Piece of Cake
Five ways to sweeten your tax strategy. Page 22
Dear Client,

Many people think of taxes as something they only need to worry about once a year. But in reality, nearly every financial decision you make has tax implications—and even seemingly small slip-ups can cost you dearly. With that in mind, turn to page 22 for our tips on avoiding common tax missteps.

Elsewhere in this issue we make a case for revisiting your international allocation (page 13), dig into why dividend-paying stocks may be especially attractive now (page 26), and much more.

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

Sincerely,

Joseph Vietri
Senior Vice President, Investor Services
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### CORRECTION: Winter 2020 issue

In “The Big 5” (page 26), the Social Security benefits listed in the “Why waiting to collect pays” chart were based on a birthdate of 01/02/1960 (not 12/31/1954) and an annual income of $185,000 in 2020 (not $137,700).
SCHWAB ORIGINALS

Learn

Tax Day may be approaching, but managing your taxes should be a year-round affair. Find tips for lowering your tax bill, maximizing deductions, and making tax-smart investment decisions at schwab.com/taxes.

Watch

Like any good road map, a financial plan can help you chart a course to your destination. See how planning can help to define your goals and focus your savings at schwab.com/whyplan.

Listen

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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Learn

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Tamar Dorsey
Vice President, Brand Journalism

Sara Smith
Editor in Chief

Jeremy Hartley
Managing Editor

Stacia Miller
Associate Managing Editor

ONWARD
On Firm Footing

Schwab’s Investing Principles can help you create a clear path toward your goals.

When confronted with instability, there can be great comfort in focusing on what you can control.

In 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
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Missing the Match

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

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:

1. **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.
The Bottom Line

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.”

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.

Whether your company has cut back on matching contributions or not, one thing’s for sure: “Sticking to your plan, even when times are tough, gives you the best shot at reaching your goal,” Rob says. “Your future self will thank you for it.”

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 review an investment strategy for his or her own particular situation before making any investment decision. (0321-0VKJ)

A Cut Above?

Why stock splits may soon be a thing of the past.

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—nor 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 42 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>
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<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></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></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Make a tax-smart charitable gift of appreciated assets</td>
<td></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.

**LET'S TALK**

Need help getting started or putting your plan into action? Work one-on-one with your Schwab financial consultant to pinpoint your goals and develop a road map for achieving them. Call today to schedule an appointment.

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 review an investment strategy for his or her own particular situation before making any investment decision. (0321-0UX3)
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.

Anytime 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.

**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.

### Lot 1
- **Cost basis:** $11,375
- **Market value:** $12,500
- **Potential gain:** $1,125

### Lot 2
- **Cost basis:** $10,425
- **Market value:** $12,500
- **Potential gain:** $2,075

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.

### Lot 3
- **Cost basis:** $15,940
- **Market value:** $12,500
- **Potential loss:** ($3,440)

### Lot 4
- **Cost basis:** $15,995
- **Market value:** $12,500
- **Potential loss:** ($3,495)

**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.

**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 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. 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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Illustration by Maria Hergeta

S P R I N G  2 0 2 1  |  O N W A R D  |  1 1

Paper Trail

Getting your estate plan in order—and storing the details in a safe, accessible way—can help shield your family from unnecessary heartache and expense.

Should the worst come to pass, the last thing you’d want is for your family to have to track down your assets, insurance, and other information. That’s why it’s so important to draft detailed plans, ensure relevant parties are aware of your wishes, and keep all necessary documents secured in a safe, accessible place.

Here, two Schwab estate specialists offer five steps you can take now to help make the settlement of your estate as easy as possible for your loved ones.

ILLUSTRATION BY MARIA HERGETA
1 Make sure your estate plan is complete and up to date

“Ideally, a full estate plan should include a financial power of attorney, a health care power of attorney, a living will, a living trust, and a last will and testament or, alternatively, a pour-over will that would automatically place any overlooked assets into your trust,” says Patrick Schultz, a tax, trust, and estate specialist with Schwab. (See “Terms of engagement,” below right.)

What’s more, you should periodically reconfirm that the beneficiaries of all your insurance policies and retirement accounts are up to date. “If there’s a discrepancy between your account beneficiaries and those you’ve named in other documents, like your will, the beneficiaries named for your accounts will generally take precedence,” Patrick says.

Also be sure that ownership is assigned to all assets in a way that matches your wishes. Any financial accounts or real assets designated joint tenancy with rights of survivorship bypass probate—the lengthy legal process of validating your estate, including your will. “Joint titling makes the transfer of assets nearly seamless,” Patrick says. Be aware, however, that adding heirs as joint owners gives them the same authority over the assets as you have, and you’ll need their consent if you want to change or remove such ownership in the future.

2 Keep a master list of your accounts and real assets

Patrick recommends creating a physical spreadsheet that lists all of your financial accounts and real assets. “For any account where there’s money, include the institution, approximate value, and titling details,” he says. You can also include this information in a section of your will, or as a worksheet in your trust document.

Aside from financial accounts, it’s important to list all your bills—and how to pay them. “Many folks aren’t getting physical bills anymore, so this simple step can help keep ongoing commitments from going sideways until your heirs can close out the estate,” says Matthew Olsen, managing director of estate services at Schwab.

3 Create a list of trusted professionals

Your attorney, CPA, and financial advisor are the most important contacts to include, Patrick says, but anyone who might have a formal role in settling your estate, such as your executor, should also go on the list.

Terms of engagement

Six terms to know when creating your estate plan.

- **Financial power of attorney:** Authorizes an individual to act on your behalf in financial matters, such as managing investments and paying bills and taxes.

- **Health care power of attorney:** Authorizes an individual to make health care decisions if you become incapacitated.

- **Last will and testament:** Directs the distribution of your assets after your death.

- **Living trust:** A revocable trust that can be altered at any time before your passing.

- **Living will:** Details your desires regarding medical treatment in the event you are no longer able to express informed consent.

- **Pour-over will:** Used in conjunction with a revocable trust to pass any property not already in your trust to your trust upon your death.

4 Secure all relevant documents—and make copies

Keep all of the documents listed previously—along with insurance policies, property deeds, and the like—in a fire- and waterproof box that can easily be located in the event of your passing. “I also encourage clients to include their most current tax returns, which can help identify any stocks or other assets you have overlooked in your plan,” Matthew says.

Patrick also recommends making copies—which are generally as good as originals in every state—and keeping them in a separate location. However, beware of storing any important documents in a safe deposit box. “If your loved ones aren’t on your list of authorized persons, it can take a court order to access the contents,” Patrick says. Conversely, you can authorize multiple people to access your safe deposit box, but each person must accompany you to the bank in question, provide proof of identification, and sign a physical authorization card.

You might also consider an online record-keeping service to store digital copies of important documents in a secure, central location. Such services typically allow you to grant other individuals access to the information during or after your lifetime.

5 Talk to your loved ones

Even with all your documents packaged up, Matthew advocates having a conversation with your family—particularly your executor. “Show them not only where all your documentation is but also how to access it,” he says. “The aftermath of your passing may not be the most comfortable topic to address, but in the end, you will have given them immeasurable peace of mind.”

A good plan makes all the difference, and Schwab can help. Call your Schwab financial consultant to talk through your trust and estate considerations.
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.1

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 unsustainable 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 for investors.

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. ■

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

<table>
<thead>
<tr>
<th>07/81–07/90</th>
<th>07/90–03/01</th>
<th>03/01–12/07</th>
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<td>14.9%</td>
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<tr>
<td>21.1%</td>
<td>11.1%</td>
<td>4.8%</td>
<td>1.1%</td>
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</table>

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.

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1 Bloomberg, MSCI Europe Index, as of 10/27/2020.

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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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.

### Lower your expectations

Returns for all asset classes are expected to be lower over the next decade.

<table>
<thead>
<tr>
<th>Asset Type</th>
<th>Annualized historical total returns (1970–2020)</th>
<th>Forecast total returns (04/2020–03/2030)</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. large-cap stocks</td>
<td>10.1%</td>
<td>9.8%</td>
</tr>
<tr>
<td>U.S. small-cap stocks</td>
<td>7.1%</td>
<td>7.4%</td>
</tr>
<tr>
<td>International large-cap stocks</td>
<td>8.1%</td>
<td>7.7%</td>
</tr>
<tr>
<td>U.S. investment-grade bonds</td>
<td>7.3%</td>
<td>7.7%</td>
</tr>
<tr>
<td>Cash investments</td>
<td>1.9%</td>
<td>4.7%</td>
</tr>
</tbody>
</table>

Source: Charles Schwab Investment Advisory and Morningstar Direct. Data as of 03/31/2020. Indexes representing the investment types are: S&P 500® Index (U.S. large-cap stocks); Russell 2000® Index (U.S. small-cap stocks); MSCI EAFE Index (international large-cap stocks); Bloomberg Barclays U.S. Aggregate Bond Index (U.S. investment-grade bonds); and Bloomberg Barclays 1–3 Month U.S. Treasury Bill Index (cash investments). Past performance is no guarantee of future results.

### Let’s Talk

Want help creating a globally diversified portfolio of investments? Call your Schwab financial consultant to discuss the right level of investment advice based on your goals.
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Go With the Flow

Three popular indicators for trading momentum.

By Kevin Horner

M omentum 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 trend is not sustainable? 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 moving relatively steady. 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 current 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 the number of words in today’s tax code at some 7.7 million.

No wonder it’s such a hard recipe to follow. Taxes affect nearly every part of our financial lives, says 4th: "Taxes affect nearly every part of our financial lives," says Hayden Adams, CPA, CFP®, director of tax and financial planning at The Schwab Center for Financial Research. "It’s no surprise, then, that even seemingly small slip-ups can have a major impact on how much tax you owe, and consequently how much of your income you get to keep."

Here, Hayden shares five common tax planning missteps—and how to avoid them.

**Misstep #1**

**Sticking with default 40(k) options**

If you participate in your employer’s workplace retirement plan, you’re most likely enrolled in a traditional 401(k) or a similar account, which allows you to make pretax contributions that reduce your taxable income dollar for dollar. The immediate tax benefit of such contributions is appealing to many, and people are subject to the unknowns of future tax rates—which are as high as 37% for some taxpayers. The nonpartisan Tax Foundation puts the number of words in today’s tax code at some 7.7 million. Thus, many investors prefer the immediate tax break to taking the time to review what they might owe in the future.

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).

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 tax planning 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, because they generally have few taxable distributions to shareholders, and municipal bonds, whose income is generally tax-free at the federal level and for in-state residents.

According to IRS data, nearly 60% of workers believe their current income tax rate is lower than it was when they’re ready to take withdrawals. “Younger workers who still have relatively low income often fall into this group,” Hayden says. “However, even higher-earning individuals 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 about how to determine if a Roth 401(k) is right for you at schwab.com/roth401k.

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

**Misstep #3**

**Having too much tax withheld from your paycheck**

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While today’s tax rates near historic lows, realizing gains sooner might actually be the better way to go in some situations. “The Tax Cut and Jobs Act of 2017 reduced taxes for many 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.”

Delaying taxes

When it comes to paying taxes on investment gains, says Hayden, “you could have been paying taxes on your returns for potential growth, so it’s worth investing in the tax planning 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, because they generally have few taxable distributions to shareholders, and municipal bonds, whose income is generally tax-free at the federal level and for in-state residents.

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

**Misstep #4**

**Misleading your retirement distributions**

Failing to take the IRS-mandated required minimum distributions (RMDs) from your tax-deferred 401(k) and IRA accounts starting at age 72 will result in a 50% penalty on the difference between what you should have taken and what you did take. However, there’s a lesser-known hazard lies in withering assets from your tax-free, tax-deferred, and Roth accounts at the wrong time in order to fund your retirement. “There’s an opportunity cost that comes from withholding too much in taxes,” Hayden says. “You could be holding a great deal of cash that you could be earning a return on.”

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

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

“Letting taxes eat into your returns” Hayden says. “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.

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

**Misstep #5**

**Delaying taxes**

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

**Let experts be your guide**

Taxes can befuddle even the sharpest minds. “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 through this process.”

See page 25 for important information. Please read the Schwab Intelligent Portfolios® disclosure brochures for important information. Schwab Intelligent Portfolios® is a program of Charles Schwab & Co., Inc. (“Schwab”), a duly registered investment advisor and broker dealer. Portfolio management services are performed by Charles Schwab Investment Management Inc. (“CSIAM”). Schwab and CSIAM are subsidiaries of The Charles Schwab Corporation. Schwab Intelligent Income℠ is an optional feature for clients to receive recurring, automated withdrawals from their accounts. Schwab does not guarantee any specific tax results as Schwab Intelligent Income withdrawals, nor does it guarantee any specific tax results such as meeting life expectancy, subject to an early withdrawal penalty. The information provided here is for general informational purposes only and should not be considered an investment recommendation or personalized investment advice. The investment strategies mentioned here may not be suitable for everyone. Each investor needs to review an investment strategy for his or her particular situation before making any investment decision. Investing involves risk, including loss of principal. 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, financial planner, or investment manager. Roth IRA owners require a 5-year holding period before earnings can be withdrawn tax free and subsequent conversions will require their own 5-year holding period. In addition, earnings distributions prior to age 59½ are subject to early withdrawal penalties (402(j)-500).
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.
at the end of 2019. If you had reinvested the dividends, you would have ended up with $16,941—nearly twice as much (see “More bang for your buck,” right).

With the S&P 500 yielding 1.52% as of December 31, 2020, dividends could also prove an attractive alternative to Treasuries and other fixed income investments in the coming years. “Of course, dividend-paying stocks are generally much more risky than bonds, something income investors in particular should consider when such comes to fruition,” Steve says.

What’s more, dividends aren’t guaranteed, unlike, say, the interest payments from Treasuries. Companies can trim or slash their dividends at any time, at their discretion. A company that had recently increased its dividend at the time of writing was planning to pay shareholders a dividend of roughly 380 dividend-paying companies in the S&P 500 suspended or reduced their payouts.

Fortunately, companies generally only cut dividends when they’re in distress, Steve says, “so favoring those whose sound financial metrics can help mitigate this risk.”

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 broader market. “‘That dividend is a high yield at a big yield, try to determine why it is so high,”

Dividend yield is calculated by dividing a stock’s total 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, the opposite is true when earnings are falling,” Steve says. “Before jumping at a big yield, try to determine why it is so high.”

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 to its shareholders than it’s earning,” Steve says. “In such cases, it may be able to cover its dividends from cash reserves, but that can last only so long.”

If a company whose stock you own is losing money but still paying a dividend, it may be time to sell. “Dividend payments in financial strains may try to siphon off a dividend cut—which can drive away shareholders—by funding payouts with borrowed funds or dwindling 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. “‘The board of directors knows that,’ Steve says, “the company is going to pay its creditors before it pays its dividends.’”

A good rule of thumb is to favor companies with 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 its ability to cover its short-term obligations.

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 five years or so. Indeed, companies that grow their dividends tend to outperform their peers over time (see “Supersize me,” bottom left). Not every company has a strong track record of regular 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 if they don’t in 2021. “Most have 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.

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. “If you’re a low-growth investor, you might be willing to accept its higher volatility to exchange for its greater income prospects,” Steve says. “But if you’re nearing or in retirement, you might want to stick with dividend-paying stocks from low-volatility industries.”

6. Consider a fund: If you’re worried about the potential for price declines despite the value of your dividend stocks, consider instead a dividend-focused exchange-traded fund (ETF) or mutual fund. Such funds typically hold stocks that form a history of distributing dividends to their shareholders, and they provide a greater level of diversification than you can get by 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/screencaster 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 Industries and choose a sector.

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

To research dividend-paying stock funds, log in to schwab.com/ETFscreener (for ETFs) or schwab.com/fund screener (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, you can use the payouts 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 sure whether you 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.

Supersize me

Over the past 40 years, stocks that maintained or grew their dividends outperformed those that cut their payouts or offered none at all.

<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>1990</td>
<td>$10,000</td>
<td>$10,000</td>
</tr>
<tr>
<td>1995</td>
<td>$10,000</td>
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<tr>
<td>2015</td>
<td>$10,000</td>
<td>$10,000</td>
</tr>
<tr>
<td>2020</td>
<td>$10,000</td>
<td>$10,000</td>
</tr>
</tbody>
</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, expenses, and cannot be invested in directly. Past performance is no guarantee of future results.

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S P R I N G  2 0 2 1

ONWARD

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.

HABIT 1 Start investing now

The earlier you start, 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."

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

Source: Schwab Center for Financial Research. The example is hypothetical and provided for illustrative purposes only. Total contributions and total earnings calculations assume a lump-sum investment on January 1 of each year and a 6% average annual return, and do not reflect the effects of investment fees or taxes.

HABIT 2 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.

HABIT 3 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.

Source: Schwab Center for Financial Research. The example is hypothetical and provided for illustrative purposes only. Portfolio performance during market crashes is based on monthly data, not peak-to-trough declines. The blended portfolio is composed of 60% stocks and 40% bonds. Stocks are represented by the S&P 500® Index and bonds are represented by the Bloomberg Barclays U.S. Aggregate Index. The blended portfolio is rebalanced annually. Returns include reinvestment of dividends, interest, and capital gains.

---

**HABIT**

**2** 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.

- Stock index: S&P 500®
- Bond index: Bloomberg Barclays U.S. Aggregate

**HABIT**

**3** 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.

- Lower fees keep your portfolio’s value closer to the impact of market performance.

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Source: Schwab Center for Financial Research and Morningstar. Data from 09/30/2000 through 09/30/2020. The example is hypothetical and provided for illustrative purposes only. Portfolio performance during market crashes is based on monthly data, not peak-to-trough declines. The blended portfolio is composed of 60% stocks and 40% bonds. Stocks are represented by the S&P 500® Index and bonds are represented by the Bloomberg Barclays U.S. Aggregate Index. The blended portfolio is rebalanced annually. Returns include reinvestment of dividends, interest, and capital gains.

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Source: Schwab Center for Financial Research. The example is hypothetical and provided for illustrative purposes only. Ending portfolio balances assume a starting balance of $100,000, a 6% average annual return, no additional contributions or withdrawals, and do not reflect the effects of taxes.
Stay invested

When the market’s in free fall, it’s tempting to flee to the safety of cash. However, pulling out of the market for even a month during a downturn could seriously stunt your returns, as the examples below show.

“The problem with selling during a market drop is that by the time you act, the worst may already be behind you,” Mark says. “Thus, not only are you locking in your losses, but you’re likely to miss some of the best days of the recovery, which often happen within the first few months.”

Cumulative returns following market bottom

- 1 year later: 46%
- 2 years later: 70%
- 3 years later: 83%

Stayed fully invested through bear market

Market returns are represented by the S&P 500® Total Return Index. Examples assume investors who switched money. Listen and subscribe for free at schwab.com/financialdecoder.

Moved investments into cash for 1 month

Moved investments into cash for 3 months

Moved investments into cash for 6 months

- Financial Decoder, a Schwab original podcast, reveals the biases that might cloud your judgment and cost you money. Listen and subscribe for free at schwab.com/financialdecoder.

Make tax-smart decisions

Taxes may be a certainty, but there’s still plenty you can do to try to minimize them. For example, how you sell appreciated investments can have a big impact on how much of your gains you get to keep.

“Never want to think about taxes after the fact, because by then it’s too late,” Mark says. “Instead, taxes should be an integral part of your investment choices—because seemingly small decisions can have big implications on your tax bill.” (See “Sweeten Your Tax Strategy,” page 22.)

Let’s say you’re looking to realize a $50,000 gain on an investment you’ve held 11 months. Because you’ve held the investment less than a year, your gains will be taxed at your marginal federal tax rate—24% for a single filer making $100,000—resulting in a $12,000 tax bill ($50,000 x 24%).

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 x 15%).

- 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 x 24%).

- Approach 3: Combine approaches 1 and 2—holding on to your investment for at least another month and a day and realizing $55,000 in losses to offset your $50,000 gain, resulting in a $2,250 tax bill ($15,000 x 15%).

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

Increase savings at every opportunity

Instead of saving a flat dollar amount each year (see “Scenario 1,” below), consider contributing a percentage of your income so your contributions increase anytime your income does (see “Scenario 2”). “Of all the ways to save more, this approach is pretty painless,” Mark says. “It doesn’t eat into your take-home pay because it’s being skimmed off your raise. It’s harder to miss what you never had to begin with.”

Better yet, increase that percentage by at least a point anytime you get a raise, which can have an even greater impact on your portfolio value (see “Scenario 3”).

- If your 401(k) plan offers the option to automatically step up your percentage contribution on a regular basis, consider taking advantage of it.

Move to wealth management

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Create and follow a financial plan

Last but not least, Schwab’s 2019 Modern Wealth Survey found that individuals who have a written financial plan are more likely to exhibit other healthy habits, as well. “It’s not surprising that people who put in the effort to plan for the future are more likely to take the steps necessary to make that vision a reality,” Mark says.

- If you don’t have a plan yet, retirement is a great place to start. With Schwab Plan™, clients can see what it takes to retire the way they want. Get a complimentary plan at schwab.com/schwabplan.

Source: Schwab Modern Wealth Survey. The online survey was conducted from 02/08/2019 through 03/17/2019 in partnership with Lighthouse Research among a national sample of Americans ages 21 to 75. Quotes were set so that the sample is demographically representative as possible.

Source: Schwab Center for Financial Research. Example 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 pretax income in the first year and then contributes the 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 5% annually at the start of every year beginning at 25 and then increases her contribution rate by 1 percentage point each raise.

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. Please read the Schwab Intelligent Portfolios Solutions™ disclosure brochures for important information, pricing, and disclosures related to the Schwab Intelligent Portfolios and Schwab Intelligent Portfolios Premium programs. Schwab Intelligent Portfolios® and Schwab Intelligent Portfolios Premium® are made available through Charles Schwab & Co., Inc. (“Schwab”), a dually registered investment advisor and broker dealer. Portfolio management services are provided by Charles Schwab Investment Advisory, Inc. (“CSIA”). Schwab and CSIA are subsidiaries of The Charles Schwab Corporation. The information provided here is for general informational purposes only and should not be considered an individualized recommendation or personalized investment advice. The investment strategies mentioned here may not be suitable for everyone. Each investor needs to review an investment strategy for his or her own particular situation before making any investment decision. 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. While Schwab Plan is available to clients at no cost, any investments you ultimately make may incur costs such as fund operating expenses and advisory fees. Diversification, asset allocation, and rebalancing strategies do not ensure a profit and do not protect against losses in declining markets. 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. Investing involves risk, including loss of principal. (0321-04DZ)
The Bank

How to borrow against your own assets.

Debt often gets a bad rap. But when managed responsibly, it can help you achieve your financial goals. In fact, the more assets you have, the more lending solutions you may have at your disposal.

Clients who have built up their net worth—whether in their homes or investment portfolios—could have broader borrowing options by using their own assets as collateral,” says Chris Kawashima, a senior research analyst at the Schwab Center for Financial Research. “But doing so exposes those assets to increased risk, so you’ve got to have the fortitude and investment knowledge to manage such debt effectively.”

Let’s take a look at three asset-backed lending solutions—and under what circumstances they might be most appropriate.

1 **Home-equity line of credit**

   **What it is:** A home equity line of credit (HELOC) allows you to borrow against the equity in your home. As with a credit card, you draw from and repay an available line of credit, usually at variable interest rates.

   Unlike credit cards, HELOCs typically have a fixed draw period (often five to 10 years), after which time the line of credit is closed and any remaining balance must be paid back, with interest, before the repayment period ends (often 10 to 20 years).

   **When to use it:** Although you can use a HELOC for many purposes, it’s particularly well-suited to:

   - **Home improvements:** If you itemize your deductions, the IRS may allow you to deduct interest paid if the funds are used to “buy, build, or substantially improve your home.” That can make HELOCs an attractive option for financing home improvements.

   - **Liquidity:** Even if you don’t have an immediate cash need, establishing a HELOC can be a great way to back up your emergency fund or short-term savings. For example, if you need cash during a market selloff and want to avoid tapping your cash reserves or selling securities at a loss, drawing on a HELOC could offer an alternative source of funds. “Should the markets bounce back, you can replenish what you borrowed,” Chris says. “In that way, the loan can act as a nice little safety net.”

   - **Debt consolidation:** Interest rates on HELOCs often are much lower than those charged by credit cards and personal loans, making them a potentially attractive option for consolidating debt and reducing borrowing costs. Because a HELOC is secured
**Margin**

**What it is:** Just as a bank can lend you money against the equity in your home, your brokerage firm can lend you money against the value of eligible stocks, bonds, exchange-traded funds, and mutual funds in your portfolio. Margin loans typically require a margin account, a marginable securities—and generally are limited to 50% of the investments’ value. Interest rates vary depending on the amount being borrowed but tend to be lower than unsecured lending options such as credit cards.

**When to use it:** Funds borrowed on margin are usually used for:

- **Additional investments:** Active traders may establish a margin account to take advantage of a time-sensitive opportunity to buy or sell securities. Convertible bonds or preferred stocks, for example, are traded in the secondary market as security prices rise and fall. If you think a convertible bond will rise in value, you can “buy” the bond by borrowing the required margin with your broker.

- **Margin and bank-offered securities-based line of credit** involves a high degree of risk. At any time, including in the event that the loan value of collateral is insufficient to cover any margin call, Schwab Bank may demand immediate repayment of outstanding obligations or require you to add additional cash or securities to the pledged collateral account in order to avoid the sale of pledged assets. Pledged diversified assets may not help if the market value of your pledged assets are below the applicable maintenance level, and your portfolio’s value declines before you repay the money, you could face a hefty maintenance call—or a large tax bill if appreciated securities are sold to meet the maintenance requirement.*


**Securities-based lines of credit**

**What it is:** Like margin, a securities-based line of credit offered through a bank allows you to borrow against the value of your portfolio, usually at variable interest rates. Assets are pledged as collateral and held in a separate brokerage account at a broker-dealer. Unlike margin, these non-purpose credit lines may not be used to purchase securities or pay down margin loans, nor can the funds be deposited into any brokerage account. Such lines of credit also tend to require more borrowing than a margin account (Schwab Bank’s Pledged Asset Line, for example, has a minimum line size of $100,000 and an initial minimum advance of $70,000).

**When to use it:** Because of the large initial advance requirement that may apply, a securities-based line of credit is best for:

- **Bridge financing:** “We typically see a securities-based line of credit used for something that would otherwise be a short-term loan,” Chris says. “For example, clients who wish to buy a new home before they’ve sold their current one have found that this type of credit line can provide a useful bridge between the two transactions.”

- **Additional investment opportunities:** You may have a quick need access to cash but don’t want to sell your investments—which can trigger capital gains taxes and upset your investment strategy—or a securities-based line of credit could be a solution. “Because of the high initial advance requirement, it’s best to establish this type of credit line when you have an immediate cash need, such as a significant tax bill,” Chris says. “Once you take the initial advance, however, you can use the credit line for smaller liquidity needs going forward.”

**P.S.** It’s important that the assets in your account are diversified. If you’re overly concentrated in a particular investment, you could quickly find yourself below the required maintenance threshold if that investment declines considerably.

**Let’s Talk**

Considering borrowing against your assets? For help thinking through your options, call your Schwab financial consultant.

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**Asset-backed borrowing at a glance**

<table>
<thead>
<tr>
<th>Home equity line of credit</th>
<th>Margin loan</th>
<th>Bank-sponsored secured line of credit</th>
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</thead>
<tbody>
<tr>
<td><strong>Assets used as collateral</strong></td>
<td>Real estate, including your primary residence and second home</td>
<td>Eligible securities in most nonretirement accounts</td>
</tr>
<tr>
<td><strong>Minimum collateral requirement</strong></td>
<td>Established by the lender and typically based on a requested line amount and the associated home value</td>
<td>Typically $2,000; some brokers may require more</td>
</tr>
<tr>
<td><strong>Borrowing limits</strong></td>
<td>Varies by lender. Check with your financial consultant for details</td>
<td>Typically 50% of the assets’ value</td>
</tr>
<tr>
<td><strong>Maintenance requirements</strong></td>
<td>N/A</td>
<td>Typically 30% of the assets’ margin credit line amount (which you may face a maintenance call)</td>
</tr>
<tr>
<td><strong>Term</strong></td>
<td>Typically a revolving line of credit until the draw period ends, followed by a repayment period</td>
<td>Revolving line of credit, meaning no set draw or repayment periods</td>
</tr>
<tr>
<td><strong>Approved uses</strong></td>
<td>Acceptable for most purposes, but check with your financial consultant</td>
<td>Any purpose</td>
</tr>
<tr>
<td><strong>Ideal uses</strong></td>
<td>Debt consolidation, Home improvements, Short-term or long-term liquidity needs</td>
<td>Stock purchases, Short-term liquidity needs, Long-term liquidity needs</td>
</tr>
</tbody>
</table>

*See page 42 for important information. **When considering a margin loan, you should determine how the use of margin fits your own investment philosophy. Because of the risks involved, it is important that you fully understand the rules and requirements involved in trading securities on margin. Margin trading increases your level of market risk. Your downside is not limited to the collateral value in your margin account. Schwab may initiate the sale of any securities in your account, without contacting you, to meet a margin call. Schwab may increase the size of its margin call at any time, without notice.**

**IDEA:”**

- **Bridge financing:** “We typically see a securities-based line of credit used for something that would otherwise be a short-term loan,” Chris says. “For example, clients who wish to buy a new home before they’ve sold

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**Bridge financing:** “We typically see a securities-based line of credit used for something that would otherwise be a short-term loan,” Chris says. “For example, clients who wish to buy a new home before they’ve sold

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**Bridge financing:** “We typically see a securities-based line of credit used for something that would otherwise be a short-term loan,” Chris says. “For example, clients who wish to buy a new home before they’ve sold
Looking for predictable income and the flexibility to reinvest if rates go up? Schwab’s CD & Treasury Ladder Builder can help.

**What is a bond ladder?**

A bond ladder is a fixed income strategy designed to provide predictable income while helping you manage interest rate risk.

A 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.

**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.

Including changes in interest rates and credit quality, market valuations, liquidity, prepayments, early redemption, corporate events, tax ramifications, and other factors. Certificates of deposit available through Schwab CD OneSource® typically offer a fixed rate of return, although some offer variable rates. They are FDIC-insured, offered through Charles Schwab & Co., Inc., and in most cases subject to an early withdrawal penalty. CDs from an FDIC-insured institution are insured, in aggregate, up to $250,000 (including principal and interest) per depositor, per insured institution. CDs you purchase from a particular bank are aggregated with any other deposits you may have with the issuing bank for determining FDIC insurance coverage. You are responsible for monitoring the total amount of deposits (including principal and interest) that you hold with any one issuer and determining the extent of your deposit insurance coverage. (0221-0JDL)

Schwab’s CD & Treasury Ladder Builder at schwab.com/ladderbuilder.

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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.

See page 42 for important information.

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Pg. 20–21: Past performance is no guarantee of future results and the opinions presented cannot be viewed as an indicator of future performance.

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(0321-1PNM)
ON YOUR SIDE

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 “highflyers” 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

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<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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</thead>
<tbody>
<tr>
<td>Tesla</td>
<td>02/04/2011</td>
<td>$668.91</td>
<td>12/2020</td>
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<td>Square</td>
<td>02/08/2018</td>
<td>$98.14</td>
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<td>Lululemon</td>
<td>02/06/2014</td>
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<td>DocuSign</td>
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<td>$41.47</td>
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<td>Moderna</td>
<td>02/06/2020</td>
<td>$41.34</td>
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Source: FactSet. Market cap subject to change based on current market conditions.
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<table>
<thead>
<tr>
<th>Interest Rate Discount</th>
<th>Qualifying Assets Range</th>
<th>Discount</th>
</tr>
</thead>
<tbody>
<tr>
<td>0.250%</td>
<td>$250K - $999K</td>
<td></td>
</tr>
<tr>
<td>0.500%</td>
<td>$1M - $4.9M</td>
<td></td>
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<tr>
<td>0.750%</td>
<td>$5M+</td>
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</tbody>
</table>

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