105,850.

However, costs where you live could be much higher or lower than those averages. In California, for example, the average cost of a private room in a nursing home is $137,240; in Texas, it’s $54,912. And these figures are estimated to increase 2% to 3% annually on top of inflation, so the cost you may pay if you do eventually need care is likely to be much higher.

**How much can I rely on family support?**

The vast majority—80%—of long-term care is provided at home by unpaid family members and friends. But before you rely on this option, think about the emotional and financial toll such caregiving could take on your loved ones—even if they’re willing to help. In fact, that’s why many people choose to purchase insurance.

**How much does LTC insurance cost?**

As with most types of insurance, the cost of an LTC policy will vary depending on the type, amount, and length of coverage you choose, as well as your age, gender, and overall health. That said, if you’re considering purchasing a policy, make sure the premiums fit your budget. Generally speaking, payments shouldn’t exceed 7% of your monthly expenses.

The American Association for Long-Term Care Insurance (AALTCI) offers resources to help you research and compare LTC insurance at aaltci.org/long-term-care-insurance-rates.

**Will I qualify for LTC insurance?**

Even if you can afford an LTC policy, you may not qualify. Unlike health insurance, preexisting health conditions—such as a progressive neurological condition or a recent stroke—can affect your eligibility for LTC insurance. According to the AALTCI, roughly half of applicants ages 75 or older were denied coverage in 2019, compared with about a third of those ages 65 to 69.

**At what age should I consider LTC insurance?**

The need for long-term care may arise suddenly, such as after a heart attack, hip fracture, or stroke. Most often, however, it develops gradually, as people get older and frailer or as an illness or disability gets worse. Most LTC claims begin when people are in their 80s.

Because of that, somewhere between ages 50 and 65 is generally the most cost-effective time to buy. The younger you are, the lower the cost—but if you purchase too early, you’ll be paying premiums for a longer period of time. On the flip side, premiums go up the older and less healthy you are, and there’s a chance you’ll be denied coverage if your health deteriorates or you develop a certain illness.

**Explore your options**

There’s really no way around it—the decision to purchase LTC insurance is complicated. Hopefully the answers to these questions can get you started. Talk to an insurance agent as you explore options, features, and potential costs among different policies and carriers. If LTC insurance isn’t an option, a financial planner can help you strategize alternatives and assess the potential impact to your finances and estate plan if you are counting on covering LTC costs out of pocket.

---

**What about Medicaid and Medicare?**

Households that qualify for Medicaid may have access to LTC support. That said, Medicaid was designed to assist people who are at or very near poverty levels, meaning most middle-income and affluent individuals won’t qualify.

As for Medicare, it will pay only for medically necessary skilled nursing and home care, such as giving shots, physical therapy, and changing dressings—not custodial care like bathing and eating.

---

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

See page 38 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. Where specific advice is necessary or appropriate, Schwab recommends that you consult with a qualified tax advisor, CPA, financial planner, insurance professional, or investment manager. (0321-VLJ)
It may be time to revisit your international allocation.

By Jeffrey Kleintop

In what’s known as home bias, investors around the world tend to hold mostly their own country’s stocks—often at the expense of competing opportunities abroad.

Having little or no foreign exposure may not seem like a negative when your portfolio’s doing well, but an absence of international equities could mean missing out on potentially greater returns, true diversification across sectors, and a hedge against those years in which U.S. stocks struggle.

Here’s what to consider when looking for opportunities abroad.

**Sector diversification**

First off, no one country offers full global stock market exposure. In fact, it’s surprising how much some major countries’ stock markets perform like a single sector of the global stock market.

- In the United States, the largest sector—technology—seems to drive overall performance. Indeed, the U.S. stock market acts a lot like one big tech fund.
- In Japan, the stock market closely tracks the global financial sector.

That’s not to say financial companies dominate Japan’s stock market, but the influence of global financial conditions on all types of Japanese companies is evident in their performance.

- The Canadian stock market performs much like the energy sector. The Canadian economy is more reliant than most on natural resources. Even the banks are tied to the sector’s performance.

Accordingly, over the past decade the U.S. stock market performed best among the three as the world’s technology sector hit new heights. Japan posted relatively modest gains—in line
with the global financial sector—and Canada proved the weakest of the trio, held back by the world energy sector, which posted a net loss over the past 10 years.

These examples illustrate the potentially dangerous lack of diversification inherent in having a portfolio with a large home bias—even if your home country happens to be among the world’s largest economies.

Dollar direction
If you hold a stock that is denominated in a currency other than the U.S. dollar, you can either benefit or suffer from changes in exchange rates. For example, in July 2020 European stocks fell 1.5% when measured in euros; however, because the dollar fell against the euro by 4.8% that same month, European stocks actually posted a 3.5% gain when measured in dollars.

Thus, if the dollar is embarking on a long-term slide propelled by wide budget deficits and zero-interest-rate policy, it could act as a consistent boost to the performance of international stocks, as measured in dollars.

Change in leadership
Market leadership usually switches between U.S. and international stocks at the start of a new economic cycle:

- In the 1980s, international stocks—led by Japan—outperformed the United States for most of the decade.
- In the 1990s, the dot-com economy paved the way for U.S. stock market leadership.
- In the 2000s, international markets again took the lead—until the 2008–2009 global financial crisis restored the reign of U.S. stocks (see “And the winner is ...,” above).

These changes in leadership typically are triggered by a breakdown in fundamentals, such as unsustainably high stock valuations and dwindling earnings expectations. We’re currently seeing signs of fundamental deterioration in U.S. stocks—and as a result, international stocks may again take the lead.

Going global
If the U.S. stock market’s past decade of outperformance caused your portfolio to drift from its long-term allocation targets, now may be a good time to consider rebalancing your portfolio back toward international stocks. Fortunately, achieving global diversification has never been easier and stocks. Fortunately, achieving global diversification has never been easier or less expensive; a broad international mutual fund or exchange-traded fund can give you exposure to a lot of sectors and stocks.

How much exposure you should have to international investments is another matter—one that depends on your risk tolerance and time horizon. If your global allocation is out of line with your target, start making small shifts as part of your regular rebalancing routine. This gradual approach will allow you to adjust the balance of your portfolio over time rather than in one dramatic move that could result in a big tax bill or, worse, turn out to be poorly timed.

Schwab Intelligent Portfolios® can build and manage a globally diversified portfolio of exchange-traded funds along with a cash allocation on your behalf. Learn more at schwab.com/intelligent.

And the winner is ...
U.S. and international stocks keep trading the title of greatest annualized total returns.

![Graph showing annualized total returns for U.S. and International stocks]

Source: Charles Schwab and Bloomberg, as of 10/27/2020. Annualized total return between cycle peaks measured by MSCI USA Index and MSCI EAFE Index. Past performance is no guarantee of future results.

Jeffrey Kleintop (@jeffreykleintop), CFA®, is senior vice president and chief global investment strategist at Charles Schwab & Co., Inc.

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Why Bonds Still Matter

Despite yields at near-historic lows, bonds can still be a bulwark against stock market declines.

By Kathy Jones

Do bonds still provide adequate diversification? That was the question many investors were asking in March 2020 when bonds and stocks sold off at the same time—before the Federal Reserve stepped in to calm markets.

In fact, some have gone so far as to proclaim that the “traditional” portfolio of 60% stocks and 40% bonds is no longer optimal. We believe such concerns are overblown for three reasons:

1) Even when offering very low yields, intermediate-term U.S. Treasuries generally have held their value or appreciated during significant stock market declines—a trend that was borne out amid last year’s turmoil. On the other hand, short-term Treasuries—which are considered a cash equivalent—have failed to provide a similar hedge (see “A port in the storm,” below).

2) Despite the blip last spring, Treasuries continue to demonstrate negative correlation with stocks over the short and medium terms, helping cement their status as a safe haven during times of market stress—and there’s no clear alternative to fill that role.

3) The 60/40 split was never right for everyone, since the right mix of asset classes for your particular portfolio has more to do with your specific goals and capacity for risk.

Beyond diversification

Diversification benefits aside, the high returns seen from intermediate Treasuries last year aren’t likely to be repeated over the next few years. Starting yields for fixed income investments are a reliable barometer of future returns over the long run, and bond yields are currently near or at historic lows.

However, we do see the potential for 10-year Treasury yields to rise to the 1% level in the coming months—even as

A port in the storm

Over the past 30 years, intermediate-term Treasuries have provided a better hedge against market declines than short-term Treasuries.

Source: Schwab Center for Financial Research, with data from Morningstar. Intermediate-term Treasuries are represented by the Ibbotson U.S. Intermediate-Term Government Bond Index and T-bills are represented by the Ibbotson U.S. 30-day Treasury Bill Index. Dates represent the start of commonly accepted bear markets (periods during which the S&P 500® Index declined at least 20%), plus September 2018 (when the S&P 500 fell 19%). Past performance is no guarantee of future results.
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With Asia representing 80% of the emerging market investment universe, having a deep understanding of this complex region is critical. The Matthews Emerging Markets Equity Fund applies our 29 years of investment expertise in Asia to other emerging markets around the world, so that you don’t miss out on some of the most attractive investment opportunities today.

Uncover new investment opportunities at MatthewsAsia.com/Emerging-Markets or view the Matthews Asia Funds available on the Schwab Mutual Fund OneSource Select List® at www.schwab.com/matthewsasia.

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the Fed keeps short-term interest rates near zero—assuming the economy continues to recover. Consequently, we suggest reducing the overall duration in your portfolio to mitigate the risk of rising long-term interest rates, while maintaining an allocation to intermediate-term bonds for their diversification benefits. (Duration is a measure of the sensitivity of bond prices to changes in interest rates.)

Indeed, you might consider holding a mix of short- and intermediate-term bonds to manage the effects of rising interest rates. Short-term bonds provide the flexibility to reinvest if rates rise, while longer-term bonds provide stable yields that can help offset the effects of another round of market turmoil.

Alternatively, you could use a bond ladder—a portfolio of individual bonds or certificates of deposit that mature at regular intervals—which also allows you to reinvest the proceeds from maturing bonds in higher-yielding bonds once interest rates move up.

Beyond 60/40
If the traditional 60/40 stocks-to-bonds allocation isn’t optimal, what’s an investor to do? For one, make sure your portfolio allocation matches your risk tolerance and goals rather than a supposedly one-size-fits-all target allocation.

Beyond that, we suggest broader diversification across all asset classes, not just bonds. Our anticipated returns for both bonds and stocks are lower for the next 10 years than over the past 50 years, due in part to high starting valuations and low inflation projections (see “Lower your expectations,” above). As a result, we suggest exposure to a wide array of global asset classes to help manage risk and provide a broader set of investment opportunities.

Within fixed income, we still believe most investors should allocate the bulk of their portfolios to what we consider “core” bonds (think Treasuries and highly rated corporate and municipal bonds) for stability and capital preservation—but also include exposure to riskier investments like emerging-market bonds, high-yield corporates, and preferred securities, assuming you can tolerate the higher volatility that typically accompanies them.

And while we don’t expect inflation to be a significant problem over the next few years, we believe holding some inflation-linked bonds, such as Treasury Inflation-Protected Securities (TIPS), makes sense, to mitigate the risk of an unexpected spike in inflation.

Kathy Jones (@kathyjones) is senior vice president and chief fixed income strategist at the Schwab Center for Financial Research.

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Go With the Flow
Three popular indicators for trading momentum.

By Kevin Horner

Momentum traders operate under the assumption that an asset price moving strongly in a given direction will continue to move in that direction. A price trend can reverse at any time, of course, but it’s less likely to do so when momentum is strong or accelerating.

But what clues might suggest that a stock is trending sustainably? Here are a few indicators I like to use—along with strategies for how to deploy them.

Trading volume
As a friend of mine likes to say, “Volume is the rocket fuel for further price appreciation.” That’s because when a stock’s trading volume is above average or increasing, it can be an important signal of traders’ commitment to the current direction (see “Time is of the essence,” lower right).

Alternatively, when volume is below average or falling, momentum may be waning, and a reversal could be in the offing.

Moving averages
Traders can use moving averages—a calculation of a stock’s average price over a set number of days—to determine if a stock is trending higher or lower, or remaining relatively stable.

When a stock breaks above or below a moving average, it could signal the start of a rising or falling trend. For momentum traders, the question is which moving average to use.

Time is the essence
When checking a stock’s trading volume, time of day matters.

Volume tends to be heavier across the board during the market’s open and close, and lighter during the middle hours of the session—both of which can make it difficult to assess a stock’s true volume. To mitigate this, you can look to average volume over time, available through Schwab’s StreetSmart Edge® trading platform. This indicator shows how intraday trading volume compares with the average trading volume for a given time of day—down to the last minute—over the past five trading days. A stock that doesn’t look like it’s trading heavily at noon might actually be trading more heavily than in the previous five days.

Finding little advantages like this can be the difference between a losing and a winning trade.

When a stock breaks above its five- or 10-day moving average, for example, it may be a terrific opportunity for short-term gains. If you enter such a position, be sure to set a stop order for just below the moving average to help minimize your loss in the event the momentum doesn’t hold. Momentum can be fleeting, so such positions must be managed actively as they can quickly unwind.

Those inclined to hold on to a stock longer—or who don’t want to manage a trade too closely—will want to see the price break through the longer-term averages. For instance, a stock that breaks through a 50- or 200-day moving average is more likely to convert momentum into a longer-term trend (see “Time frame matters,” left).

News and commentary
Qualitative inputs may also be useful when trading momentum. When I’m thinking of entering or exiting a stock with strong momentum, I always look to see if there’s any upcoming news that could knock it off its recent trajectory.

For example, a pending earnings announcement could easily derail the stock if the numbers disappoint. I also check Twitter as a crowdsourcing function, looking to see what traders I respect are saying about a stock. This can provide some timely clues about whether enthusiasm for a stock may be overblown or justified based on these collective sentiments, and I’ll take particular note of traders advising to take some profits at certain price points.

Protect yourself
Often, a stock retreats after a strong run because traders are waiting to see if the price breaks below its moving averages and volume declines. There’s nothing wrong with reducing or closing out some positions during these times of consolidation.

Another strategy is to reduce the size of your position in a trade as the price breaks below certain moving averages (see “Different strokes,” above right).

When the price breaks below all the moving averages, however, it’s a pretty good sign that the positive trend is broken at that point.

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Sweeten Your Tax Strategy

Five tax planning missteps—and how to avoid them.
The nonpartisan Tax Foundation puts inertia and make a change,” he says. Yet just 18% of workers contribute to them—a trend roughly 70% of employers offer Roth 401(k) options, particular tax situation. You to make pretax contributions that reduce your traditional 401(k) or similar account, which allows Sticking with default 401(k) options Misstep #1 Financial Research. “It’s no surprise, then, that even after-tax dollars—meaning there’s no immediate Roth accounts tend to be best for those who want tax flexibility in retirement may want to consider a Roth, since it’s a hedge against potentially higher future tax rates.”

Read more here to determine if a Roth 401(k) is right for you at schwab.com/roth401k.

Misstep #2 Letting taxes eat into your returns Every dollar lost to taxes is one you can’t reinvest or spend for potential growth, so it’s worth investing in the most tax-efficient way possible. “You have to be especially careful with investments held in taxable brokerage and savings accounts, because over time taxes can have a huge effect on your after-tax returns,” Hayden says. One rule of thumb is to hold investments that pay a lot of interest or nonqualified dividends—which are taxed at ordinary income rates—in tax-deferred accounts like 401(k)s and individual retirement accounts (IRAs), where you won’t pay taxes until you start making withdrawals. Assets that tend to lose less of their returns to taxes make sense for taxable accounts such as your regular brokerage account. These investments include exchange-traded funds and tax-managed mutual funds, which have relatively few taxable distributions to shareholders, and municipal bonds, whose income is generally tax-free at the federal level and for in-state residents. Another thing to keep in mind is that gains on stock-based investments held in taxable brokerage accounts are taxed differently depending on how long you held the asset before selling it. If you’ve owned an investment for at least a year and a day, any gains will be taxed at long-term capital gains rates of 0%, 15%, or 20% (depending on your income). Conversely gains on investments held for a year or less are taxed at ordinary income tax rates—which are as high as 37% for those in the top tax bracket—plus a 3.8% surtax for individuals whose modified adjusted gross income is more than $200,000 ($250,000 for married couples).

Learn more about tax-efficient investing at schwab.com/taxes.

Misstep #3 Having too much tax withheld from your paycheck According to IRS data, nearly three quarters of 2018 tax returns filed claimed a 50% penalty on the difference between what you should have taken and what you did take. Hundreds of lesser-known hidden lies in withdrawing assets from your taxable, tax-deferred, and Roth accounts at the wrong times is one of the worst mistakes. For example, converting some or all of your traditional IRA assets to a Roth IRA this year—and paying income taxes on the converted amount, including early withdrawal fees—may not be wise. Gains in a traditional IRA are subject to the wash-sale rule. For example, if you owned an investment for any Roth contributions, the longer you wait to withdraw those funds, the longer those securities have to earn back that tax hit. Hayden recommends the following withdrawal order as a good start toward maximizing tax efficiency:

1st: RMDs
2nd: Interest and dividends from taxable accounts
3rd: Manning bonds and certificates of deposit from taxable accounts
4th: Assets from taxable and nonqualified retirement accounts
5th: Roth 401(k)s and Roth IRAs

With today’s tax rates near historic lows, realizing gains sooner might actually be the better way to go in some situations.

Another thing to keep in mind is that gains on stock-based investments held in taxable brokerage accounts are taxed differently depending on how long you held the asset before selling it. If you’ve owned an investment for at least a year and a day, any gains will be taxed at long-term capital gains rates of 0%, 15%, or 20% (depending on your income). Conversely gains on investments held for a year or less are taxed at ordinary income tax rates—which are as high as 37% for those in the top tax bracket—plus a 3.8% surtax for individuals whose modified adjusted gross income is more than $200,000 ($250,000 for married couples).

Learn more about tax-efficient investing at schwab.com/taxes.

Misstep #5 Delaying taxes When it comes to paying taxes on investment gains, says tax-savvy wisdom is to delay as long as possible. But with today’s tax rates near historic lows, realizing gains sooner might actually be the better way to go in some situations.

“The Tax Cuts and Jobs Act of 2017 reduced many taxes for people,” Hayden says. “But with those provisions set to expire after 2025, you may want to consider some tax strategies that allow you to capitalize on the lower tax rates while they’re still around.”

Hayden recommends the following withdrawal order as a good start toward maximizing tax efficiency:

1st: RMDs
2nd: Interest and dividends from taxable accounts
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4th: Assets from taxable and nonqualified retirement accounts
5th: Roth 401(k)s and Roth IRAs

“You could end up paying quite a bit more in taxes over the course of your retirement if you don’t draw down your savings in the most tax-efficient manner,” Hayden says.

Schwab Intelligent Income℠, a feature available with Schwab Intelligent Portfolios®, can help you create a tax-smart withdrawal strategy. Learn more at schwab.com/intelligentincome.

Learn more about tax-efficient investing at schwab.com/taxes.

Let experts be your guide Taxes can be confusing. “You may be capable of learning all of this on your own, but do you really want to?” Hayden says. “After all, there’s a world full of experts out there who can help you go through this process.”

“Earnings on Roth 401(k) contributions are eligible for tax-free investment growth as long as the distribution occurs at least five years after the first Roth 401(k) contribution and the account holder has reached age 59½, has reached retirement, or has died. “Profits” held for the account at least five years.”

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With attractive yields and potentially competitive returns, dividend-paying stocks could be just what the doctor ordered.

Today’s low interest rates—plus the prospect of below-average stock returns over the coming decade—are a one-two punch for both income-focused investors and savers struggling to regain lost ground in the wake of an uneven recovery. However, whether you’re looking to generate extra income or to potentially pump up total returns from your stock portfolio, dividend-paying stocks are uniquely suited to help soften the blow.

Here’s what to know about dividend stocks, and how to pick the best ones for you.

The perks (and pitfalls) of dividend payers

Dividend payers tend to be big, well-established companies that have an abundance of cash. “They often can’t compete with the rapid appreciation of fledgling, fast-growing companies, so they use dividend payouts as an enticement,” says Steve Greiner, vice president of Schwab Equity Ratings®.

Dividends, when reinvested, can significantly boost total returns over time, making dividend-paying stocks an attractive option for older and younger investors alike.

For example, if you invested $1,000 in a hypothetical investment that tracked the S&P 500® Index on January 1, 1990, but didn’t reinvest the dividends, your investment would have been worth $8,982.

ILLUSTRATION BY BEX GLENDINING
How to pick dividend stocks

These six tips can help you identify dividend-paying stocks with strong financial health:

1. Don’t chase high dividend yields: “There’s a reason—and not always a good one—that a security is offering payouts that are well above its peers or the market, and the reason is that it’s not doing well,” Steve says. “Keep your focus on a big yield, try to determine why it’s so high.”

Dividend yield is calculated by dividing a stock’s annual dividend payments by its current share price. A high or rising yield is due to a shrinking share price, that’s a bad sign and could indicate that a dividend cut is on the horizon.

If a rising dividend yield is due to rising profits, on the other hand, that’s a much more auspicious sign. “When net profits rise, dividends tend to follow suit, so just be sure you know what’s causing the increase before buying the stock,” he says.

2. Assess the payout ratio: This metric—which is calculated by dividing dividends per share by earnings per share—tells you how much of a company’s earnings are going toward the dividend. “A ratio higher than 100% means the company is paying out more than 100% of its earnings, or using cash reserves,” Steve says. “It’s rare that such measures turn things around, though. They’re usually just delaying the inevitable.”

3. Check the balance sheet: High levels of debt represent a competing use of cash. “A company’s balance sheet is particularly valuable to income investors in particular should consider whether such situations,” Steve says. “If you’re looking at a company, it’s likely going to pay its creditors before it pays its dividends. A ratio too high, which is a good indicator of a company’s current liabilities—of 2 or higher, which is a good indicator of a company’s asset quality—and its current liabilities—are known for steady dividends and lower volatility, but they also tend to offer less growth potential. Dividend-paying tech companies, on the other hand, could offer attractive dividends along with the opportunity for larger price gains, but they also tend to be more volatile.

If you’re a long-term investor, you might want to stick with dividend-paying tech companies that have a “current ratio”—a measure of the company’s current assets versus its current liabilities—of 2 or higher, which is a good indicator of a company’s asset quality. 

4. Look at dividend growth: Generally speaking, you want to find companies that not only pay steady dividends but also increase them at regular intervals—say, once per year over the past three years. “Buying stocks in companies that grow their dividends tend to outperform their peers over time (see “Supermise,” left) Not only that, but a strong history of dividend growth also helps keep pace with inflation—which is particularly valuable to income-seeking investors,” Steve says.

Nevertheless, you probably should give companies a break if they didn’t increase dividends in 2020, or even in 2021. “Most have been hoarding cash to help weather the economic uncertainty, so it’s not unreasonable for them to keep dividends flat until the economy bounces back,” Steve says.

5. Understand sector risk: Some sectors offer a more attractive combination of dividends and growth than others—but they also offer different risk characteristics that you should consider when researching dividend payers for your portfolio. Stocks from the banking, consumer staples, and utilities sectors, for example, are known for steady dividends and lower volatility, but they also tend to offer less growth potential. Dividend-paying tech companies, on the other hand, could offer attractive dividends along with the opportunity for larger price gains, but they also tend to be more volatile.

If you’re a long-term investor, you might want to stick with tech companies that have a “current ratio”—a measure of the company’s current assets versus its current liabilities—of 2 or higher, which is a good indicator of a company’s asset quality. 

6. Consider a fund: If you’re worried about the potential for price declines along the way, the value of most dividend stocks, consider instead a dividend-focused exchange-traded fund (ETF) or mutual fund. Such funds typically hold stocks that have a history of distributing dividends to their shareholders, and they provide a greater level of diversification than buying a handful of dividend-paying stocks.

Do your homework

No matter what stage of life you’re in, dividend-paying stocks can be a great way to supplement your income and improve your portfolio’s growth potential. Just be sure you research their overall financial health, not just their dividend rates, before investing.

Research can pay dividends

How to research dividend payers on schwab.com

Log in to schwab.com/stockscreener to research dividend stocks by:

■ Current ratio: Select Financial Strength under the Choose Criteria menu, then select Current Ratio.

■ Payout ratio: Select Dividends under the Choose Criteria menu, then select Payout Ratio - TTM and choose a range.

■ Sector: Select Basic under the Choose Criteria menu, then select Sectors and choose a sector.

To review a stock’s dividend growth, log in to schwab.com/research-tools, search for the company name or ticker symbol, and select the Dividends tab on the stock’s research page.

To research dividend-paying stock funds, log in to schwab.com/ETF screener (for ETFs) or schwab.com/fundscreener (for mutual funds), select Distributions under the Choose Criteria menu, then select Distribution Yield and choose a range.

When not to reinvest

Three situations in which you might want to deploy dividend payouts elsewhere:

■ You’re in or near retirement: When you’re living off your savings, taking income from your dividends allows you to let more of your portfolio stay invested for growth. If you’re nearing retirement, on the other hand, the dividends you use to build up your cash and short-term reserves as you prepare for the transition to life after work.

■ Your portfolio is out of balance: Reinvesting the dividends of a well-performing investment back into that investment can throw your portfolio off balance over time. In such cases, you might want to take the cash and reinvest it elsewhere.

■ The investment is underperforming: If you’re worried about an investment’s future prospects but aren’t quite ready to let it go, you may not want to reinvest the payouts back into that investment. Instead, you might use the dividends to dip your toe into prospective investments that could ultimately replace the underperforming investment.

More bang for your buck

Reinvesting dividends could significantly boost total returns over time.

<table>
<thead>
<tr>
<th>Year</th>
<th>S&amp;P 500 (price returns)</th>
<th>S&amp;P 500 (total returns)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2020</td>
<td>$10,000</td>
<td>$11,500</td>
</tr>
<tr>
<td>2019</td>
<td>$5,000</td>
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<tr>
<td>2018</td>
<td>$2,000</td>
<td>$2,380</td>
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</table>

Source: Charles Schwab. Data from 01/01/1990 through 12/31/2020. Calculations assume a starting portfolio value of $1,000. Indexes are unmanaged, do not incur management fees, costs, and expenses, and cannot be invested in directly. Past performance is no guarantee of future results.
Diversify, diversify, diversify

Investing across and within asset classes can not only help protect against large drops but also potentially boost your portfolio’s value. For example, over the past 20 years a diversified portfolio of stocks and bonds would have had an ending value nearly 9% greater than an all-stock portfolio—and been less volatile in the bargain.

“A diversified portfolio won’t always outperform an all-stock portfolio, but it will generally lose less of its value during a downturn,” Mark says. “And when your portfolio is less volatile, you’re less likely to make rash decisions that could undercut your savings.”

Learn more about creating a diversified portfolio of exchange-traded funds, along with a cash allocation, tailored to your goals and risk tolerance at schwab.com/intelligent.

Minimize fees

Management fees—from expense ratios charged by index funds to the annual fees charged by an advisor—are often a necessary part of investing. That said, even seemingly small differences can erode your returns over time.

“Make sure you’re getting what you pay for—whether that’s strong returns, exceptional service, emotional support that keeps you on track, or practical, trustworthy advice,” Mark says. “In any case, it’s wise to scrutinize your investment expenses regularly, perhaps as part of your annual portfolio review.”

Research low-cost exchange-traded funds and mutual funds at schwab.com/research-tools.

Start investing now

The sooner you begin, the less you may have to save to reach your goal, thanks to the potential for long-term compound growth. Consider two investors who each wanted to save $1 million by age 65:

- **Rosa** started investing at age 25 and so needed to save just $5,720 a year to achieve her goal.
- **Jin** didn’t start investing until he was 35 and so needed to save $11,125 a year to achieve the same goal.

“Age 35 is still quite young, but Jin nevertheless had to save nearly 50% more than Rosa to achieve the same goal,” says Mark Riepe, head of the Schwab Center for Financial Research. “Not everyone will be able to do that, which is why it’s so important to invest as much as you can as early as you can.”

Set up automatic contributions to your Schwab accounts at schwab.com/contribute.

Source: Schwab Center for Financial Research. The example is hypothetical and provided for illustrative purposes only. The example assumes a 6% average annual return and does not reflect the effects of investment fees or taxes.

Habit 1: Start investing now

- **Total contributions**
  - Rosa: $766,197
  - Jin: $655,149
  - **Total earnings**
  - Rosa: $344,875
  - Jin: $234,520

Habit 2: Diversify, diversify, diversify

Habit 3: Minimize fees

There are many roads to financial well-being, but research suggests those who enjoy uncommon success share common behaviors. Here’s a data-driven look at what makes seven such habits so effective—and how to start incorporating them into your own financial life.
To reduce your tax bill, you could take one of three common approaches:

- **Approach 1**: Hang on to the investment for at least a year and a day at which point any gains would be taxed at your long-term capital gains rate of 15%, resulting in a $7,500 tax bill ($50,000 × 0.15).1
- **Approach 2**: Sell another investment at a loss in order to offset some or all of your short-term $50,000 gain. For example, if you realize $35,000 in losses, your gains would be reduced to just $15,000, resulting in a $3,600 tax bill ($15,000 × 0.24).
- **Approach 3**: Combine approaches 1 and 2—holding on to your investment for at least another month and a day and realizing $35,000 in losses to offset your $50,000 gain, resulting in a $2,250 tax bill ($15,000 × 0.15).

Find more ways to make tax-smart decisions and potentially lower your tax bill at schwab.com/taxstrategies.

Source: Schwab Center for Financial Research. Scenario assumes a starting salary of $40,000, annual cost-of-living increases of 2%, and a 1% raise every five years. The example is hypothetical and provided for illustrative purposes only. It is not intended to represent a specific investment product. Ending portfolio balances assume a 6% average annual return and do not reflect the effects of investment fees or taxes. In Scenario 1, the investor contributes 5% of his pretax income in the first year and then contributes this same dollar figure in subsequent years. In Scenario 2, the investor contributes 5% annually at the start of every year from age 25 through age 65. In Scenario 3, the investor contributes 1% annually at the start of every year beginning at 25 and then increases her contribution rate by 1 percentage point each raise.

*Long-term capital gains rates are 0%, 15%, or 20%, depending on income; plus a 3.8% surtax for certain high-income earners. If you decide to hold on to the investment for at least a year and a day, be aware that your investments could increase in value during that time.

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A bond ladder is a fixed income strategy designed to provide predictable income while helping you manage interest rate risk. A bond ladder works like this: You purchase a collection of individual CDs or bonds (the rungs on the ladder) that mature on staggered dates in the future (the distance between the rungs represents time). As CDs or bonds mature, you can either pocket the principal or reinvest it in new CDs or bonds, thereby adding another rung to the end of your ladder. If interest rates rise, your new investment could pay a higher rate, boosting your overall yield from the ladder. If rates fall, you’ve still got the other rungs in the ladder making steady payments. Either way, you’re not locked into a single yield.

Note: The minimum investment for each rung is $1,000, and each ladder must have at least two rungs.

Here’s how you can build a CD or Treasury ladder using Schwab’s new online tool:

**Step 1** Design your ladder

First, choose whether you’d like your ladder to be made of certificates of deposit (CDs) or Treasuries. Then, decide how many rungs you’d like in your ladder. The CD & Treasury Ladder Builder offers prebuilt ladders of one, two, or five years, or you can opt for a custom ladder of up to 10 years.

Next, choose how far in the future you’d like to receive your first principal payment, as well as the frequency of your coupon payments: monthly (CDs only), semiannually, or at maturity.

Finally, identify which account you’d like to use and enter your initial investment amount.

**Step 2** Choose your investments

Once you’ve designed your ladder, the CD & Treasury Ladder Builder will provide a list of investments you can choose to be your rungs. If your ladder has five rungs, you will receive five lists of investments that meet the criteria you’ve set for your ladder.

**Step 3** Review and place your orders

Once your ladder is complete, you’ll have a chance to review your orders and then buy each of the investments you’ve selected as rungs.

In addition, with some CD ladders, you can choose to use our rollover feature to automatically reinvest the principal from maturing CDs in new investments.

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

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   Start by entering your goals, like when you plan to retire and how much you’ll need for expenses to support your lifestyle. Then input your financial information, like your income, investments, and assets.

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   Advanced technology runs 1,000 simulated market projections with your input to generate the probability you will reach your goals. Stress test your plan with an interactive tool that lets you see the impact of adjusting your retirement age, expenses, and more.

3. Review your plan and take action.
   See what steps you could take next to put your plan into action, and update it to stay on track as your circumstances change. Every time you view or update your plan, you’ll receive an updated probability of success score for reaching your retirement goals.

See page 38 for important information. IMPORTANT: The projections or other information generated by Schwab Plan™ regarding the likelihood of various investment outcomes are hypothetical in nature, do not reflect actual investment results, and are not guarantees of future results. Investing involves risk, including loss of principal. Schwab Plan is available to clients at no cost, but any investments you ultimately make may incur costs such as advisory fees. (0121-009U)
Schwab’s 1099 Dashboard Helps Simplify Tax Season

Looking for your Schwab tax forms? See them all on your 1099 Dashboard.

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:
  - Form 1099-B*
  - Form 1099-DIV*
  - Form 1099-INT
  - Form 1099-MISC
  - Form 1099-NEC
  - Form 1099-R
  
  *For employer-sponsored accounts.

- Educational resources, including filing dates and other tax-related information.

- Quick links to easily manage paperless and security preferences.

See page 38 for important information.

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- 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 Form 1099 Composite information during the month of February. In early February 2021, 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 by Friday, February 5. In mid-February 2021, 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 by Friday, February 19. Mailing of paper 1099 Composites typically takes place after tax forms are made available online. Please allow several days for postal delivery.

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◆ 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.

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The Secret Tesla Reveals About Index Investing

How you buy the market matters.

As I think most investors know by now, Tesla joined the S&P 500® Index in late December. What’s less known is that Tesla became one of the country’s top 500 stocks by market cap back in 2013.

That is a roughly seven-year gap and about a 3,100% increase in Tesla’s stock price during that time. It’s an extraordinary story, and ironic in a way. The meteoric rise of a single company reveals something every investor should know about an investment strategy that in many ways is the exact opposite of individual stock-picking—index investing.

The wisdom of the market

The stock market is actively picking winning and losing stocks every minute of every day in a rational, unemotional way based on all the information available about companies’ growth potential. Because of that, many investors—myself included—have come to believe that one of the simplest and most effective ways to manage money is to just “buy the market.”

At its heart, an index uses the pooled wisdom of the market as its manager. Harnessing that process is what index investing is all about: using objective criteria to win the day over human...
emotions and feelings. It’s why so few actively managed investments beat indexes over time.

But indexes come in many different shapes and sizes. Understanding those nuances is important.

Which brings us back to Tesla, which didn’t enter the S&P 500 Index back in 2013 because a committee of people chose not to include it despite the fact it was one of the largest U.S. stocks even back then. Many investors find this surprising, and Tesla is far from the only one of America’s largest 500 companies by market capitalization not represented in the S&P 500 Index.

Markets pick winners and losers very efficiently—but how you buy the market matters
In my view, the smart way to buy the market is through:

■ Indexes that rely on objective criteria like market cap. I believe the very spirit of index investing is that it should be objective, transparent, and rules-based. The Schwab 1000 Index®, for example, is made up of the top 1,000 U.S. common stocks as defined by market cap. In other words, it lets the market determine which companies get included. The S&P 500 Index uses a more subjective approach—via a committee—to decide which companies should enter the index, looking at factors like profitability, sector representation, or other considerations investors may not be aware of.

■ Indexes that are large enough to capture the fast-growing up-and-comers earlier in their success. The Schwab 1000 Index, for example, combines large-cap and mid-cap stocks in a single index. And it’s in those second 500 stocks—the smaller end of the companies in the index—where you can find the innovative “highfliers” before they possibly become part of the S&P 500 Index. Tesla became part of the Schwab 1000 Index in February of 2011, and then continued to grow rapidly for two years to become one of the largest stocks in the U.S. But there are many others. Companies like Lululemon, Moderna, Square, and DocuSign—none of which is in the S&P 500 Index yet.

My intent is not to beat up on any one index. But as index investing continues to take hold, I believe investors have something to learn from the Tesla story. I believe the ideal selection criteria for what goes into an index belongs in the hands of the dispassionate market. Market wisdom versus subjective choice.

It’s not enough to decide you want to buy the market. How you buy the market matters.

■ Learn more about the Schwab 1000 Index at schwab.com/1000.

Charles R. Schwab
Founder & Chairman

<table>
<thead>
<tr>
<th>Stock</th>
<th>Date added to Schwab 1000 Index</th>
<th>Market cap (in billions USD, as of 12/31/2020)</th>
<th>Date added to S&amp;P 500 Index</th>
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Source: FactSet. Market cap subject to change based on current market conditions.

See page 38 for important information. Investments that track each of these indexes may have different performance as a result of fees, expenses, and tracking error, among other variables. Indexes are unmanaged, do not incur management fees, costs, and expenses, and cannot be invested in directly. Past performance is no guarantee of future results and the opinions presented cannot be viewed as an indicator of future performance. All corporate names and market data 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. (0321-0170)
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The more qualifying assets you have with Schwab and Schwab Bank, the more you may save on home loans.¹

Call Quicken Loans at 877-524-2932 or visit schwab.com/mortgages to get started.

In order to participate, the borrower must agree that the lender, Quicken Loans, may share their information with Charles Schwab Bank, and Charles Schwab Bank will share their information with the lender Quicken Loans. Nothing herein is or should be interpreted as an obligation to lend. Loans are subject to credit and collateral approval. Other conditions and restrictions may apply. This offer is subject to change or withdrawal at any time and without notice. Interest rate discounts cannot be combined with any other offers or rate discounts. Hazard insurance may be required.

¹. 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 0.250% - 0.750% 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.