Mind Over Matter
Overcoming the mental mix-ups that may be costing you money. Page 32
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Protecting Your Portfolio

Defensive assets can help you weather a downturn.

People are generally inclined to believe that negative outcomes are more likely than positive ones. This psychological pitfall, known as negativity bias, causes many investors to assume the worst: that when a market is rising, it will come crashing down, and that when a market is falling, it won’t ever bounce back.

Of course, sometimes a negative outlook is justified, which is why it may be wise to diversify with defensive assets, including cash investments (such as certificates of deposit and money market funds), U.S. Treasuries and even precious metals. Such investments may not appreciate as rapidly as stocks during a bull market, but they have historically outperformed during a bear market (see “Playing Defense,” page 13).

Defensive assets can also help your portfolio recover faster. Indeed, the Schwab Center for Financial Research found that a diversified portfolio recovered from the Great Recession 17 months faster than did an all-stock portfolio.1

Regardless of what the market is doing, the most important thing is to stick to an asset allocation that’s appropriate for your goals and time horizon. And remember: If you need help reassessing your portfolio, we’re always just an online message (log in to schwab.com/chat) or phone call away.

Sincerely,

Walt Bettinger
President & CEO

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1The diversified portfolio, composed of 60% stocks and 40% bonds, was rebalanced annually. Stocks are represented by the S&P 500® Index, and bonds are represented by the Bloomberg Barclays U.S. Aggregate Bond Index. Returns assume reinvestment of dividends and interest. Fees and expenses would lower returns.

See page 42 for important information. ◆ Past performance is no guarantee of future results. ◆ Diversification strategies do not ensure a profit and do not protect against losses in declining markets. (0518-80B1)
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According to Intuit, independent contractors will account for 43% of the U.S. workforce by 2020—up from 36% in 2015.¹

Although being your own boss can mean greater flexibility, it requires shouldering many financial...
responsible normally assumed by an employer. Here are the three biggest—and what to know about each.

1 Tax payments
Without an employer to withhold income and payroll taxes, you’ll need to make estimated tax payments to avoid potential penalties. You'll also be on the hook for both the employee and employer portions of Medicare and Social Security taxes, though the employer portion is tax-deductible.

2 Tax deductions
Most entrepreneurs earn what’s known as pass-through income, which is taxed at individual rates. Under the new Tax Cuts and Jobs Act, many pass-through business owners will be able to deduct 20% of their qualified business income, subject to certain limitations. In addition, business-related expenses can also be deducted, including office space, retirement contributions, technology and travel.

3 Retirement savings
Self-employed workers can maximize their retirement savings by making both employer and employee contributions. For example, individual 401(k) plans allow you to contribute as much as $18,500 as the employee, plus up to 20% of your net earnings as the employer, for a combined maximum of $55,000 in 2018. (The employee contribution for those 50 and older is $24,500, for a combined maximum of $61,000.) You may also be able to deduct employer contributions as a business expense.

If you’re thinking of becoming self-employed, consider consulting a tax or financial advisor, who can help analyze how such a change might affect your personal financial situation.

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 that you consult with a qualified tax advisor, CPA, financial planner or investment manager.

From Deluge to Drip
Should you cut a stock that cuts its dividend?

While more than 60% of the companies that make up the S&P 500® Index increased their quarterly dividends in 2017,1 a handful actually reduced their payouts. Should such cuts be viewed as a sign of underlying trouble?

Not necessarily, says Steve Greiner, senior vice president of Schwab Equity Ratings® at the Schwab Center for Financial Research. “A reduced dividend could be a red flag,” he says, “but is rarely reason enough to sell.” In fact, some companies hoard cash in advance of a merger, to put cash back on their balance sheets or for a host of other productive reasons.

Investors should instead view a dividend cut as an opportunity to reevaluate the investment. “Review its fundamentals, check its Schwab Equity Rating (see “Next Steps,” below left) and avail yourself of recent commentaries and company news,” Steve says. “If your reasons for owning the stock are still valid, by all means keep it. But if they’re not, it might be time to make a change.”

See page 42 for important information. • Schwab Equity Ratings and general buy/hold/sell guidance are not personal recommendations for any particular investor or client and do not take into account the financial, investment or other objectives or needs of, and may not be suitable for, any particular investor or client. Investors and clients should consider Schwab Equity Ratings as only a single factor in making their investment decisions while taking into account the current market environment. • Investing involves risk, including loss of principal. (0518-7XT1)
Don’t Fight the Fed

Why this popular investing adage rarely holds water.

Every time the Federal Reserve embarks on a new cycle of interest-rate cuts or hikes, market watchers warn investors, “Don’t fight the Fed!”

The belief is that higher rates heighten the competition stocks face from other investments, most notably bonds. They also make it more expensive for companies to finance their operations, payroll and purchases, which tends to reduce profits and undermine stock performance. (Lower rates have the opposite effect.) Ergo, investors should reduce their exposure to equities during the Fed’s current campaign to boost short-term rates—right?

Not exactly, says Liz Ann Sonders, chief investment strategist at Charles Schwab & Co., Inc. “In fact, stocks have generally done well during most rate-hike cycles,” she says (see “Hand in hand,” above).

Whether investors should cut back on equities could depend on multiple factors, including why the Fed is tightening its policy. “If the Fed is repeatedly raising rates in an attempt to bring inflation under control—as was the case during the 1973–1974 rate-hike cycle—then it can be a very negative environment for stocks,” Liz Ann says. “But in the current climate, in which rates are rising but remain low by historical standards, equities should continue to benefit, at least in the short term.”

See page 42 for important information.
(0518-8N72)

Read additional market insights at schwab.com/insights.

Hand in hand
From 1946 through 2006, the S&P 500® Index rose during all but two of 12 Fed-tightening cycles.

Source: Ned Davis Research, Inc. Data from 04/01/1946 through 05/01/2006. Tightening cycles are defined as periods during which three or more consecutive rate increases occurred. Past performance is no guarantee of future results.
The College Board estimates a child born this year will spend more than $150,000 in today’s dollars to attend a four-year, in-state public university. That may seem too lofty a savings target given the competing (and more important) goal of funding retirement—but investing even a modest sum each month can go a long way toward reducing your child’s debt burden down the road.

“The ideal time to start is right after a child is born,” says Robert Aruldoss, a senior research analyst at the Schwab Center for Financial Research. “But regardless of when you begin, every dollar you’re able to invest is one less your child may need to borrow.”

Here’s a look at how close you may be able to get to the $150,000 mark—and how much you might need to borrow—if you were to start investing $250 a month when your child is born versus when he or she turns 5.

1College Cost Calculator. | 2Assuming a 5% annual rate of return.

See page 42 for important information. Investing involves risk, including loss of principal. Where specific advice is necessary or appropriate, Schwab recommends consultation with a qualified tax advisor, CPA, financial planner or investment manager. (0518-7Y0J)

Explore Schwab’s college savings accounts at schwab.com/college.
Investors should consider carefully information contained in the prospectus, including investment objectives, risks, charges, and expenses. You can request a prospectus by calling 1-800-435-4000. Please read the prospectus carefully before investing. Past performance does not guarantee future performance.

Investment returns and principal value will fluctuate, and shares, when redeemed, may be worth more or less than their original cost.

Fixed income securities are subject to increased loss of principal during periods of rising interest rates. Fixed income investments are subject to various other risks, including changes in credit quality, market valuations, liquidity, prepayments, early redemption, corporate events, tax ramifications, and other factors.

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Dear Reader,

Congratulations are in order! Landing a job right out of college is a huge step toward financial independence. It’s also a great time for your daughter to be entering the workforce. According to a study by the executive search firm Korn Ferry, the average starting salary in 2017 for new college grads was $49,785—the highest it’s ever been. And it was even greater in major cities: $60,190 in New York and $62,829 in San Francisco.1

Of course, rents in those cities are also sky-high, meaning even a substantial starting salary might not be enough to make ends meet. In fact, about 40% of adult children ages 22 through 24 receive some financial assistance from their parents, who shell out roughly $3,000 a year, on average.2

I think it’s great you want to assist your daughter as she navigates this new (and often challenging) stage of life. But before you do, I’d urge you to think about how such support could impact the future—both hers and yours. Here are three factors to consider as you determine the best way to help your daughter prepare for life on her own.

Making ends meet
First, have your daughter make a list of essential expenses—including rent, food, health insurance, transportation, cell phone and student loans—and compare it with her after-tax income. (She can visit schwab.com/moneywise for budgeting tips and tools.)

If she finds that her expenses exceed her take-home pay, you may be tempted to help make up the

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1 Making ends meet
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If she finds that her expenses exceed her take-home pay, you may be tempted to help make up the...
difference. Before you commit to doing so, however, ask yourself:

- Am I in good shape for retirement?
- Do I have enough saved for emergencies and unexpected expenses?
- Am I adequately insured?

If helping your daughter means jeopardizing your own financial security, it’s probably not a wise move. We don’t want to be in a position where our kids have to support us later in life.

That said, it generally does make sense to lend our kids a hand when we can, especially if the assistance will help them become more financially secure down the road. For example, you might decide to help with startup costs, such as a security deposit on an apartment, so she can accept her dream job in a more expensive city. Or you could provide longer-term assistance—such as keeping her on your health insurance until she’s 26, which you’re allowed to do, thanks to the Patient Protection and Affordable Care Act.

In general, though, I believe it’s best to limit your financial support to essential expenses. There’s no harm in treating her to something special from time to time, but you don’t want her to consider you a lifelong source of funds.

Managing student loans

Student debt is one of the most daunting financial pressures new grads face. According to the latest national numbers from the Institute for College Access & Success, 69% of 2014 graduates carried an average of $28,950 in student-loan debt.

If your daughter has such debt, emphasize how important it is to make every payment on time, lest her credit rating suffer. You might also help her investigate whether she’s eligible for an income-driven repayment plan, which would allow her to pay only a percentage of her income, or the Public Service Loan Forgiveness Program, which is available to employees of government organizations and tax-exempt nonprofits. (You can find more information about both these programs at studentaid.ed.gov)

If she doesn’t qualify for such programs, you could investigate whether consolidating or refinancing her loans would help make her monthly payment more manageable. But make sure to do your due diligence: Federal loans typically offer 10-year repayment terms, while consolidated or refinanced loans often have terms of 20 years or more. Extending her loan term will almost certainly reduce her monthly payment—but will also mean paying a lot more in interest over the life of the loan.

Maintaining good credit

Be sure, too, to discuss the pros and cons of credit cards—including the perils of revolving debt, the importance of making on-time payments and the benefits of paying off balances in full. Not only will lenders and landlords consider her credit history when she applies for an apartment or a car loan, but many employers now use applicants’ credit scores as a proxy for responsibility.

And finally ...

As much as we want to take care of and protect our children, it’s often good to let them figure things out for themselves. Even if it means subsisting on ramen and sharing a fifth-floor walk-up with three roommates, living within one’s means is a life lesson worth learning.

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


Find more insights from Carrie at schwab.com/askcarrie.
Playing Defense

Four asset classes that can help protect your portfolio during a downturn.

By Anthony Davidow
Bucking the trend

In 2008, defensive assets posted positive returns as domestic and international equities suffered debilitating losses.

1. Cash and cash equivalents

**Why:** Putting a chunk of your portfolio in money market funds or certificates of deposit (CDs) won’t generate much in the way of interest, but these low-risk products do offer liquidity in case of emergency. Flexibility as new investment opportunities arise and stability relative to other asset classes. What’s more, CDs are insured by the Federal Deposit Insurance Corporation (up to $250,000 per depositor), so you won’t lose your money even if the issuing bank fails.

**How much:** Generally speaking, even the most aggressive investors should hold at least 5% of their portfolios in cash and cash equivalents; for conservative investors, that allocation may be closer to 30%.

2. Gold and other precious metals

**Why:** Because of its finite supply, gold tends to maintain its value even during periods of economic upheaval. Other precious metals may also hold up well, though that can depend in part on what they’re used for. (Platinum, for instance, is used in the catalytic converters found in many automobiles, whose sales tend to rise and fall with the broader economy.)

Even during a bull market, the prices of precious metals tend to move independently of stocks, enhancing any potential diversification benefits. And because their prices tend to rise along with inflation, they may also provide a hedge against broad cost increases. That said, precious metals’ prices can be affected by world events, import controls and other external risks; they also tend to be more volatile than those of other defensive assets, which may make them unsuitable for risk-averse investors.

**How much:** Precious metals, together with other commodities and real estate, should account for as much as 9% of an aggressive portfolio; less aggressive investors may want to limit such exposure to 5%, while the most conservative investors may want to avoid the asset class entirely.


**Why:** These securities are issued by government-owned corporations (GOCs), such as Amtrak, and government-sponsored enterprises (GSEs), such as the Federal Home Loan Mortgage Corporation, otherwise known as Freddie Mac. Unlike federal agency bonds, which are backed by the full faith and credit of the U.S. government, GOC and GSE bonds are solely the responsibility of the issuer, meaning the federal government is under no obligation to save them from default. This can make these bonds riskier than Treasuries, and investors are offered incrementally higher yields as a result.

Like Treasuries, agency bonds’ prices fluctuate in response to interest rates, which could affect bond price on the secondary market. Furthermore, many agency bonds are callable, meaning the issuer may choose to pay back the principal before the maturity date, thereby cutting coupon payments short.

**How much:** U.S. government–related bonds, together with Treasuries (see below), should make up anywhere from 10% to 70% of your portfolio, depending on your risk tolerance. However, the most aggressive investors may want to avoid such exposure altogether.

4. U.S. Treasury bonds

**Why:** Treasuries are backed by the full faith and credit of the U.S. government, making them one of the most stable investments for protecting capital. Intermediate-term Treasuries (those with maturities of 3 to 10 years) have held up particularly well during downturns, registering positive total returns during all but one of the 28 bear markets since 1929.

Should the Federal Reserve continue to push rates higher, Treasury prices on the secondary market may decline.

That’s likely of little concern to investors who plan to hold their Treasuries to maturity but is a risk nonetheless.

**How much:** See “U.S. government-related bonds,” left.

Finding your mix

Ultimately, you expose to each of these asset classes should depend upon your personal risk tolerance, time horizon and market outlook. A qualified financial advisor can help you determine the right mix for your needs.

**Mark Hubert, “If the Bear’s Near, Which Assets Protect You?” wsj.com, 01/08/15.**
Bonds vs. Bond Funds

Which one’s right for you?

By Kathy Jones

Individual bonds

Many investors are drawn to individual bonds because of the reliable income they provide—namely, set interest payments (typically every six months) and a date on which the principal is paid back. That said, there are a number of uncertainties when it comes to individual bonds:

- **Call risk**, or the chance that a bond could be redeemed, or called, by the issuer prior to maturity—at which point you would receive the predetermined call price, an amount that could be less than what you paid.
- **Default risk**, or the likelihood that the issuer will be unable to return a bondholder’s principal. This is rarely the case for bonds with higher credit ratings but is a risk nonetheless.
- **Interest-rate risk**, or the effect of rate increases on a bond’s market value. If you plan to hold a bond until it matures, you will receive its face (or par) value regardless of prevailing interest rates; however, if you sell before it reaches maturity, higher interest rates can negatively impact a bond’s price.
- **Optionality**, which is the ability of bondholders to influence bond performance.

Adequate diversification is another issue. The Schwab Center for Financial Research recommends holding investment-grade bonds from at least 10 issuers to achieve adequate diversification, which can require a significant initial investment.

Bond funds

There are several advantages to the ubiquitous investment vehicles known as bond funds:

- **Cost**: Because they buy in bulk, fund managers often have access to better prices than those available to individual investors.
- **Diversification**: Corporate- and municipal bond funds, for example, rarely hold fewer than 30 issuers, and commonly own hundreds, so adequate diversification is frequently part and parcel of any bond fund.
- **Know-how**: Fund managers regularly employ dedicated research departments, which can be particularly helpful when accessing unfamiliar or especially complex parts of the market.
- **Call risk**, or the chance that a bond could be redeemed, or called, by the issuer prior to maturity—at which point you would receive the predetermined call price, an amount that could be less than what you paid.

What’s more, it can be easier to reinvest interest payments and set up automatic investment plans with bond funds than with individual bonds.

With no-load, no-transaction-fee funds, you can also regularly contribute smaller amounts to grow your assets over time, which is advantageous to those who don’t have the funds on hand to build a diversified portfolio of individual bonds from scratch.

Of course, bond funds also have their shortcomings. Chief among them:

- **Potential loss of principal**: Because most bond funds don’t mature, you generally won’t see your principal investment returned to you on a set date; rather, you’re subject to the vagaries of the market and so could suffer losses in a downturn.
- **Unpredictable income**: Unlike the predictable income generated by most individual bonds, the income from bond funds rises and falls along with interest rates and the value of the funds’ underlying holdings. Be that as it may, fund managers frequently compensate by buying and selling bonds to maximize income, and those looking to sell in the near future should note that short-term bond funds tend to be less sensitive to changing interest rates.
- **Unpredictable taxes**: Fund managers frequently buy and sell bonds and pass capital gains on to investors, which can negatively affect your tax bill.

Either/or—or both?

For those looking for exposure to investment-grade corporate bonds, municipal bonds, U.S. Treasuries and other lower-risk areas of the market, the relative predictability of individual bonds can make the most sense. For those looking to access high-yield and international bonds and other areas of greater risk (and potential reward), the professional management and diversification offered by bond funds can be a significant advantage. And for those wanting a mix of relatively safe and relatively risky investments, combining the two vehicles can provide an optimal middle ground.

With no-load, no-transaction-fee funds, you can also regularly contribute smaller amounts to grow your assets over time.

See page 42 for important information.

- Fixed-income securities are subject to increased loss of principal during periods of rising interest rates. Fixed-income investments are subject to various other risks including changes in credit quality, market valuations, liquidity, prepayments, early redemption, corporate events, tax ramifications and other factors.
- Government bond fund shares are not guaranteed. Their price and investment return will fluctuate with market conditions and interest rates. Shares, when redeemed, may be worth more or less than their original cost.
- Lower-rated securities are subject to greater credit risk, default risk, and liquidity risk. (0518-82VT)
Is a Roth IRA Conversion Right for You?

Paying taxes today could save you money down the road.
By Rob Williams

Does it ever make sense to pay taxes on retirement savings sooner rather than later? When it comes to a Roth Individual Retirement Account (IRA), the answer could be yes.

That’s because, although a Roth IRA is funded with after-tax dollars, qualified withdrawals are entirely tax-free.

What’s more, Roth IRAs aren’t subject to the required minimum distributions (RMDs) the IRS mandates you take from most other retirement accounts once you reach age 70½, giving you greater control over your taxable income in retirement.

The hitch is that you can’t contribute to a Roth IRA in 2018 if your income equals or exceeds certain limits ($135,000 for single filers and $199,000 for married couples filing jointly). But there’s a workaround: A Roth IRA conversion allows anyone, regardless of income level, to convert existing IRA funds to a Roth IRA.

Should you convert to a Roth IRA?
You must pay income taxes on any converted funds in the year of the conversion, but there are two scenarios in which that might be to your advantage:

1. You believe your tax bracket will be higher in retirement: In this scenario, paying taxes at your current tax rate is preferable to paying a higher rate after you’ve stopped working. This may sound far-fetched, but it isn’t particularly difficult to do, especially if you haven’t yet hit your peak earning years or you’ve accumulated significant savings in your retirement accounts.

2. You want to maximize your estate for your heirs: If you don’t need to tap your IRA funds during your lifetime, converting to a Roth allows your savings to grow undiminished by RMDs, potentially leaving more for your heirs—who will also benefit from tax-free withdrawals during their lifetimes.

That said, the decision to convert to a Roth IRA doesn’t have to be all or nothing. You may find dividing your savings among a Roth and traditional IRA and/or a Roth and traditional 401(k) is the optimal solution.

How do you convert to a Roth IRA?
If you do decide a Roth IRA conversion is right for you, you’ll need to determine two things:

1. When to execute the conversion: If you have a significant balance in your traditional IRA, you may want to carry out multiple Roth IRA conversions over several years. For example, you might convert just enough to keep yourself from being catapulted into the next tax bracket. If done properly, a multiyear approach could allow you to convert a large portion of your savings to a Roth while limiting the tax impact. Early in retirement—when your earned income drops but before RMDs kick in—can be an especially good time to implement this strategy.

2. How you’ll pay the resulting tax bill: Ideally, you’d have cash on hand outside your IRA to pay the income tax on any converted funds—for several reasons:

• Any IRA money used to pay taxes won’t be accumulating gains tax-free for retirement, undermining the very purpose of a Roth IRA conversion.

• If you sell appreciated assets to pay the conversion tax, capital-gains taxes could further undermine the benefits of a conversion. Plus, if you’re under 59½ and withdraw money from a tax-deferred account, you’ll incur a 10% federal penalty (state penalties may also apply).

In short, converting to a Roth IRA can give you the potential to cut your tax bill in retirement, but be sure to consult a qualified tax advisor and financial planner before making the move.

Need help deciding if you should convert to a Roth IRA? Use our tool at schwab.com/rothconversion or call 888-484-5340 to speak with a Schwab investment professional.

See page 42 for important information.

*This information 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 that you consult with a qualified tax advisor, CPA, financial planner or investment manager. (0518-8N8V)
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You expect the full package: free standard checks, no account minimums, mobile deposits,¹ Apple Pay®, and bill pay. With Schwab Bank you get all of that and none of the fees:

■ Unlimited ATM fee rebates worldwide²
■ No monthly account service fees
■ No foreign transaction fees³

This account is linked to your Schwab One® brokerage account, so transferring funds is easy. Learn more and open an account at schwab.com/checking or call 1-866-215-1863.

¹Schwab Mobile Deposit™ service is subject to certain eligibility requirements, limitations, and other conditions. Enrollment is not guaranteed. Mobile deposits are subject to the Bank’s hold policy. Requires a wireless signal or mobile connection.

²Unlimited ATM fee rebates apply to cash withdrawals using your debit card wherever it is accepted. ATM fee rebates do not apply to any fees other than those assessed for using an ATM to withdraw cash from your Schwab Bank account. Schwab Bank makes its best effort to identify those ATM fees eligible for rebate, based on information it receives from Visa® and ATM operators. In the event that you have not received a rebate for a fee that you believe is eligible, please call a Schwab Bank Client Service Specialist for assistance at 1-888-403-9000. Schwab Bank reserves the right to modify or discontinue the ATM fee rebate at any time.

³If you use your debit card to withdraw foreign currency from an ATM or to pay for a purchase with foreign currency, we charge your account for the U.S. dollar equivalent of the transaction. Depending on the specific arrangements that are in place, the exchange rate and calculation of the U.S. dollar equivalent will be done by the bank at which you complete the transaction, the network to which the ATM belongs, or Visa. The bank or network may also charge a fee.

The Schwab Bank High Yield Investor Checking® account is available only as a linked account with a Schwab One® brokerage account. The Schwab One brokerage account has no minimum balance requirements when opened with a linked High Yield Investor Checking account.

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Brokerage Products: Not FDIC-Insured • No Bank Guarantee • May Lose Value
Bears vs. Bulls

When it comes to stamina and strength, which comes out on top?

Psychologically speaking, the pain investors feel from a loss is roughly twice as powerful as the pleasure they receive from an equivalent gain (see “This Is Your Brain on Money,” page 32)—which is one reason bear markets (those with losses of 20% or more) loom so large.

In truth, however, bears don’t hold a candle to bulls. Bulls have reigned for a cumulative 50 of the past 61 years. And while the last two bears clawed back a combined $12.3 trillion in wealth, the last two bulls unleashed $22.7 trillion—or nearly double what was lost.

Here’s a look at how the two markets stack up.

Regardles of what the market is doing, a well-diversified portfolio can help you stay on track. Do you have the right mix of investments? Call us at 888-484-5340 to discuss your strategy.

Source: Yardeni Research and YCharts. S&P 500® Index data from 07/15/1957 through 02/28/2018. Total days for bear and bull markets include weekends and holidays.

See page 42 for important information. Past performance is no guarantee of future results. • Investing involves risk, including loss of principal. • Indexes are unmanaged, do not incur management fees, costs and expenses, and cannot be invested in directly. • Diversification strategies do not ensure a profit and do not protect against losses in declining markets. (0518-8005)
You've ever gotten so hung up on a winning or losing position that you lost sight of your overall profitability? Here are four tactics that can help improve your performance—regardless of how any single position may fare.

1. **Set reasonable expectations**

You don't have to be right all the time to be profitable; in fact, you don't need to be right even half the time. The trick is to set—and sustain—a reasonable “expectancy” of profits versus losses.

For example, I'm generally looking for a profitability ratio of 3 to 1, or $3 in profits for every $1 in losses. That way, even if I get only four out of every 10 trades right, I'll still be in the black (see “A winning strategy,” right).

I recommend using a profitability tracking tool—such as the Gain/Loss Analyzer available to Schwab Trading Services clients (see “You win some, you lose some,” lower right)—to determine whether you're on the right side of your expectancy. If you find your profitability ratio falling short of your goal, it may be time to...

2. **Analyze your losses**

Start by taking a hard look at your losers. Did you sustain losses across the board or did just a handful of especially bad trades sink your performance?

For me, the biggest barrier to success is overconfidence. For example, I nearly always set a stop-loss order when adding a new position. However, on more than one occasion I've gone back and removed it, convinced the declining stocks would bounce back. They rarely did, of course, and my losses worsened exponentially as a result.

If, like me, you sometimes have trouble sticking to your trading plan, it can help to remember that successful trading is as much about preserving money as making it. After all, if you don't maintain the capital you have, how are you going to turn a profit down the road?

3. **Examine your winners**

Study your winning trades, as well, including how the stocks performed after you sold your positions. Painful as it is to acknowledge, every trader inevitably leaves at least some gains on the table.

Indeed, one common habit among traders is to sell as soon as they've seen the move they expected. But one of the surest ways to meet or even exceed your expectancy is to hold the stocks you like as long as you can. To do so, try selling half a winning position at your target price and setting a new stop order for the remaining half. This can help you lock in the profit on both halves of your position while also giving yourself more room to run.

4. **Review regularly**

How often you should review your overall performance depends on your trading frequency. If you make fewer than five trades per month, for example, a monthly or quarterly review should be sufficient. If you're trading every day, on the other hand, you should check in more often. I typically make 15 to 20 trades a month and review my performance weekly.

The important thing is to make it a regular habit. Consistency and discipline are the hallmarks of successful traders. You don't develop these traits through happenstance but rather by carefully studying your own strengths and weaknesses.

Check Yourself

How regularly reviewing your trading performance can yield better results.

By Kevin Horner

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**A winning strategy**

Even when your losers outnumber your winners, you can still come out ahead.

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<tr>
<td><strong>NUMBER OF TRADES</strong></td>
<td><strong>AVERAGE GAIN/LOSS</strong></td>
<td><strong>PROFIT</strong></td>
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<tr>
<td>WINNING TRADES</td>
<td>4</td>
<td>$3</td>
</tr>
<tr>
<td>LOSING TRADES</td>
<td>6</td>
<td>–$1</td>
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<tr>
<td>TOTAL PROFIT</td>
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**You win some, you lose some**

Schwab’s Gain/Loss Analyzer tool (schwab.com/analyzertool) provides a variety of performance metrics, including the gain/loss ratio, the profitability rate, total gains and total losses.

For illustrative purposes only.

*After logging in, select Trade Source under the Trade tab and look for Gain/Loss Analyzer in the column at right.

**LETS TALK**

Need help with your trade plan? Call 877-807-9240 to speak with a Schwab trading specialist.

Kevin Horner is a senior manager of trading services education at Schwab Trading Services.

**SUMMER 2018 | ON INVESTING | 23**
The Backup Plan
What to do when retirement savings run short.
**THE BACKUP PLAN**

When it comes to retirement, even the best-laid plans can sometimes go awry. Should the market turns against you, for example, or employment opportunities dry up, even the most diligent savers may find they need to stretch their dollars further than anticipated. So, what are the best available options? Here are four common fallbacks—and the pros and cons of each.

### 1. **Save more**

Setting aside a greater amount each month is perhaps the most obvious strategy. But by the time you discover a shortfall, it may be too late. After all, compound interest—which accounts for the lion’s share of many retirement portfolios—needs time to work its magic. (See “A little goes a long way,” upper right.)

“The power of compounding depends on three factors: How much you save, how much you earn on your savings, and how long you save,” explains Mark Riepe, a senior vice president at the Schwab Center for Financial Research. “Lengthier time frames benefit the other two—which is why it’s so important to start early” (see “Early beats often,” middle right).

### 2. **Risk more**

Another tempting response to a loss may be to take more risk with your investments in search of greater potential returns. “But the correlation between risk and potential reward typically holds true only over the long term,” Mark says, “and even then, it isn’t perfect.”

Younger investors, who have the luxury of time to ride out market ups and downs, might feel comfortable holding more volatile assets. But if you decide to embrace risk in your later years, you should do so with only a fraction of your funds. Mark suggests setting aside the savings required to pay necessary expenses and then using a portion of what remains to pursue a more aggressive strategy.

### 3. **Work longer**

Most people assume they will just keep working if their retirement savings fall short. “This is a legitimate backup plan,” Mark says, “but it’s far from foolproof.” For example, health issues or a corporate restructuring can force a person to retire earlier than anticipated.

### 4. **Spend less**

For most people, cutting expenses is perhaps the least desirable option. However, it’s also the most common when all else fails. “Redefining what a comfortable retirement looks like is sometimes necessary,” Mark says, “but that doesn’t mean it has to be Draconian.”

Together with your spouse—and, if appropriate, an accountant or a financial advisor—review which expenses are discretionary and which aren’t. If you think you’ll need to pare down in the future, practice changing spending habits in the present to see what’s possible. Sometimes it takes a big move—literally—to make ends meet. “Relocating to an area with a lower cost of living sometimes seems to be able to get your spending on track,” Mark says (see “Location, location, location,” above).

As with your principal retirement plan, it’s best to begin formulating your backup plan as early as possible. “Time truly is your best friend,” Mark says. “Not just when it comes to investing, but also when it comes to taking the necessary steps to secure a comfortable retirement.”

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**A little goes a long way**

A person who invests just $3,000 a year for 40 years could end up with nearly $600,000—three-quarters of which would be from compound returns.

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**Early beats often**

Alma invests $10,000 when she’s 31 and lets the money grow for 20 years. Dave invests $2,000 a year, beginning at age 41, for 10 years. By age 50, Alma has nearly 15% more than Dave, despite having saved half as much.

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**Location, location, location**

When push comes to shove, cash-strapped retirees may want to move inland, where the cost of living in major metropolitan areas is often less than 100% of the national average.

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**Breaking ties**

Most of the reasons older workers face early retirement are beyond their control. After all, compound interest—which accounts for the lion’s share of many retirement portfolios—needs time to work its magic (see “A little goes a long way,” middle right). The chart above is hypothetical and for illustrative purposes only. Earnings assume a 6% annual rate of return and do not reflect the effects of fees or taxes.

**Source:** 2017 Retirement Confidence Survey, Employee Benefit Research Institute.
Seeing Is Believing

How improvements in transparency are making emerging markets more attractive.
Investing in emerging markets can sometimes feel like a leap of faith. Such countries often let individual companies decide how much—or how little—financial information to disclose to investors. And with that lack of transparency comes risk. The less insight you have, the harder it is to see the whole picture. But times are changing. Many emerging-market economies are making great strides in improving their corporate governance and investor protections. Several, including Malaysia and South Africa, even boast corporate governance scores well above those of some developed economies, according to a 2016 report published by the International Monetary Fund (IMF). That’s not to say improved corporate governance is a panacea that will propel an emerging-market economy to developed-market status overnight. Such advances can help emerging-market companies attract more capital, strengthen their balance sheets and weather external shocks. “Ultimately, improvements in transparency and corporate governance can increase the valuation of emerging-market stocks that were previously discounted because investors deemed them too risky,” says Michelle Gibbey, director of international research at the Schwab Center for Financial Research.

Obscure no longer

During the past three decades, emerging markets have gone from fringe asset class to portfolio mainstay, thanks largely to their higher growth prospects relative to more-advanced economies. In 2017, for instance, the gains stacked up by the MSCI Emerging Markets Index outstripped those of the S&P 500® by 15 percentage points (5% versus 22%, respectively).

However, the downside can be just as profound. During 2008’s global financial crisis, the MSCI Emerging Markets Index returned −53% (compared with −37% for the S&P 500). Because investors had limited information with which to judge the potential impact of such a downturn, IMF researchers theorized they were more likely to flee to the relative safety of other, more-above-ground investments. As transparency and corporate governance improved, researchers were able to test their hypothesis under real-world conditions. In examining the global downturns of 2013 and 2016, they found that when an emerging economy moved from the lower to the upper end of certain governance indicators, the impact of a global shock to the country’s companies was reduced by an average of 50%.

No quick fix

Of course, not all emerging markets have improved equally in terms of transparency. And there are other risks to consider, including currency fluctuations, political instability and increased volatility. “You can’t focus on just one criterion when deciding where to invest,” Michelle says. “Places like Turkey, for instance, might be improving in transparency but could also have a deteriorating political environment.” Indeed, increased transparency might be most useful as a deciding factor when comparing potential emerging-market investments. Sources such as the IMF, the World Bank and the World Economic Forum can be helpful in understanding which countries are rated highest for investor transparency or are trending in the right direction. Michelle says. (See “Into the light.”) Transparency International, a global watchdog group that has been critical of emerging markets’ progress, has its own scoring system for corporate reporting and anticorruption measures. “Many emerging-market countries have great regulations in place concerning corporate transparency, but those regulations are not always implemented effectively,” says Katja Bechtel, head of the organization’s business-in-integrity unit. Katja points to her team’s report, Transparency in Corporate Reporting: Assessing Emerging Market Multinationals (2016), which evaluates the disclosure practices of 100 major emerging-market multinational companies, as being among the most useful in providing transparency laws.

Pulling back the curtain

If, after weighing all available information, an investment in an emerging-market stock still seems like a good fit for your portfolio, ask yourself the following questions before making a move:

1. **Where’s the listing?** Investors interested in an emerging-market stock should first see whether it’s listed on a major U.S. exchange with an American depositary receipt (ADR) designation. Such companies are required to file an annual report with the U.S. Securities and Exchange Commission using generally accepted accounting principles, which allows investors to effectively compare companies in similar industries across geographies. If no ADR is available, check to see if you can gain exposure to the stock via an emerging-market mutual fund or exchange-traded fund (ETF).

2. **Am I sufficiently diversified?** Investing in emerging-market stocks through index mutual funds and ETFs can be a relatively low-cost way for investors to achieve diversification. Failing that, be wary of overconcentration by country or industry. For example, Schwab suggests conservative investors allocate about 5% of their portfolios to international equities (including both developed- and emerging-market companies), while moderate investors may want closer to 15% and aggressive investors as much as 25%.

3. **Should I go active?** In addition to passively run index mutual funds and ETFs, investors may want to consider actively managed mutual funds, whose dedicated country and regional analysts are often better able to monitor corporate and market developments than individual investors. They may even spot improvements in governance and transparency that can benefit a stock before others catch on. However, actively managed funds often carry higher fees and frequently underperform their passively managed counterparts, so do your due diligence and make sure you’re getting your money’s worth.

**See page 42 for important information.**

• **International investments involve additional risks, including differences in accounting standards, currency fluctuations, geopolitical risk, foreign taxes and regulations and the potential for illiquidity.** Investing in emerging markets may accentuate those risks. • **Diversification strategies do not ensure a profit and do not protect against losses in declining markets.** • **Past performance is no guarantee of future results.** (0518-BBNDS)

### Into the light

Many emerging-market nations have made great strides in their governance and reporting standards. However, investing in them could still result in potentially substantial risk. Here are the highest-ranking across three areas of transparency:

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<thead>
<tr>
<th>Auditing and reporting standards</th>
<th>Extent of disclosure</th>
<th>Investor protection</th>
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<tr>
<td>South Africa</td>
<td>1. Malaysia</td>
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<td>Brazil</td>
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Source: The International Monetary Fund, the World Bank and the World Economic Forum.

### Put the real power of Asia in your portfolio.

With Asia representing one-third of global GDP and more than half of the world’s annual growth, we believe that investors should consider making a dedicated allocation to the world’s fastest growing region. For over 25 years, we have pursued an active, fundamental approach to investing in Asia, resulting in portfolios with average active share of 85% and holdings that we believe represent a better exposure to the future growth of the region. Find out more about our experience, insight and passion for Asia—and the role Asia can play in your portfolio—at schwab.com/asia.

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Take our eight-question quiz to test your knowledge of the mental mix-ups that may be costing you cash.
The answers—and why they matter

1. You buy stock in XYZ Corp. and, after several lackluster earnings reports, it’s down 25% from what you paid for it. Which is the best course of action?

   - Reassess the stock as though it were a prospective investment
   - Hold on to the stock until it regains its lost ground
   - Reduce your exposure to equities in an effort to help insulate your portfolio against future shocks

2. A year after buying two particularly promising stocks, one has surged while the other has slumped. How do you rate your performance?

   - You congratulate yourself on your stock-picking acumen
   - You acknowledge you’re one for two
   - You don’t fret the loss and remind yourself that your portfolio is still up overall
   - You’re upset and alter your investments to help minimize future losses

3. Your investment advisor suggests a number of new stocks to replace several long-held, albeit underperforming, investments. How should you react?

   - You hold on to the old stocks because they’ve long been a trusted part of your portfolio
   - You listen to your advisor’s reasoning and consider the new stocks over the old
   - You explore other industries with an eye toward diversification
   - You downplay your advisor’s concerns and redo your research on technology trends

4. You inherit $100,000 in cash. What’s your next step?

   - You hold the inheritance in cash while you evaluate and reevaluate possible investments
   - You invest the money according to the asset allocation in your existing retirement plan
   - Yes, because of potentially market-moving news from a trusted source
   - No, because multiple factors influence a stock’s performance

5. After the recent stock market correction, you review your investment plan. Which is the best course of action?

   - Maintain your current allocation because your long-term goals remain unchanged
   - Reassess the stock as though it were a new investment opportunity
   - Reduce your exposure to equities in an effort to help insulate your portfolio against future shocks

6. Your portfolio gains 10% for two consecutive years, before losing half of those profits in year three. How do you react to the ups and downs?

   - You don’t fret the loss and remind yourself that your portfolio is still up overall
   - You’re upset and alter your investments to help minimize future losses

7. Although U.S. technology stocks have helped your portfolio achieve double-digit annual growth, your financial advisor now believes the sector to be overvalued. How do you assess?

   - You explore other industries with an eye toward diversification
   - You downplay your advisor’s concerns and redo your research on technology trends

8. You see a TV interviewer praising a CEO for several new products her company has developed. Should you buy the stock based on the segment?

   - Yes, because potentially market-moving news from a trusted source
   - No, because multiple factors influence a stock’s performance

Answer A: Renexamining the investment is the right move. However, many investors will instead hold a stock until it reaches a value they have in their head (the price they paid for it, say, or a previous high)—a behavioral bias known as anchoring. Getting wed to a number can weigh down your judgment, even when the price you’re anchored to is irrelevant to the decision at hand.

Answer B: An honest assessment reveals your track record to be lackluster at best. However, many investors will instead recall how they knew the surging stock was going to be a winner all along, while conveniently forgetting they were equally hopeful about the second stock—a failure of logic known as hindsight bias.

Indeed, people consistently misremember the odds they assigned to an outcome once that outcome is known. In one landmark study, researchers surveyed groups of university students prior to former President Richard Nixon’s breakthrough trip to China in 1972 about the probability of certain events taking place, such as a face-to-face meeting with Chairman Mao Zedong. Surveyed again after the trip, the students often misremembered their predictions in light of what actually transpired—invariably giving themselves higher marks than were warranted.

Answer C: Putting your $100,000 windfall to work in the market may be the right choice; since cash tends to underperform the stock market over the long haul, even when it’s invested at the market’s peak. However, many investors suffer from analysis paralysis, or choice overload, that can cause them to sit on the sidelines rather than get in the game. Indeed, a 2000 study found shoppers were 1½ times more likely to visit a display showcasing a large number of jams—but 10 times more likely to make a purchase from one with a more limited selection.

Answer D: When it comes to financial decisions, long-term trends are historically more reliable than near-term events. After all, it took only 19 trading days after the events...
Following a financial plan can help you avoid emotional decision-making. See how Schwab can help you get started at schwab.com/advice.
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Put our active investment approach to work for you today.

*160 of our 369 mutual funds had a 10-year track record as of 3/31/18. (Includes all share classes and excludes funds used in insurance products.) 135 of these 160 funds (84%) beat their Lipper averages for the 10-year period. 257 of 342 (75%), 194 of 234 (83%), 155 of 186 (83%), of T. Rowe Price funds outperformed their Lipper average for the 1-, 3-, 5-year periods ended 3/31/18, respectively. Calculations are based on cumulative total return. Not all funds outperformed for all periods. (Source for data: Lipper Inc.) Schwab and Mutual Fund OneSource are trademarks of Charles Schwab & Co., Inc. Used with permission. T. Rowe Price Investment Services, Inc., Distributor.
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• Discounted pricing for Schwab clients2
• Convenient loan origination via Quicken’s industry-leading technology
• Convenient closing options—in person or online

Buying a new home can be a huge undertaking, but Schwab Bank and Quicken Loans can help simplify the process.

When you get a home loan from Quicken Loans, you can expect:

• Discounted pricing for Schwab clients2
• Convenient loan origination via Quicken’s industry-leading technology
• Convenient closing options—in person or online

See page 42 for additional offer information. • This offer is subject to change or withdrawal at any time and without notice. Nothing herein is or should be interpreted as an obligation to lend. Loans are subject to credit and property approval. Other conditions and restrictions may apply. Hazard insurance may be required. Program terms and conditions are subject to change. Advantaged pricing may be available based upon total assets held at Charles Schwab. • Charles Schwab Bank and Charles Schwab & Co., Inc. are separate but affiliated companies and subsidiaries of The Charles Schwab Corporation. Investment products are offered by Charles Schwab & Co., Inc. (Member SIPC).
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**Cash solutions from Schwab and Schwab Bank®**

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¹Federal Deposit Insurance Corporation (FDIC) insurance covers deposits received at an insured bank, including deposits in a checking account, negotiable order of withdrawal account, savings account, money market deposit account, certificates of deposit, or an official item issued by a bank, such as a cashier's check or money order. At the time of publication, each depositor is insured to at least $250,000 per insured bank. ²Bank Sweep is the default cash feature for most new accounts. The Schwab One Interest feature and the Money Fund Sweep feature are two additional cash features available to certain accounts. Please note Schwab One Interest and the Money Fund Sweep feature are not FDIC-insured. ³Schwab Bank High Yield Investor Checking accounts are available only as linked accounts with Schwab One accounts. The Schwab One brokerage account has no minimum balance requirements, and there is no requirement to fund this account when it is opened with a linked High Yield Investor Checking account.

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³Federal Deposit Insurance Corporation (FDIC) insurance covers deposits received at an insured bank, including deposits in a checking account, negotiable order of withdrawal account, savings account, money market deposit account, certificates of deposit, or an official item issued by a bank, such as a cashier's check or money order. At the time of publication, each depositor is insured to at least $250,000 per insured bank. ²Bank Sweep is the default cash feature for most new accounts. The Schwab One Interest feature and the Money Fund Sweep feature are two additional cash features available to certain accounts. Please note Schwab One Interest and the Money Fund Sweep feature are not FDIC-insured. ³Schwab Bank High Yield Investor Checking accounts are available only as linked accounts with Schwab One accounts. The Schwab One brokerage account has no minimum balance requirements, and there is no requirement to fund this account when it is opened with a linked High Yield Investor Checking account.

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³Federal Deposit Insurance Corporation (FDIC) insurance covers deposits received at an insured bank, including deposits in a checking account, negotiable order of withdrawal account, savings account, money market deposit account, certificates of deposit, or an official item issued by a bank, such as a cashier's check or money order. At the time of publication, each depositor is insured to at least $250,000 per insured bank. ²Bank Sweep is the default cash feature for most new accounts. The Schwab One Interest feature and the Money Fund Sweep feature are two additional cash features available to certain accounts. Please note Schwab One Interest and the Money Fund Sweep feature are not FDIC-insured. ³Schwab Bank High Yield Investor Checking accounts are available only as linked accounts with Schwab One accounts. The Schwab One brokerage account has no minimum balance requirements, and there is no requirement to fund this account when it is opened with a linked High Yield Investor Checking account.

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Pg. 8–9, 32–36: Examples provided are for illustrative purposes only and not intended to be reflective of results you can expect to achieve.

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- The Bloomberg Barclays U.S. 10 Year Treasury Bond Index measures the performance of U.S. Treasury securities that have a remaining maturity of 10 years, are rated investment grade and have $250 million or more of outstanding face value. The Bloomberg Barclays U.S. Agency Bond Index measures the performance of the agency sector of the U.S. government bond market and is composed of investment-grade native-currency U.S. Dollar-denominated debentures issued by government and government-related agencies, including the Federal National Mortgage Association ("Fannie-Mae"). The Bloomberg Barclays U.S. Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market. The Bloomberg Barclays U.S. Short Treasury Index includes aged U.S. Treasury bills, notes and bonds with a remaining maturity from 1 up to (but not including) 12 months. It excludes zero coupon strips. The MSCI EAFE Index captures large- and mid-cap representation across developed markets countries around the world, excluding the U.S. and Canada. The index covers approximately 85% of the free float-adjusted market capitalization in each country. The MSCI Emerging Markets Index captures large- and mid-cap representation across 24 emerging markets countries. The index covers approximately 85% of the free float-adjusted market capitalization in each country. The Russell 2000® Index measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000 Index is a subset of the Russell 3000® Index, representing approximately 10% of the total market capitalization of that index. It includes approximately 2,000 of the smallest securities, based on a combination of their market cap and current index membership. The S&P 500® Index is a market-capitalization-weighted index comprising 500 widely traded stocks chosen for market size, liquidity and industry-group representation. The S&P GSCI Gold Index is a sub-index of the S&P GSCI. It is comprised of 24 raw materials from all commodity sectors and serves as a measure of commodity performance over time.

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Keep in mind that a high relative ranking does not always mean the fund achieved a positive return during the period. Lipper rankings do not take into account sales charges and are based on historical total returns, which are not indicative of future results. Note that rankings are based on the performance of all share classes and sales load types as reported by Lipper. Rankings for other share classes may be higher or lower.

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Charles R. Schwab
Founder & Chairman

See page 42 for important information. ◆ There are trading costs, associated with each buy and sell transaction for stocks. Frequent trading increases these costs. (0518-8DY2)
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