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## 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, <<I/we/I>> encourage you to reach out to <<me/us/us>> at <<FC phone/FC phone or PC phone/877-297-1126>>. <<I/We/We>> welcome every opportunity to help you achieve your goals.

Sincerely,

A handwritten signature in black ink that reads "Joseph A. Vietri".

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).

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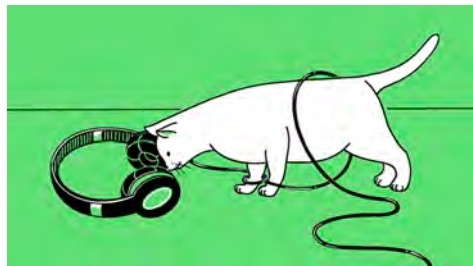
# SCHWAB ORIGINALS

## 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](https://schwab.com/taxes).

## Listen



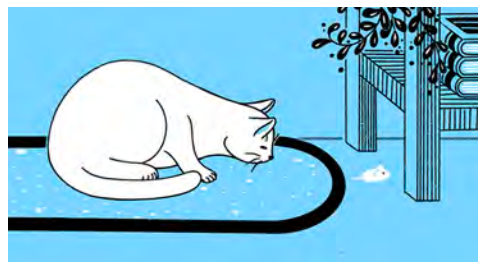
Mark Riepe and *Financial Decoder*™ return for Season 6 with new episodes about the emotional biases that can cloud your financial judgment and cost you money. Listen and subscribe at [schwab.com/financialdecoder](https://schwab.com/financialdecoder).

## 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](https://schwab.com/whyplan).

## Follow



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(0321-0PZZ)



# ONWARD

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ILLUSTRATIONS BY SHREYA GUPTA

# CEO's NOTE

## 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.**

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

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

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

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

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

Sincerely,



Walt Bettinger  
President & CEO

See page 42 for important information.

◆ Investing involves risk, including loss of principal. (0321-0S2M)





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# THE BOTTOM LINE

CONTENTS RETIREMENT | STOCK SPLITS | FINANCIAL BINGO | EMERGENCY PREPAREDNESS | AND MORE



## Missing the Match

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

**W**hen 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. ▶



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

reducing your own contributions would only compound the issue."

**3 Review your plan:** Sometimes we let our retirement plans run on autopilot, 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."

## NEXT STEPS

You can still contribute to your IRA for 2020. Log in to [schwab.com/contribute](https://schwab.com/contribute) today.

**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**re stock splits a boon for investors—or just a numbers game? That's the question many investors may be pondering in the wake of 2020's high-profile Apple and Tesla splits.

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

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

Despite the potential for short-term outperformance, however, investors shouldn't scramble to purchase shares of a stock just because they're cheaper. "When a stock splits, it can feel like you're getting a better value because

your money can buy more shares," says Steve Greiner, senior vice president of Schwab Equity Ratings®. "However, a split doesn't change a company's underlying health—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.

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## LEARN MORE

Find out more about Schwab Stock Slices™ at [schwab.com/stockslices](https://schwab.com/stockslices).



# 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.

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

## 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.

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# An Ounce of Prevention

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

**W**ith 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.



## LET'S TALK

Need help thinking through your emergency plan?  
Call your Schwab financial consultant to schedule an appointment.

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

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

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

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

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

# The Basics of Cost Basis

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

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

profit or loss but also any taxes you might owe.

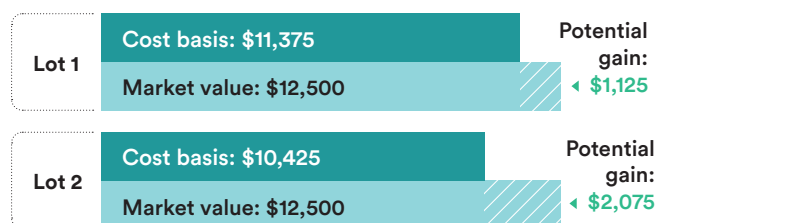
When instructing your brokerage firm which shares to sell, you can choose from one of several methods for calculating your cost basis:

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

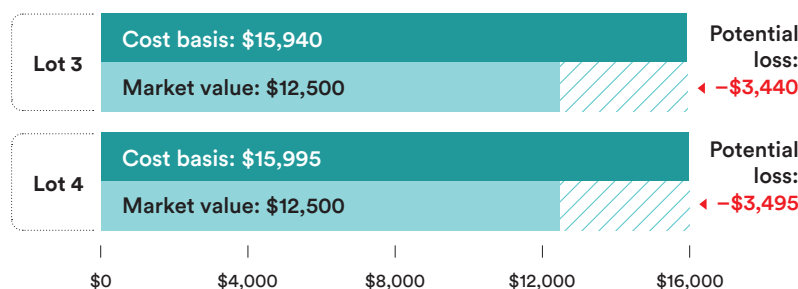
## Case in point

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*.



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*.



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)

**NEXT  
STEPS**

To review or update your default cost basis methods for your Schwab accounts, log in to [schwab.com/accountsettings](https://schwab.com/accountsettings).



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# FAMILY MATTERS

## 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.**

**S**hould 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. ▶



**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.” ■

**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. (0321-0CCF)

**LET'S TALK**

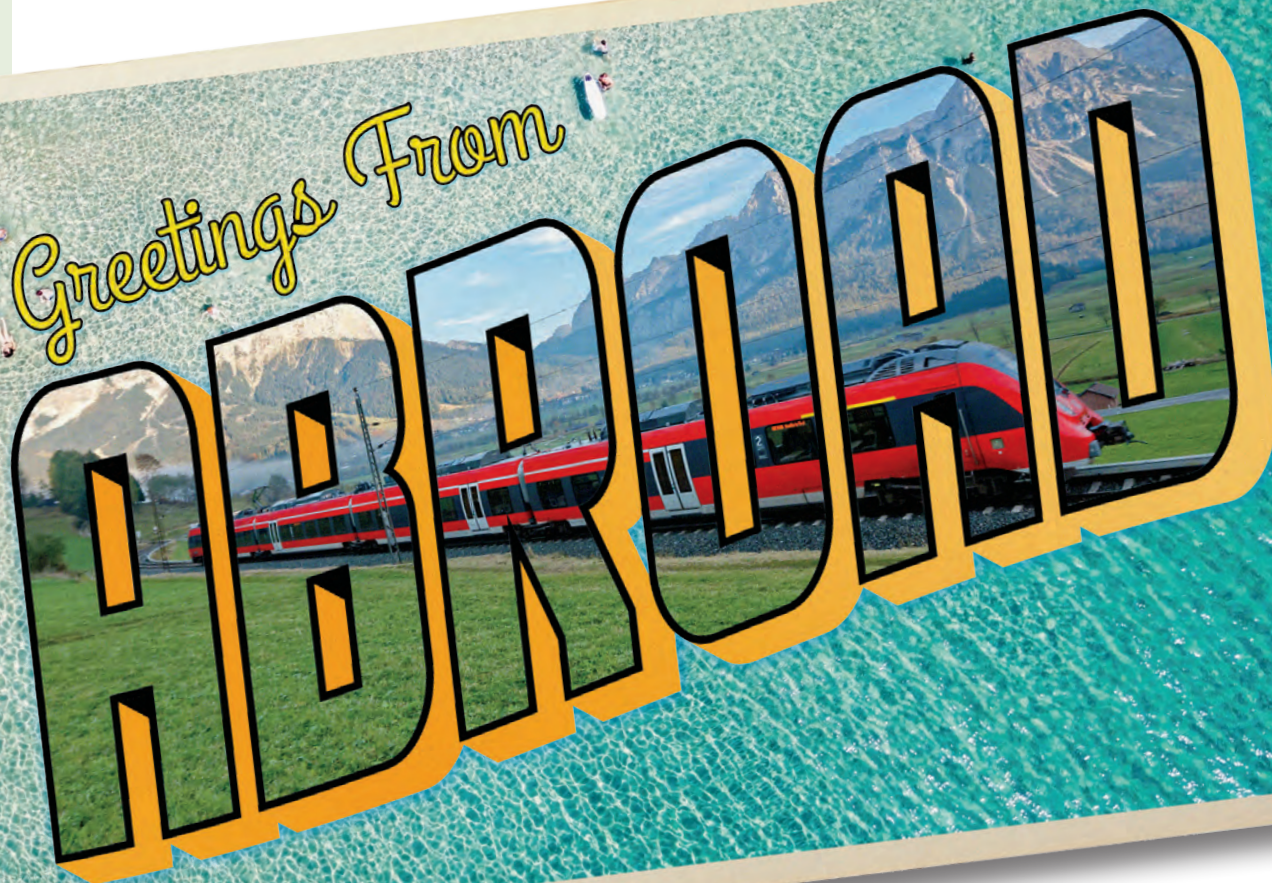
A good plan makes all the difference, and Schwab can help. Call your Schwab financial consultant to talk through your trust and estate considerations.



# PERSPECTIVES

CONTENTS INTERNATIONAL EQUITIES | BONDS

Greetings From



## It may be time to revisit your international allocation.

By Jeffrey Kleintop

**I**n 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 3.3% gain when measured in dollars.<sup>1</sup>

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.

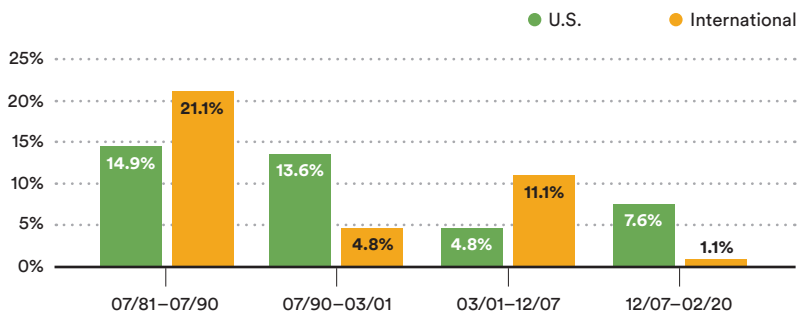
### Change in leadership

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

## And the winner is ...

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



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.**

2008–2009 global financial crisis restored the reign of U.S. stocks (see “And the winner is ...,” above).

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

### Going global

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

How *much* exposure you should have to international investments is another matter—one that depends on your risk tolerance and time horizon.

If your global allocation is out of line with your target, start making small shifts as part of your regular rebalancing routine. This gradual approach will allow you to adjust the

balance of your portfolio over time rather than in one dramatic move that could result in a big tax bill or, worse, turn out to be poorly timed. ■

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



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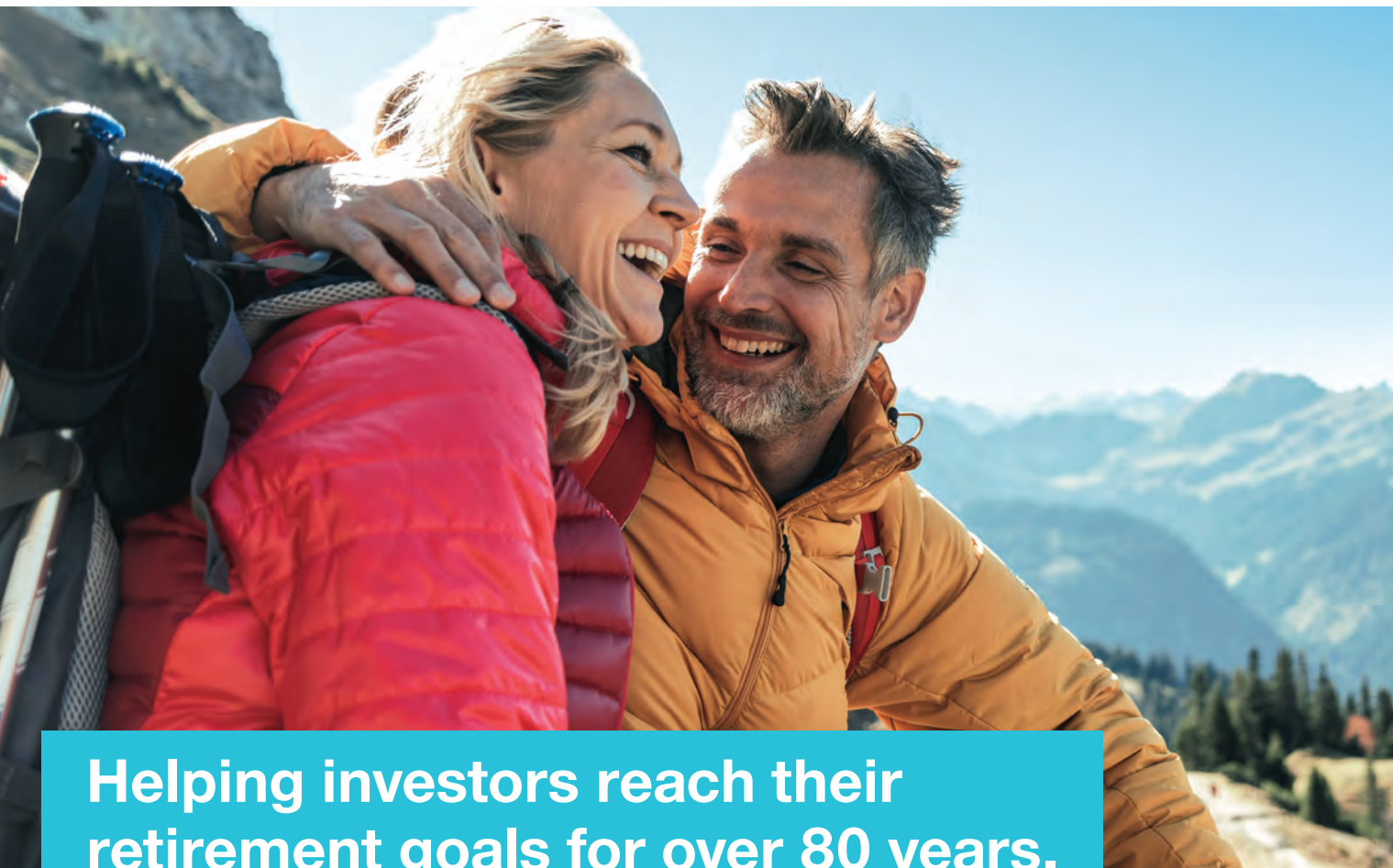
See page 42 for important information.

◆ Investors should consider carefully information contained in the prospectus or, if available, the summary prospectus, including investment objectives, risks, charges, and expenses. Please read it carefully before investing. ◆ 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. ◆ International investments involve additional risks, which include differences in financial accounting standards, currency fluctuations, geopolitical risk, foreign taxes and regulations, and the potential for illiquid markets. Investing in emerging markets may accentuate these risks. ◆ Past performance is no guarantee of future results and the opinions presented cannot be viewed as an indicator of future performance. (0321-04CT)

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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

**D**o 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

**Even when offering low yields, intermediate-term U.S. Treasuries generally have held their value or appreciated during stock market declines.**

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.

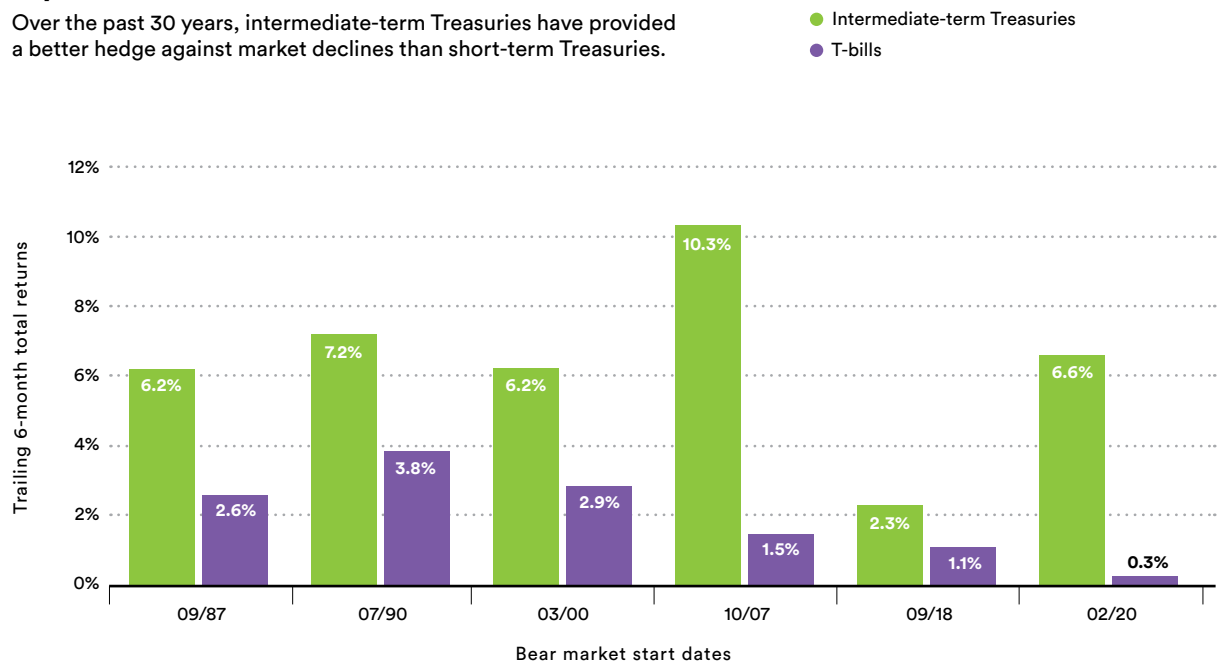
## Beyond diversification

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.

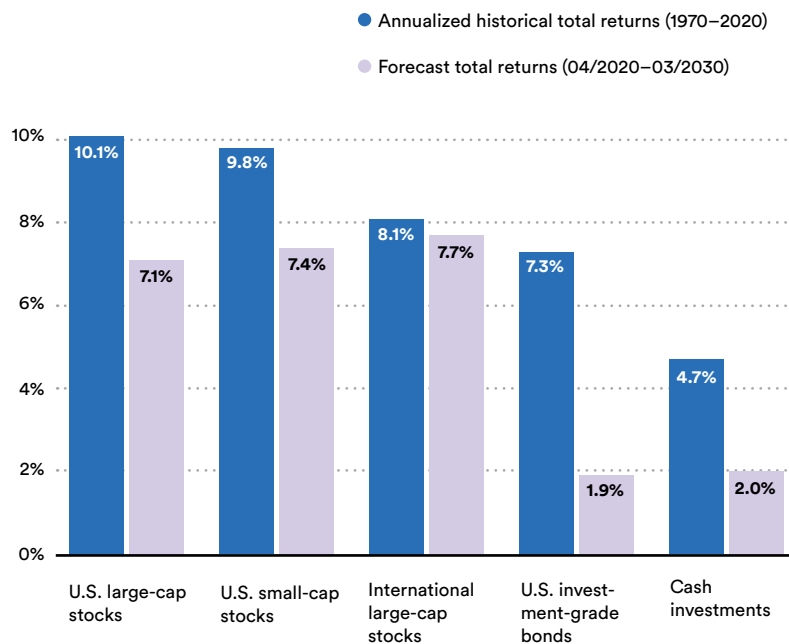
Beyond that, we suggest broader diversification across *all* asset classes, not just bonds. Our anticipated returns for both bonds and stocks are lower for the next 10 years than over the past 50 years, due in part to high starting valuations and low inflation projections (see “Lower your expectations,” 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.

### 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.

## Lower your expectations

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



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.**

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

And while we don't expect inflation to be a significant problem over the

next few years, we believe holding some inflation-linked bonds, such as Treasury Inflation-Protected Securities (TIPS), makes sense, to mitigate the risk of an unexpected spike in inflation. ■



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

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Go With the Flow

Three popular indicators for trading momentum.  
By Kevin Horner

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

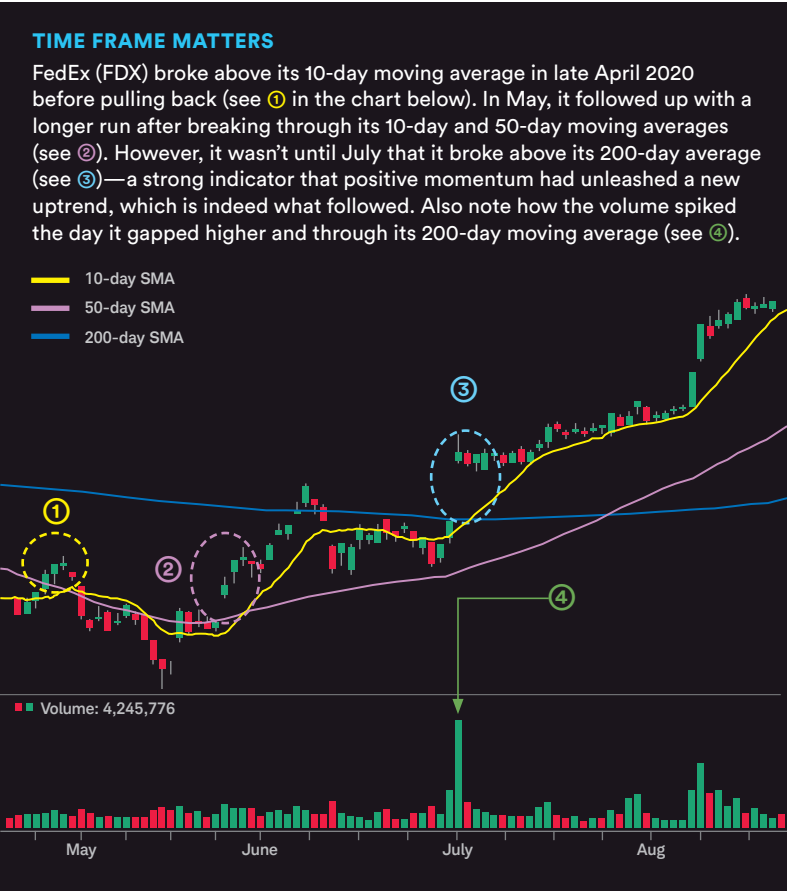
But what clues might suggest that a surge of momentum is sustainable? Here are a few indicators I like to use—along with strategies for how to deploy them.

**1 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.

**2 Moving averages**

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



Examples provided are for illustrative purposes only and not intended to be reflective of results you can expect to achieve. Screenshots are historical in nature. **Past performance is no guarantee of future results.**

Time is of 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).

**3 News and commentary**

Qualitative inputs may also be useful when trading momentum. When I’m thinking of entering or exiting a stock with strong momentum, I always look to see if there’s any upcoming news that could knock it off its recent trajectory. For example, a pending earnings announcement could easily derail the stock if the numbers disappoint.

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

**Protect yourself**

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

Another strategy is to reduce the size of your position in a trade as the price breaks below certain moving averages (see “Different strokes,” above right). When the price breaks below *all* the moving averages, however, it’s a pretty good sign that the positive trend is broken at that point.

DIFFERENT STROKES

When Tesla (TSLA) was outperforming last year, you could have:

- Used the five-day moving average as a trigger to buy Tesla last April (see ① in the chart below) and then sold a portion once it broke below the line more than a week later (see ②).
- Sold more—but not all—after the stock broke through its 20-day moving average in August (see ③). This would have still enabled you to profit once the stock regained its momentum later that month (see ④).



Examples provided are for illustrative purposes only and not intended to be reflective of results you can expect to achieve. Screenshots are historical in nature. **Past performance is no guarantee of future results.**



Kevin Horner is a senior manager of trading services education at Charles Schwab & Co., Inc.

No matter how long you’re in a momentum trade, you should build in protection against unexpected price declines. Setting a stop order below one of the moving averages is a good way to do this—just be aware that it won’t protect you against after-market or pre-open moves, and stocks with negative news often gap down. If you’re using a standard sell-stop order—which becomes a market order once your sell price is triggered—you could end up

selling far below your target price. If you’re using a stop-limit order—which will execute only at the price you set—you could end up not selling at all if no buyer is willing to meet your price.

Even with these risks, trading momentum can be a profitable strategy for both short- and long-term gains. Using a combination of volume, moving averages, and other inputs should give you some good ideas on where to start—and when to hop off before the engine sputters. ■

Want more breakdowns of popular trading strategies? Watch new episodes of Schwab’s *Trading Up-Close* at [schwab.com/trading-up-close](https://www.schwab.com/trading-up-close).

WATCH

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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 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 401(k) options

If you participate in your employer’s workplace retirement plan, you’re most likely enrolled in a traditional 401(k) or 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 be sure, but it might not be the best option for your particular tax situation.

Enter the Roth 401(k), which you fund with after-tax dollars—meaning there’s no immediate tax benefit when you contribute—but which offers tax-free growth *and* tax-free withdrawals in retirement.<sup>1</sup> According to Plan Sponsor Council of America, roughly 70% of employers offer Roth 401(k) options, yet just 18% of workers contribute to them—a trend Hayden attributes to a behavioral tendency known as status-quo bias. “When a traditional 401(k) or similar account is the default option, it’s hard to overcome inertia and make a change,” he says.

Roth accounts tend to be best for those who believe their current income tax rate is lower than it will be 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.](#)

## Misstep #2 Letting taxes eat into your returns

Every dollar lost to taxes is one you can’t spend or reinvest for potential growth, so it’s worth investing in the most tax-efficient way possible. “You have to be especially careful with investments held in taxable brokerage and savings accounts, because over time taxes can have a huge effect on your after-tax returns,” Hayden says.

One rule of thumb is to hold investments that pay a lot of interest or nonqualified dividends—which are taxed at ordinary income rates—in tax-deferred accounts like 401(k)s and individual retirement accounts (IRAs), where you won’t pay taxes until you start making withdrawals.

Assets that tend to lose less of their returns to taxes make sense for taxable accounts such as your regular brokerage account. These investments include exchange-traded funds and tax-managed mutual funds, which trigger relatively few taxable distributions to shareholders, and municipal bonds, whose income is generally tax-free at the federal level and for in-state residents.

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

■ [Learn more about tax-efficient investing at schwab.com/taxes.](#)

## Misstep #3 Having too much tax withheld from your paycheck

According to IRS data, nearly three-quarters of Americans received tax refunds in 2019, with the average refund totaling just over \$3,000.

Many taxpayers appreciate receiving a windfall each spring, but having too much tax withheld from your paychecks is like giving the U.S. government an interest-free loan until you receive your refund. “There’s an opportunity cost that comes from withholding too much in taxes,” Hayden says. “You could have been investing those dollars for potential

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

growth rather than letting them sit stagnant in government coffers.”

In a perfect world, your withholding amounts would equal your tax liability for the year, resulting in neither a tax bill nor a refund. It’s hard to get it exactly right, but the IRS Tax Withholding Estimator ([irs.gov/w4app](https://irs.gov/w4app)) can help calculate whether you should adjust your withholding. “In general, it’s a good idea to review your withholding at the start of the year and then again about halfway through,” Hayden says, “particularly when there are changes to tax law or your personal circumstances.”

■ [Learn more about tax withholding at schwab.com/taxwithholding.](#)

## Misstep #4 Mishandling your retirement distributions

Failing to take the IRS-mandated required minimum distributions (RMDs) from your tax-deferred 401(k)s and IRAs 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, a lesser-known hazard lies in withdrawing assets from your taxable, tax-deferred, and Roth accounts at the wrong times or in the wrong order. For example, because you’ve already paid taxes on any Roth contributions, the longer you wait to withdraw those funds, the longer those securities have to earn back that tax hit.

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

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

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

■ [Schwab Intelligent Income™, a feature available with Schwab Intelligent Portfolios®, can help you create a tax-smart withdrawal strategy. Learn more at schwab.com/intelligentincome.](#)

## Misstep #5 Delaying taxes

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

“The Tax Cuts and Jobs Act of 2017 reduced 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.”

For example, converting some or all of your traditional IRA assets to a Roth IRA this year—and paying income taxes on the converted amount, including earnings—allows you to lock in today’s tax rates, which may be lower than they are in the future. And once you reach age 59½, withdrawals are entirely tax-free.<sup>2</sup> “Assets in a traditional IRA are subject to the unknowns of future tax law,” Hayden says. “Assets in a Roth, on the other hand, are not—because you’ve already paid taxes on them.”

Likewise, today’s long-term capital gains rates are near historic lows. If you have sizable unrealized gains in your portfolio, you might want to consider strategically selling some of them to take advantage of today’s rates—a strategy known as tax-gain harvesting.

“With tax-gain harvesting, you sell some winning investments and recognize the gains today, potentially at a lower tax rate or no tax at all,” Hayden says. For example, say you currently have more losses than gains for the

year. Rather than carrying forward the unused losses, you could realize the equivalent amount in gains this year, which would effectively zero out the taxes you would otherwise owe on those gains.

“If you don’t need the proceeds from the sale, you could even repurchase the exact same investment at today’s market value,” Hayden says. “Just be sure each and every share sold was for a gain.” (Any shares that are sold at a *loss* are subject to the wash-sale rule, which disallows losses for tax purposes if you purchase the same or a substantially identical security within 30 days before or after the sale.)

■ [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 guide you through this process.” ■

<sup>1</sup>Earnings on Roth 401(k) contributions are eligible for tax-free treatment so long as the distribution occurs at least five years after the first Roth 401(k) contribution and the account holder has reached age 59½, has become disabled, or has died. | <sup>2</sup>Provided you’ve held the account at least five years.

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

**T**oday'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 \$16,971—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 riskier than bonds, something income investors in particular should consider when weighing their options,” 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, a risk that was realized in 2020 after 68 of the 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 with 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,” Steve says. “Before jumping at a big yield, try to determine *why* it’s so high.”

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

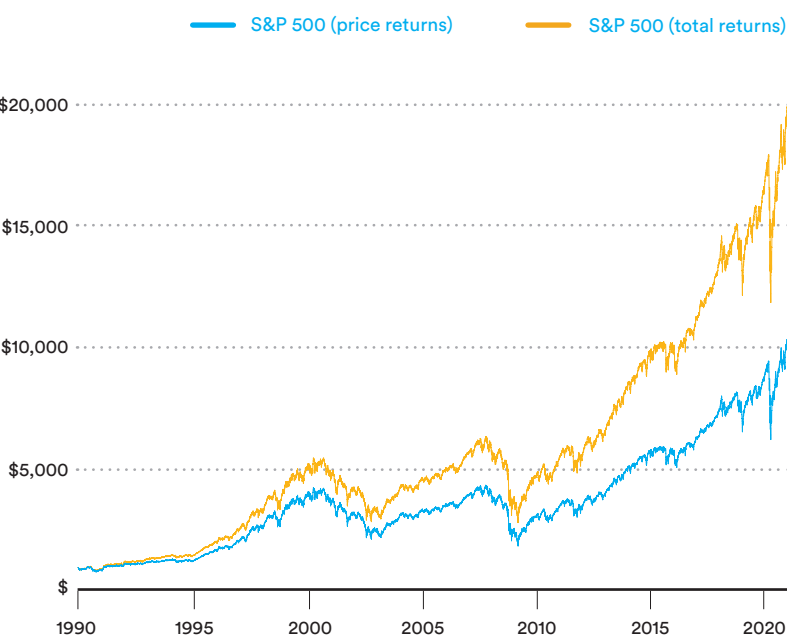
If a rising dividend yield is due to rising profits, on the other hand, that’s a much more auspicious sign. “When net profits rise, dividends tend to follow suit, so just be sure you know what’s causing the increase before buying the stock,” he says.

**2. Assess the payout ratio:** This metric—which is calculated by dividing dividends per share by earnings per share—tells you how much of a company’s earnings are going toward the dividend. “A ratio higher than 100% means the company is paying out more to its shareholders than it’s earning,” Steve says. “In such cases, it may be able to cover its dividends from available cash, 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 payers in financial straits may try to stave off a dividend cut—which can drive away

### More bang for your buck

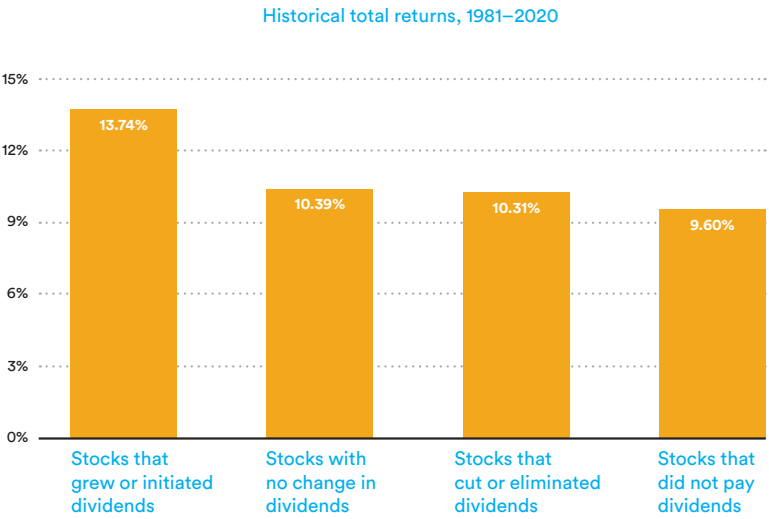
Reinvesting dividends could significantly boost total returns over time.



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

### 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.



Source: Compustat, Ned Davis Research, S&P Capital IQ, and S&P Dow Jones Indices. ©2021 Ned Davis Research, Inc. Further distribution prohibited without prior permission. All rights reserved. See additional explanatory notes and disclosures at [ndr.com/copyright.html](https://www.ndr.com/copyright.html). For data vendor disclaimers, refer to [ndr.com/vendorinfo](https://www.ndr.com/vendorinfo). **Past performance is no guarantee of future results.**

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. “If push comes to shove,” 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 three, five, or even 10 years. Indeed, companies that grow their dividends tend to outperform their peers over time (see “Supersize me,” bottom left).

Not only that, but “a strong history 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 been hoarding cash to help weather the economic uncertainty, so it’s not unreasonable for them to keep dividends flat until the economy bounces back,” Steve says.

**5. Understand sector risk:** Some sectors offer a more attractive combination

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

“If you’re a long-term investor, you might be willing to accept tech’s higher volatility in exchange for its growth and income prospects,” Steve says. “But if you’re nearing or in retirement, you might want to stick with dividend payers from less-volatile industries.”

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

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. ♦ Portfolio Management for the ThomasPartners Strategies is provided by Charles Schwab Investment Management, Inc. (“CSIM”). CSIM is a registered investment adviser and an affiliate of Charles Schwab & Co, Inc. (“Schwab”). Both CSIM and Schwab are separate entities and 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. ♦ Dividend-focused funds may underperform funds that do not limit their investment to dividend-paying stocks. Stocks held by the fund may reduce or stop paying dividends, affecting the fund’s ability to generate income. ♦ Investing involves risk, including loss of principal. (0321-026Y)

## 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 quite ready to let it go, you may not want to reinvest the payouts back into that investment. Instead, you might use the dividends to dip your toe into prospective investments that could ultimately replace the underperforming investment.

## Research can pay dividends

How to research dividend payers on [schwab.com](https://www.schwab.com).

Log in to [schwab.com/stockscreeners](https://www.schwab.com/stockscreeners) to research dividend stocks by:

- **Current ratio:** Select Financial Strength under the Choose Criteria menu, then select Current Ratio and choose a value.
- **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-tools](https://www.schwab.com/research-tools), search for the company name or ticker symbol, and select the Dividends tab on the stock’s research page.

To research dividend-paying stock funds, log in to [schwab.com/ETFscreeners](https://www.schwab.com/ETFscreeners) (for ETFs) or [schwab.com/fundscreeners](https://www.schwab.com/fundscreeners) (for mutual funds), select Distributions under the Choose Criteria menu, then select Distribution Yield and choose a range.

### NEXT STEPS

With ThomasPartners Strategies, you can get a professionally managed portfolio of dividend-paying stocks focused on growth or income. Learn more at [schwab.com/thomaspartners](https://www.schwab.com/thomaspartners).

# Seventh Heaven

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

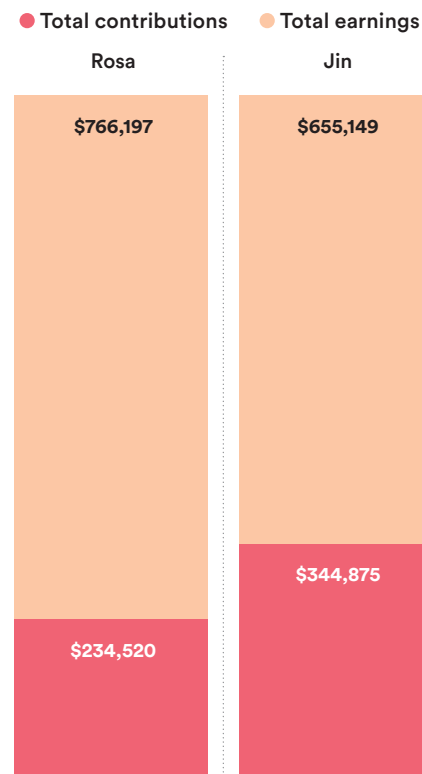
The earlier you start, the less you may have to save to reach your goal, thanks to the potential for long-term compound growth. Consider two investors who each wanted to save \$1 million by age 65:

• 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."

■ Set up automatic contributions to your Schwab accounts at [schwab.com/contribute](https://schwab.com/contribute).



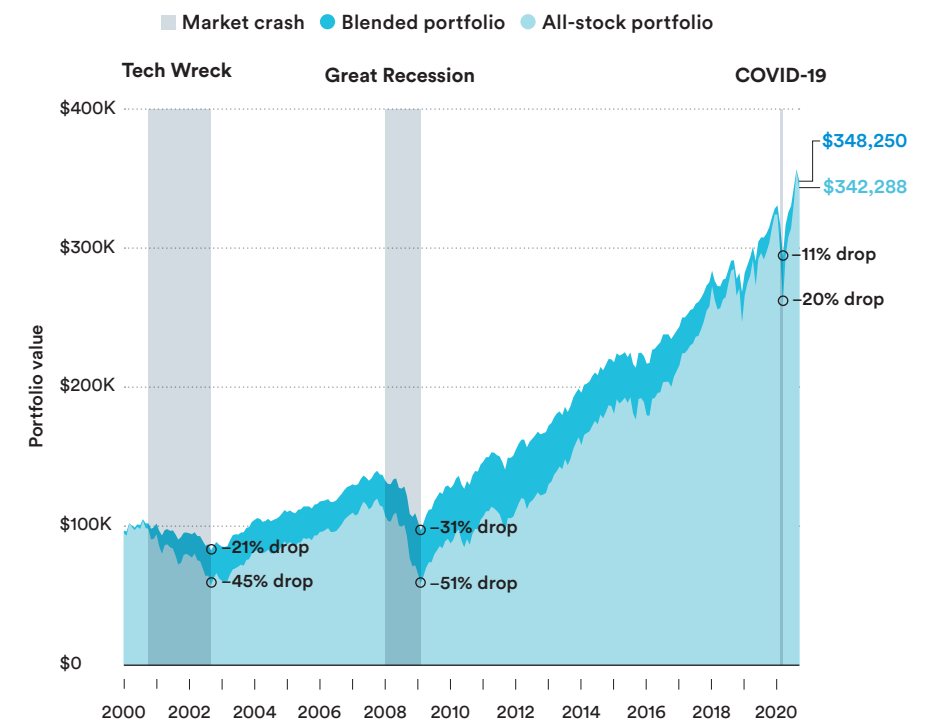
Source: Schwab Center for Financial Research. The example is hypothetical and provided for illustrative purposes only. It is not intended to represent a specific investment product. Calculations assume a lump-sum investment on January 1 of each year and a 6% average annual return, and do not reflect 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](https://schwab.com/intelligent).



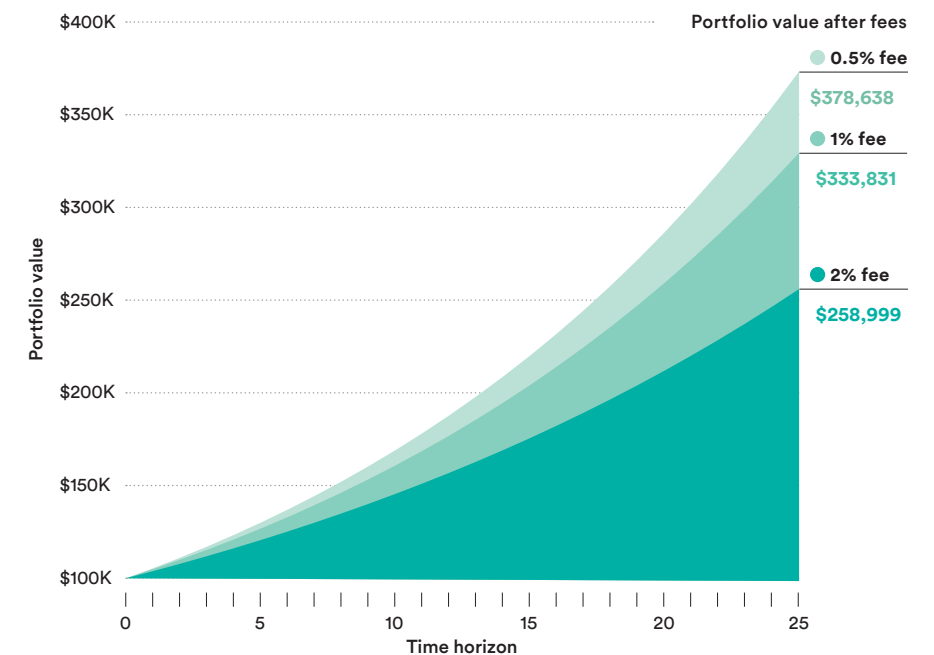
Source: Schwab Center for Financial Research and Morningstar. Data from 09/30/2000 through 09/30/2020. The example is hypothetical and provided for illustrative purposes only. Portfolio performance during market crashes is based on monthly data, not peak-to-trough declines. The blended portfolio is composed 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.

## 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](https://schwab.com/research-tools).



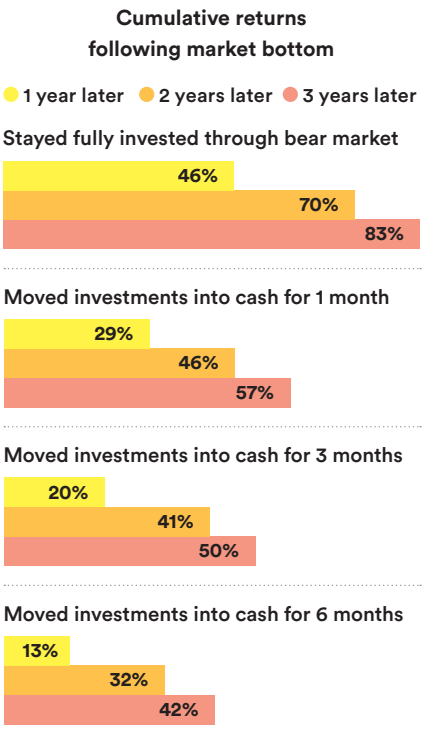
Source: Schwab Center for Financial Research. The example is hypothetical and provided for illustrative purposes only. Ending portfolio balances assume a starting balance of \$100,000, a 6% average annual return, no additional contributions or withdrawals, and do not reflect the effects of taxes.



HABIT 4 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."



■ *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](https://schwab.com/financialdecoder).

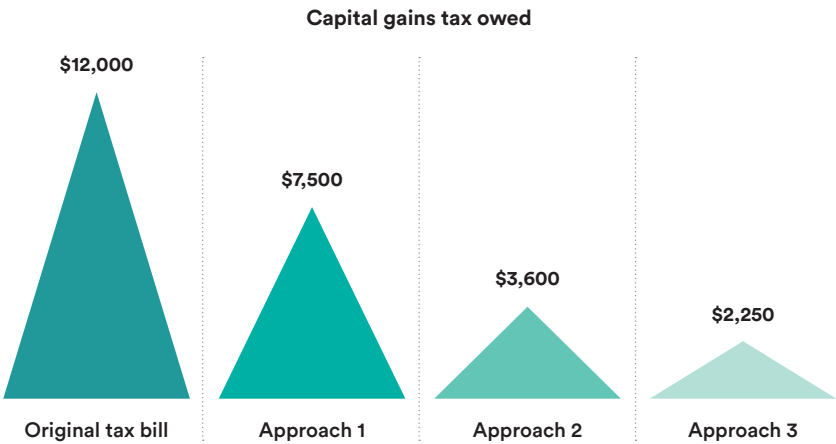
Source: Schwab Center for Financial Research and Morningstar. Data from 01/1970 through 12/2019. Market returns are represented by the S&P 500® Total Return Index, and cash returns are represented by the total returns of the Ibbotson U.S. 30-day Treasury Bill Index. Examples assume investors who switched to cash investments did so in the month that the market reached its lowest point and remained in cash for either one, three, or six months. Cumulative returns are calculated using the simple average of returns from each period and scenario. **Past performance is no guarantee of future results.**

HABIT 5 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.

"You 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 × .24).



The example is hypothetical and provided for illustrative purposes only.

<sup>1</sup>Long-term capital gains rates are 0%, 15%, or 20%, depending on income, plus a 3.8% surtax for certain high-income earners. If you decide to hold on to the investment for at least a year and a day, be aware that your investment could decrease in value during that time.

**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**

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 × .15).<sup>1</sup>

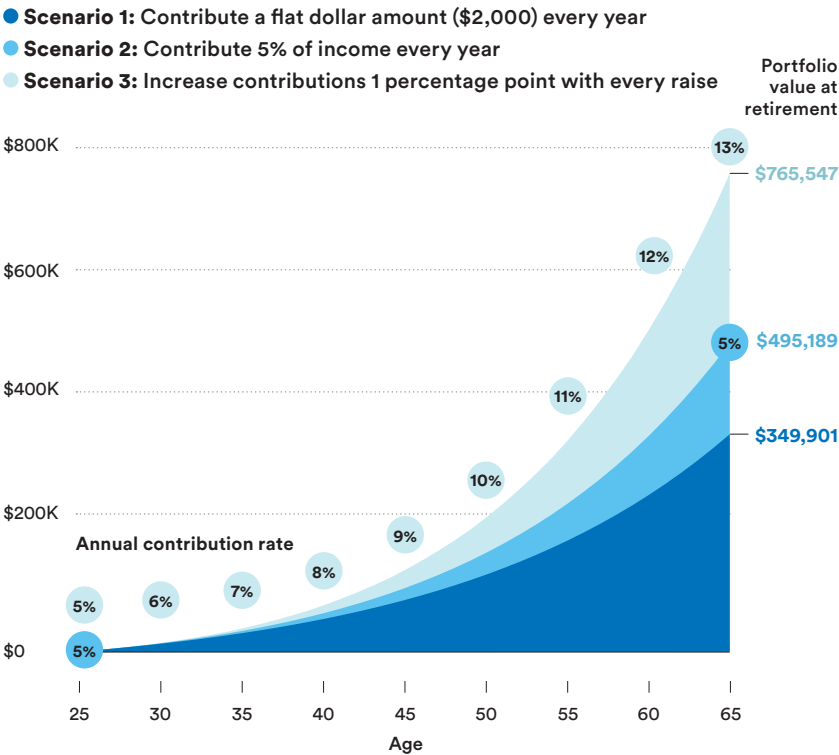
➔ **Approach 2:** Sell another investment at a loss in order to offset some or all of your short-term \$50,000 gain. For example, if you realize \$35,000 in losses, your gains would be reduced to just \$15,000, resulting in a \$3,600 tax bill (\$15,000 × .24).

➔ **Approach 3:** Combine approaches 1 and 2—holding on to your investment for at least another month and a day *and* realizing \$35,000 in losses to offset your \$50,000 gain, resulting in a \$2,250 tax bill (\$15,000 × .15).

■ Find more ways to make tax-smart decisions and potentially lower your tax bill at [schwab.com/taxstrategies](https://schwab.com/taxstrategies).

HABIT 6 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

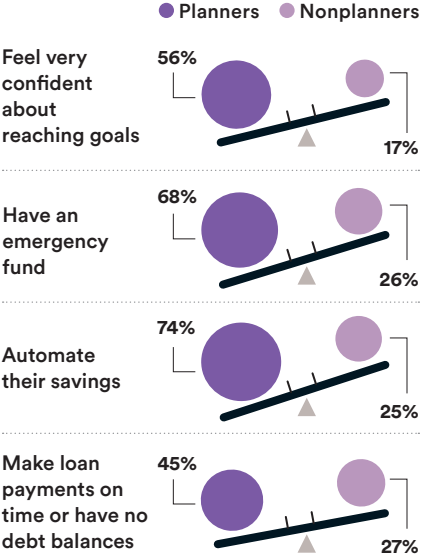


Source: Schwab Center for Financial Research. Scenarios assume a starting salary of \$40,000, annual cost-of-living increases of 2%, and a 5% raise every five years. The example is hypothetical and provided for illustrative purposes only. It is not intended to represent a specific investment product. 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 her pretax income in the first year and then contributes that 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 with each raise.

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HABIT 7 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](https://schwab.com/schwabplan).

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



# The Bank

## How to borrow against your own assets.

**D**ebt 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



# of You

by your property, however, Chris says you should have a solid payoff strategy before you consolidate higher-interest-rate debt, since you could be putting your home on the line if you can’t pay it back.

**P.S.** Lenders need time to process a HELOC application because it requires a home appraisal and a review of both your credit and financial histories, which can take weeks. “Because of the time involved, it’s best to open a HELOC well before you need the funds,” Chris says.

■ **To learn more about HELOCs, visit [schwab.com/HELOC](https://schwab.com/HELOC) or call your Schwab financial consultant.**

## 2 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 minimum of \$2,000 in cash or 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 as a way to take advantage of a trading opportunity when they don’t have adequate cash on hand. If you use the funds to purchase investments that generate taxable income—including interest, nonqualified dividends, and short-term capital gains—you may be able to deduct the interest paid if you itemize your deductions. However, if the value of your margin account falls below the maintenance requirement—the minimum dollar amount that you must maintain in the margin account once you’ve tapped the funds—your brokerage will issue a maintenance call, which requires you to either deposit more money or marginable securities, or sell some of the assets held in your account.

■ **Short-term liquidity needs:** As with any line of credit, you can draw from and replenish a margin account for any reason, not just purchasing securities. “A margin loan is a ready source of credit that may be used as a short-term loan for any need—and unlike a HELOC, there’s no lengthy application process,” Chris says. “But I can’t stress enough the importance of moderating your borrowing. If you borrow too much 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.”

**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.

■ **To learn about margin loans at Schwab, visit [schwab.com/margin](https://schwab.com/margin) or call your Schwab financial consultant.**

## 3 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.”

■ **Liquidity:** When you need quick access to cash but don’t want to sell your investments—which can trigger capital gains taxes and upend your investment strategy—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.** A securities-based line of credit from a bank is subject to a high degree of risk, which you should be sure you understand before applying. Should the market value of the pledged collateral decrease, the bank may demand immediate repayment of outstanding obligations or require you to deposit additional cash or securities to the pledged brokerage account in order to avoid the sale of pledged assets. Pledging diversified assets can help reduce this risk. Be that as it may, you should keep an eye on the value of your pledged assets—and have a backup source of funds in the event of a demand.

■ **To learn about Schwab Bank’s Pledged Asset Line, visit [schwab.com/PAL](https://schwab.com/PAL) or call your Schwab financial consultant.**

## Have an endgame

Margin and bank-offered securities-based lines of credit, in particular, are best suited for those savvy about the markets. “You need to know how much risk you’re taking on—and be vigilant about managing that risk,” Chris says.

What’s more, “it’s crucial to develop a repayment strategy, because unlike, say, a traditional mortgage, asset-backed loans generally have a more flexible repayment schedule,” Chris adds. “And whatever you do, always pay more than just the interest due each month.” ■

LET’S  
TALK

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

## Asset-backed borrowing at a glance

	Home equity line of credit	Margin loan	Bank-issued securities-based line of credit
Assets used as collateral	Real estate, including your primary residence and second home	Eligible securities in most nonretirement accounts	Eligible securities, as determined by the bank, held in a separate pledged brokerage account
Minimum collateral requirement	Established by the lender and typically based on the requested line amount and the associated home value	Typically \$2,000; some brokers may require more	Varies; many lenders, including Schwab Bank, require a \$100,000 or more minimum loan value of collateral
Borrowing limits	Varies by lender. Check with your financial consultant for details	Typically 50% of the assets’ value	Based on the loan value of eligible pledged securities, which is typically up to 70% of their current market value; bank may require a large initial advance
Maintenance requirements	N/A	Typically 30% of the assets’ market value (below which you may face a maintenance call)	Varies; Schwab Bank requires the collateral to have a loan value equal to or exceeding the greater of \$100,000 or the amount of the outstanding loans (below which you may face a demand for repayment)
Term	Typically a revolving line of credit until the draw period ends, followed by a repayment period	Revolving line of credit, meaning no set draw or repayment periods	Typically a revolving line of credit. Schwab Bank’s Pledged Asset Line remains in effect, absent a demand or termination, with no stated maturity date. It is payable immediately upon demand by Schwab Bank
Approved uses	Acceptable for most purposes, but check with your financial consultant	Any purpose	Most lawful purposes other than securities purchases or margin repayment
Ideal uses	<div>✔ Debt consolidation</div> <div>✔ Home improvements</div> <div>✔ Short- or long-term liquidity needs</div>	<div>✔ Stock purchases</div> <div>✔ Short-term liquidity needs</div> <div>✗ Long-term liquidity needs</div>	<div>✔ Bridge financing</div> <div>✔ Short- or long-term liquidity needs</div> <div>✗ Small initial borrowing need</div>

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**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 its “house” maintenance margin requirements at any time and is not required to provide you with advance written notice. You are not entitled to an extension of time on a margin call. ♦ 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. ♦ Nothing herein is or should be interpreted as an obligation to lend. Loans are subject to credit and collateral approval. Other conditions and restrictions may apply. ♦ Schwab Bank requires that the assets pledged as collateral for the Pledged Asset Line be held in a separate Pledged Account maintained at Charles Schwab & Co., Inc. (Schwab). Schwab Bank, in its sole discretion, will determine at any time the eligible collateral criteria and the loan value of collateral. Proceeds must be used for a lawful personal, commercial, or business purpose under state, federal, or other applicable law and may not be used to purchase securities, pay down margin loans, or be deposited into any brokerage account. ♦ Entering into a Pledged Asset Line and pledging securities as collateral involve a high degree of risk. At any time, including in the event that the loan value of collateral is insufficient to satisfy the minimum loan value of collateral or to support the outstanding loans, Schwab Bank may demand immediate payment of all or any portion of the outstanding obligations, or require additional cash or securities to be added to the Pledged Account maintained at Charles Schwab & Co., Inc. If a Demand is not addressed, the pledged securities may be immediately liquidated without further notice to you, which may result in tax consequences. ♦ Charles Schwab Bank, SSB, and Charles Schwab & Co., Inc., are separate but affiliated companies and subsidiaries of The Charles Schwab Corporation. Brokerage products, including the Pledged Account, are offered by Charles Schwab & Co., Inc. (Member SIPC). Charles Schwab & Co., Inc., does not solicit, offer, endorse, negotiate, or originate any mortgage loan products and is neither a licensed mortgage broker nor a licensed mortgage lender. Home lending is offered and provided by Quicken Loans LLC. Quicken Loans LLC is not affiliated with The Charles Schwab Corporation, Charles Schwab & Co., Inc., or Charles Schwab Bank, SSB. Deposit and other lending products, including the Pledged Asset Line, are offered by Charles Schwab Bank, Member FDIC and an Equal Housing Lender. **(0321-0TL4)**



# Schwab's New CD & Treasury Ladder Builder

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.

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

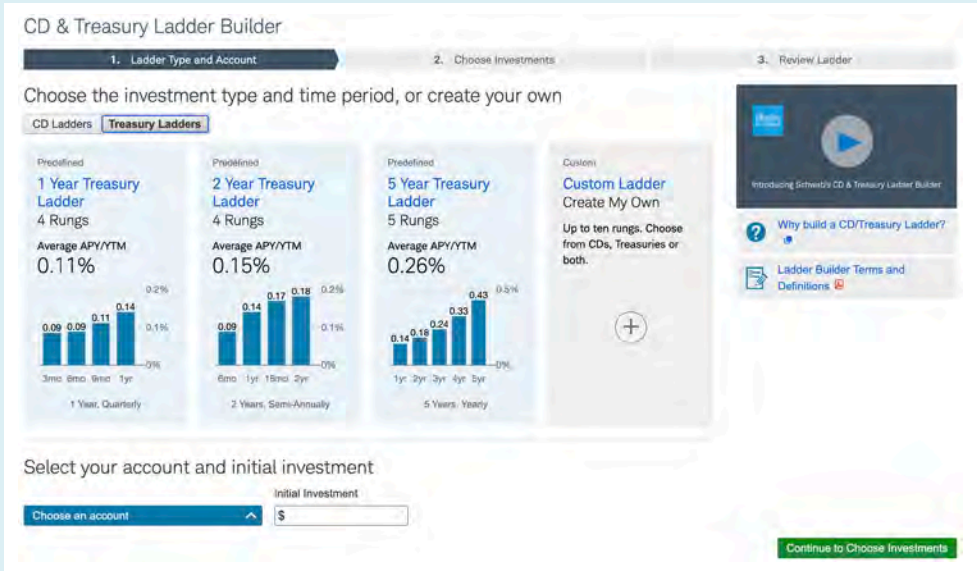
Step 1 Design your ladder

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

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

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

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

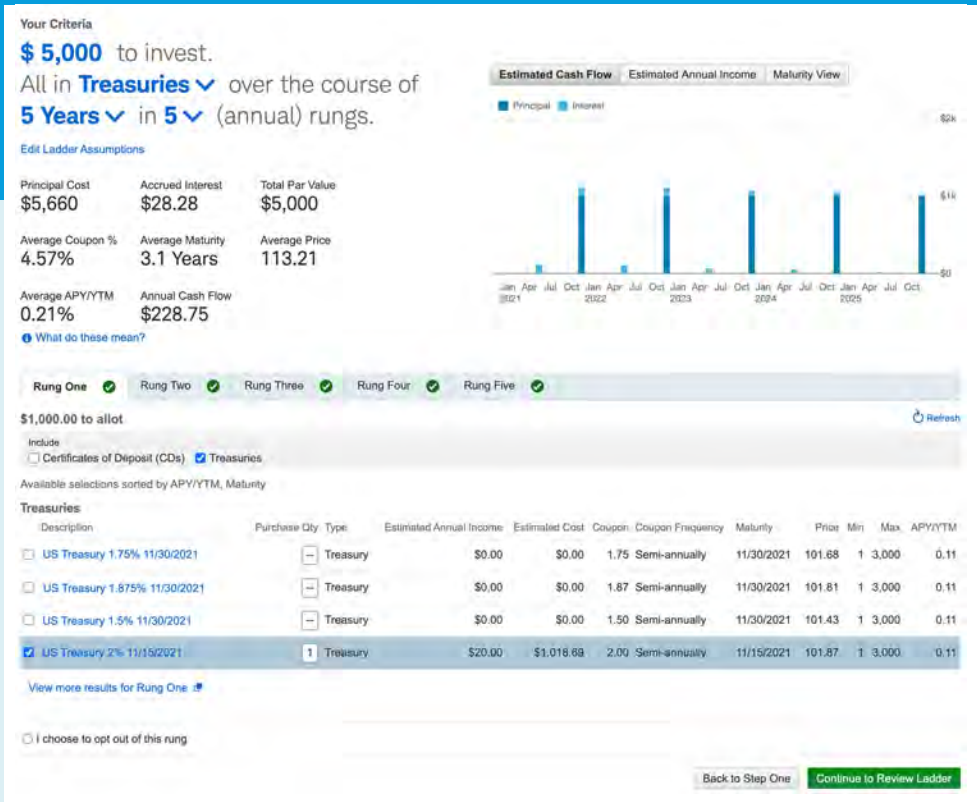


Examples provided are for illustrative purposes only and not intended to be reflective of results you can expect to achieve.

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Step 2 Choose your investments

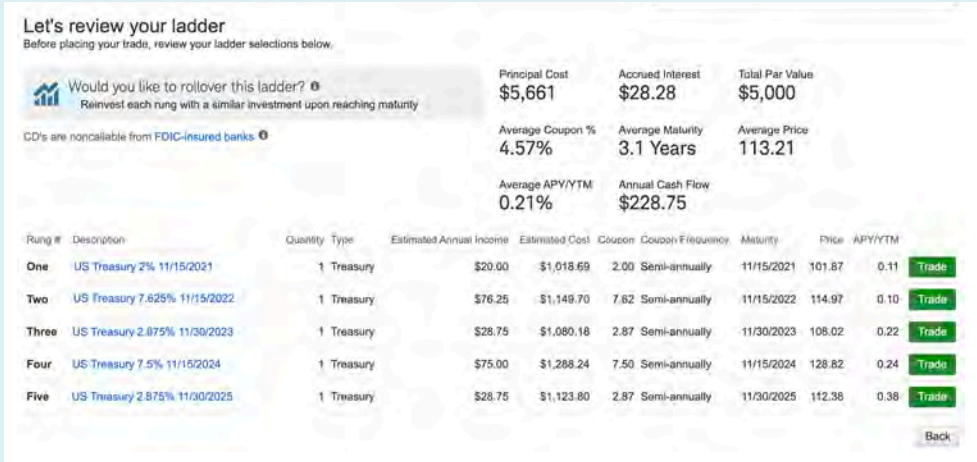
Once you've designed your ladder, the CD & Treasury Ladder Builder will provide a list of investments you can choose to be your rungs. If your ladder has five rungs, you will receive five lists of investments that meet the criteria you've set for your ladder.



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

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.



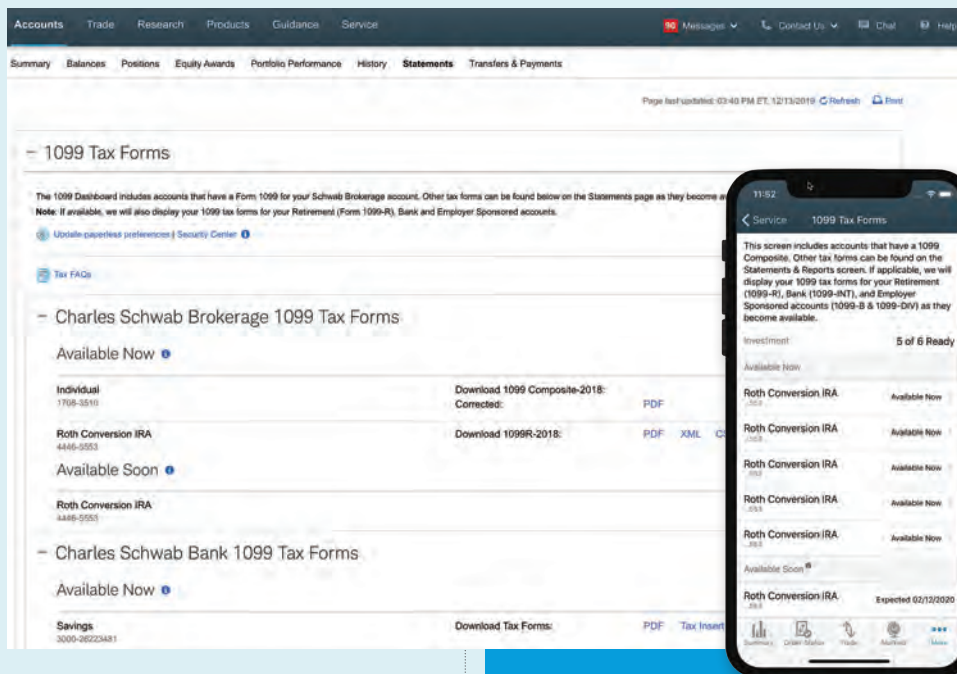
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**NEXT STEPS**  
Get started using Schwab's CD & Treasury Ladder Builder at [schwab.com/ladderbuilder](https://schwab.com/ladderbuilder).



# Schwab's 1099 Dashboard Helps Simplify Tax Season

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



On the 1099 Dashboard, you'll find:

- Expected availability dates for 1099 Composite forms for brokerage accounts that had taxable activity.
- Other tax forms as they become available:
  - Form 1099-B\*
  - Form 1099-DIV\*
  - Form 1099-INT
  - Form 1099-MISC
  - Form 1099-NEC
  - Form 1099-R
- \*For employer-sponsored accounts.
- Educational resources, including filing dates and other tax-related information.
- Quick links to easily manage paperless and security preferences.

### See page 42 for important information.

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

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

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

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



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Diversification, asset allocation, and rebalancing strategies cannot ensure a profit or protect against a loss in any given market environment. Rebalancing may cause investors to incur transaction costs and, when a nonretirement account is rebalanced, taxable events may be created that may affect your tax liability.

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International investments involve additional risks, which include differences in financial accounting standards, currency fluctuations, geopolitical risk, foreign taxes and regulations, and the potential for illiquid markets. Investing in emerging markets may accentuate these risks.

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

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## The Secret Tesla Reveals About Index Investing

How you buy the market matters.

**A**s 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

Stock	Date added to Schwab 1000 Index	Market cap (in billions USD, as of 12/31/2020)	Date added to S&P 500 Index
Tesla	02/04/2011	\$668.91	12/2020
Square	02/08/2018	\$98.14	N/A
Lululemon	02/06/2014	\$45.36	N/A
DocuSign	02/07/2019	\$41.47	N/A
Moderna	02/06/2020	\$41.34	N/A

Source: FactSet. Market cap subject to change based on current market conditions.

emotions and feelings. It's why so few actively managed investments beat indexes over time.

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

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

### Markets pick winners and losers very efficiently—but how you buy the market matters

In my view, the smart way to buy the market is through:

■ **Indexes that rely on objective criteria like market cap.** I believe the very spirit of index investing is that it should be objective, transparent, and

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

■ **Indexes that are large enough to capture the fast-growing up-and-comers earlier in their success.** The Schwab 1000 Index, for example, combines large-cap and mid-cap stocks in a single index. And it's in those second 500 stocks—the smaller end of the companies in the index—where you can find the innovative “highfliers” before they possibly become part of the S&P 500 Index. Tesla became part of the Schwab 1000 Index in February of 2011, and then continued to grow rapidly for two years to become one of the largest stocks in

the U.S. But there are many others. Companies like Lululemon, Moderna, Square, and DocuSign—none of which is in the S&P 500 Index yet.

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


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

■ [Learn more about the Schwab 1000 Index at schwab.com/1000.](https://schwab.com/1000)



Charles R. Schwab  
Founder & Chairman

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