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Leveling the Playing Field
Six new ETFs offer investors access to an innovative indexing methodology.

Everything we do as a firm is based on our belief that all investors—no matter the size of their portfolios—deserve a level playing field. When you put your hard-earned money to work, you should have access to the same types of products and solutions that institutions use every day.

Those institutional investors are increasingly seeking to improve their outcomes by diversifying their index investing with a fundamental approach. That's why our recent introduction of six new Schwab Fundamental Index ETFs is so important.

Fundamental Index methodologies represent a more nuanced approach to index-based investing. Unlike traditional market-capitalization indexing, which assigns the most weight in the index to the largest (and sometimes the most overvalued) companies, Fundamental Index methodologies screen and weight securities based on objective factors like adjusted sales, cash flow, and dividends and buybacks. As a result, Fundamental Index strategies may avoid some of the volatility that market-cap indexes tend to experience when they have particularly heavy concentrations of single stocks.

That's not to say market-cap indexing is no longer important. We believe a combination of both market-cap indexing and fundamentally weighted indexing can make sense for many investors as a way to further diversify their portfolios.

The Schwab Fundamental Index ETFs can offer investors a great way to get started with a Fundamental Index strategy, and are offered in addition to five Fundamental Index mutual funds already managed by Schwab. And because these new ETFs are part of our Schwab ETF OneSource service, Schwab clients can trade them commission-free online.

As with all our investing solutions, we developed these ETFs to help you navigate what can seem like a very challenging investing landscape. To that end, we're committed to providing advice, research, solutions and strategies designed to help you address those challenges and realize your goals.

Sincerely,

Walt Bettinger
President & CEO

“We believe a combination of both traditional indexing and fundamentally weighted indexing can make sense for many investors as a way to further diversify their portfolios.”

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Past performance is no guarantee of future results.

(1113-5792)
What Detroit’s Bankruptcy Means for Muni Bonds

Is it a sign of more to come?

When Detroit filed for bankruptcy in July 2013, some prices for municipal bonds dropped sharply amid concerns about defaults in other cities. Will more municipalities follow in Detroit’s footsteps?

Rob Williams, Director of Income Planning at the Schwab Center for Financial Research, believes that, while no muni bonds are bulletproof, Detroit’s bankruptcy filing was a matter of last resort and should be considered more broadly. “The $3.7 trillion municipal bond market is large, comprising more than 60,000 individual state and local governments, districts, authorities and other issuers,” Rob says. "Detroit is the largest US city to file for bankruptcy, so it became a headline story. But it's also an outlier, as bankruptcy remains a rare—and extremely painful—outcome for struggling municipalities.”

Although the muni bond market isn't risk-free, defaults on rated bonds generally have been confined to municipalities with the lowest bond ratings. That said, Rob believes some types of muni bonds might fare better during times of economic uncertainty. "Investors might want to consider muni revenue bonds backed by essential services like water and sewer utilities, which generally are of high credit quality and can help add diversification to a muni portfolio, all else being equal," Rob says. “Demand for these services tends to be less reliant on politics or economic conditions.”

Rob suggests sticking to highly rated bonds, particularly if you have a low tolerance for risk. "In our view, you shouldn't ignore munis altogether, especially for your bond exposure in taxable accounts,” he says. "A well-diversified portfolio could include a mix of high-quality state and local bonds, as well as essential-service muni revenue bonds.”

NEXT STEPS
Get notified when a bond’s rating changes. Log in and sign up at schwab.com/OIbondalerts.

Municipal Securities Rulemaking Board.
See page 2 for important information.
(1113-5449)
Understanding the VIX
The so-called fear index explained.

The VIX, short for “volatility index” and sometimes referred to as the “fear index,” aims to measure how much volatility investors anticipate in the S&P 500® Index during the next 30 days. It tends to rise when the stock market is turbulent and remains low when the market is calm.

Q. Why is the VIX important?
A. Some investors consider the VIX a key measure of near-term market expectations because it acts as a barometer for investor sentiment.

Q. Does the VIX affect me as a long-term investor?
A. No, the VIX is most often used as a market-timing indicator. Buy-and-hold investors are better off making trading decisions irrespective of near-term volatility.

Q. Who uses the VIX?
A. In the past, analysts and traders viewed high VIX readings as a contrarian signal to buy stocks. But in recent years, the correlation between the VIX and the S&P 500 has weakened. Many analysts and traders now use the VIX merely as a predictor of volatility, not of the market's direction.1

CALL US
For additional help and information, contact a Schwab Trading Specialist at 800-435-9050 or visit schwab.com/OItrading.

Stock Buybacks: What You Should Know
Examining the surge in stock repurchases.

In early 2013, stock buybacks were all the rage. US companies spent $208 billion repurchasing their own stocks during the first quarter of the year, putting 2013 on track to break the 2007 record, according to Birinyi Associates.1 The second quarter was just as busy, with one blue-chip technology company announcing plans for a $60 billion share buyback—the largest in US history.2

Companies decide to repurchase their shares for a number of reasons, including:

- A desire to invest excess cash.
- The potential to boost ratios like earnings per share.
- A need to cover a large employee stock-option program.
- The belief that their shares are undervalued.

On the surface, buybacks appear to be a good sign: If the company’s value stays the same or increases after the repurchase, then each share is worth more, on a relative scale, because fewer shares are in circulation. But not all companies that buy back shares are worthy of investment. Some buybacks are funded with debt, a move that could hurt during a downturn. Other buybacks may stunt reinvestment and growth by using up cash that might have been invested in beneficial ways, like research and development. And remember, just because a company announces a stock repurchase doesn’t mean it will necessarily carry it out. ■

LEARN MORE
To learn more about individual stocks, visit schwab.com/OIstocks.

1Steve Sosnick, “VIX: So Valuable, So Misunderstood,” Barron’s, May 12, 2012.

See page 2 for important information.
Past performance is no guarantee of future results.
(1113-5466)
Load vs. No-Load Mutual Funds: What’s the Difference?

Two terms to understand before you purchase mutual funds.

With a no-load mutual fund, investors are not charged a percentage-based fee by the fund for purchasing or selling shares. By comparison, load funds typically charge investors a percentage for purchasing or selling shares (front-end or back-end loads, respectively)—as much as 8.5% of your purchase price.1

But don’t mistake a load for a transaction fee, which is the cost charged by a broker to complete a trade. A broker may still charge a transaction fee on a no-load fund. Additionally, all funds, including those without loads, have operating expense ratios (OERs)—annual fees to cover things like the investment manager’s compensation, recordkeeping, taxes and more. Some funds also charge 12b-1 marketing fees, which are included in the OER. Finally, some funds may charge a short-term redemption fee if you hold the fund for less than a specified time period, often 90 days.

Other factors to consider when purchasing a fund include historical returns and portfolio turnover. Before you purchase a mutual fund, read the fund’s prospectus and do your research so you do not end up paying more in fees than you originally intended. ■

DO THE RESEARCH
To screen thousands of mutual funds by fees, performance and more, log in to schwab.com/OIfund screener.


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Why Are There Stocks in My Bond Fund?

More bond funds are turning to equities to help boost returns.

Despite a rebound earlier this year, bond yields still remain close to historic lows. To compensate and potentially increase returns, some bond fund managers have been investing more of their funds’ assets in stocks.

A total of 352 bond funds held stocks at the end of March 2013—compared with 312 three months earlier and 283 in the first quarter of 20121—representing almost one-fifth of the 1,984 taxable and non-taxable bond funds, according to the Investment Company Institute.2

Of these funds, most allocated just a few percentage points of their holdings to stocks, though in some of the more extreme cases they held as much as 20% of their assets in equities. While stocks could provide a boost to returns, they also may expose investors to a different type of risk than expected from a bond fund.

Although bond funds are only required to release their holdings on an annual basis, understanding what’s in your bond fund can help you assess whether the level of risk is right for you—or whether you should reallocate some investments. ■

LEARN MORE
View your bond fund holdings at schwab.com/OIfundscreener.


Investors should carefully consider information contained in the prospectus, including investment objectives, risks, charges and expenses. You can request a prospectus by visiting schwab.com or calling Schwab at 800-435-4000. Please read the prospectus carefully before investing. Holdings are subject to change without notice. (1113-5455)
PREDICTABLY UNPREDICTABLE

There’s no knowing what the financial markets will do. Within each asset class—stocks, fixed income, etc.—performance varies widely, as shown below. But when your investments are diversified, they can help balance each other out.

![Graph showing annual returns from 2003 to 2012]

**WHAT DOES THIS MEAN FOR YOUR PORTFOLIO?**

Your risk tolerance will largely dictate your exposure to each asset class, but you’ll want to make sure you diversify within asset classes in a way that works for you.

Conservative Allocation

- US large cap: 30%
- US small cap: 15%
- International equity: 5%
- Fixed income: 50%
- Cash investments: 5%

Moderate Allocation

- US large cap: 35%
- US small cap: 35%
- International equity: 10%
- Fixed income: 15%
- Cash investments: 25%

Aggressive Allocation

- US large cap: 20%
- US small cap: 50%
- International equity: 25%
- Fixed income: 10%
- Cash investments: 5%

**STOCKS:**
- Emerging markets
- US small cap
- US large cap
- Int’l developed markets

**FIXED INCOME:**
- High-yield bonds
- TIPS
- Core bonds
- T-bills

Source: Schwab Center for Financial Research with data provided by Morningstar, Inc. Asset class performance is represented by total returns for the following indexes: S&P 500® Index (US large cap), Russell 2000® Index (US small cap), MSCI EAFE® Net of Taxes (int’l developed), MSCI Emerging Markets IndexSM (emerging markets), Barclays US Treasury Inflation-Linked Bond Index (TIPS), Barclays US Aggregate Bond Index (core bonds: taxable investment-grade fixed-rate debt issues, including government, corporate, asset-backed and mortgage-backed securities, with maturities of one year or more), Barclays US High Yield Bond Index (high yield bonds), Citigroup US 3-Month T-Bill Index (T-bills). Returns assume reinvestment of dividends, interest and capital gains. Indexes are unmanaged, do not incur fees or expenses, and cannot be invested in directly. Performance may be affected by risks associated with non-diversification, including investments in specific countries or sectors. Additional risks may also include, but are not limited to, investments in foreign securities, especially emerging markets, real estate investment trusts (REITs), fixed income and small capitalization securities. Each individual investor should consider these risks carefully before investing in a particular security or strategy. Asset allocation strategies do not ensure a profit and do not protect against losses in declining markets. **Past performance is no guarantee of future results.** (1113-6649)

**NEXT STEPS**

Is your portfolio allocation in line with your risk tolerance? Log in and find out at schwab.com/портфельcheckup.
Dear Carrie,
I want to leave most of my estate to my children, but I also want to make meaningful contributions to a few charities. How can I best incorporate the two?

– A Reader

Dear Reader,

Building charitable giving into your estate plan is a wonderful way to extend your generosity and leave a meaningful legacy. And it’s not just for the very wealthy. In fact, there are several good ways to provide for your family while also giving to your favorite causes.

1 Make an outright gift in your will
The simplest way to include a charitable contribution in your estate is through your will.

2 Donate retirement assets
Donating a retirement account is another straightforward and tax-effective way to support a charity. You simply designate the charity as the beneficiary on your account. Because the charity is exempt from both income and estate taxes, it can receive 100% of the account’s value. You can then leave non-retirement assets, which don’t have the same income tax burden, to your children.

3 Make a split-interest gift
If you’d like to donate assets to a charity but retain some of the benefits of holding those assets, a gift of split interest might be a good option. With split-interest gifts, the donor opens and funds a trust in the charity’s name and receives a charitable income tax deduction at the time of the transfer. Opening a trust allows the donor to retain some rights to the property and also reduces the value of his or her taxable estate. In addition, the donor may be able to avoid capital gains on the assets transferred to the trust.

This may sound like it’s only for the ultra-wealthy, but it doesn’t have to be. For example, I know a couple who have been affiliated with a university for most of their lives. They met studies there, as well. Despite having fairly modest assets, this couple wanted to return to their alma mater. After careful consideration, they decided to transfer a portion of their assets into a trust that would provide them with income during their retirement years but that would ultimately pass on to the university.
Some ways to provide split-interest gifts include:

- **Charitable remainder trust (CRT):** A CRT provides either a fixed payment or a fixed percentage to the donor (or other beneficiary) every year. In either case, the amount must be at least 5% but no more than 50% of the property’s fair market value. The trust is irrevocable and must make payouts at least annually. The term can be for the life of the donor or for a set number of years. At the end of the term, the remainder goes to the designated charity. If your primary goal in setting up a CRT is to maximize the payments during your lifetime, consider whether the trust assets have the potential to appreciate. If they do, you’re better off receiving a percentage of the trust’s value every year. If you believe the assets will decline in value, you’re better off receiving a fixed payment.

- **Charitable lead trust (CLT):** A CLT is the reverse of a CRT. It provides income to a charity for a set number of years, after which the remainder passes to the donor’s heirs. It can be a good choice if you don’t need lifetime income from a particular asset. The trust is often structured to get an income tax deduction equal to the fair market value of the property transferred, with the remaining interest valued at zero to eliminate a taxable gift. Like a CRT, a CLT is irrevocable.

- **Pooled income fund (PIF):** A PIF is a trust maintained by a public charity. Individual donors contribute to the fund, which works like a CRT with the charity acting as the administrator. As with a CRT, the donor receives income during his or her lifetime. After the donor passes away, control of the funds goes to the charity. Contributions to a PIF qualify for charitable income, gift and estate tax deductions. A PIF doesn’t require the legal expense of creating an individual trust.

**Talk to your kids**

While including a charity in your estate plan is commendable, it’s wise to share your intent with your kids ahead of time so they understand your reasoning. I always recommend openly discussing your estate plan with your family so there are no surprises when inheritances are distributed. In the case of giving to charity, you’re not only talking about money, you’re talking about creating a legacy. This may be something your kids will not only admire, but also want to carry on.

Carrie Schwab-Pomerantz, CFP®, is President of Charles Schwab Foundation and Senior Vice President of Schwab Community Services at Charles Schwab & Co., Inc.

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**Consider a donor-advised fund**

One of the best-kept secrets for making the most of your giving—both during your life and as part of your estate—is a donor-advised fund. You can open this type of account with a tax-deductible contribution and then make grants to any public charity over time. You can contribute a variety of tax-deductible assets, including appreciated securities, real estate and cash.

While many people think of a donor-advised fund as a tax-smart way to give during their lifetime, they may not realize that it can also support estate and legacy planning. You can make the account the beneficiary of a will, retirement account, and/or trust to help reduce your taxable estate while continuing your giving beyond your lifetime. Plus, it’s easy. The fund sponsor, such as Schwab Charitable™, handles all the administrative details. You can even get your kids involved by naming them as successors on your account.

See page 2 for important information.

A donor’s ability to claim itemized deductions is subject to a variety of limitations depending on the donor’s specific tax situation. Consult your tax advisor for more information.

Contributions of certain real estate, private equity or other illiquid assets are accepted via a charitable intermediary, with proceeds of your donation transferred to your donor-advised account upon liquidation. This intermediary considers donations on a case-by-case basis, and assets typically must be valued at $250,000 or more. Call the Fund for more information at 800-746-6216.

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(1113-5457)
Sectors to Watch as Business Confidence Improves

Some business-reliant sectors may be poised to outperform.

By Brad SorenSen

Ever since the financial crisis of 2008, businesses’ confidence in the economy has been depressed, if not downright absent at times. One measure of this malaise is the monthly Index of Small Business Optimism produced by the National Federation for Independent Business (NFIB). It shows that small- and independent-business owners have been down on the economy’s prospects since 2007.

While consumer confidence readings can send mixed signals, we believe business confidence gauges have closer ties to real-world conditions. The logic is pretty simple: The more confident a business is in the economy’s future, the more likely it is to hire new employees, take more risks and invest in capital improvements. And, at least where employment is concerned, recent history has shown a pretty decent correlation between the index’s movement and the direction of job growth.1

During the past several years, though, businesses have remained quite reluctant to take on new employees or spend mounting cash reserves. Who could blame them? The depressed housing market morphed into a full-blown recession, a debt crisis emerged in Europe, markets bounced from one crisis to the next—and, to top it all off, government budget battles continue to create fiscal uncertainty. Not exactly confidence-inspiring.

This makes it all the more remarkable that recent optimism index readings suggest business confidence may be starting to improve. The NFIB’s Index of Small Business Optimism, while somewhat volatile this year, rose 6.1 points through July—to 94.1—and also reached its second-highest level since the recession started in 2007. We’re still a long way from the index’s average reading of 100, but at least the index appears to be moving in the right direction.

We’ve seen some positive developments recently that may be behind these modest increases in business confidence. Sequestration chatter has slowed to a simmer in Washington, Europe’s situation is steadily improving and US consumers have shown continued resilience. Barring any unforeseen shocks, this situation bodes well for business spending in the months ahead.

Given these positive signs, we believe two business-reliant sectors—information technology and industrials—could see a boost if businesses start opening their checkbooks.

Information technology

With large cash balances, increasing dividend payouts, solid management and tight inventory controls, the tech sector appears far more stable than it was during the tech bubble of the late 1990s. We believe this stability was one of the reasons to stick with the sector during the recent downturn.

Tech also appears better positioned than other sectors to benefit from a rebound in business spending. Many companies underinvested in technological improvements during the past couple of years but likely won’t be able to hold off for much longer.
during the past couple of years but likely won't be able to hold off for much longer.

**Industrials**

Although the global manufacturing picture still remains a bit murky, there are several reasons why industrials could be headed higher in the months ahead:

- Many corporate balance sheets include excess cash reserves, which could help push management to invest in new, more-efficient equipment and offset production losses due to layoffs.
- Companies wanting to hold on to cash while economic uncertainty lingers will be able to take advantage of easier access to credit.
- Inventories in the sector remain relatively low, meaning that any boost in demand will have to be met by increases in production.

For all the attention paid to consumer purchasing patterns, changes in business sentiment are important to monitor as they can point to attractive investing opportunities. Right now at least, improving spirits among business leaders point to possible outperformance for tech stocks and industrials.

*Brad Sorensen, CFA, is Director of Market and Sector Analysis at the Schwab Center for Financial Research.*


**See page 2 for important information.**

Past performance is no guarantee of future results.

(1113-5475)
How Can I Include Fundamental Strategies in My Portfolio?

Find out how to build a smarter portfolio with fundamental strategies.

BY ANTHONY B. DAVIDOW

The first generation of exchange-traded funds (ETFs), developed in the early 1990s, offered investors a cost-effective, tax-efficient way to gain market exposure by attempting to mimic popular market-capitalization indexes like the S&P 500® Index.

As ETFs evolved, though, index providers sought to provide more innovative indexing strategies. Notable among these was the development of the Fundamental Index® Series, pioneered by Robert Arnott and his colleagues at Research Affiliates®.

Fundamental strategies select and weight stocks by “fundamental factors”—financial metrics, such as sales, cash flow and dividends—that measure a company’s economic value. These factors provide another way to assess a stock’s worth in the marketplace, rather than just looking at size like traditional market-cap strategies.

Indeed, fundamental strategies can serve as an effective complement to market-cap strategies and active management, helping to create more attractive risk-adjusted portfolios. “Fundamental strategies can serve as an effective complement to market-cap strategies and active management, helping to create more attractive risk-adjusted portfolios.”

Integrated approach

Schwab believes that passive strategies that use market-cap and fundamental weights should be used together with active management in building portfolios. Here are the nuts and bolts of each:

- **Market-cap strategies:** Most major stock indexes are market-cap weighted—that is, stock weights are based on market capitalization, which is calculated by multiplying the price of each stock by its number of shares outstanding. This means the largest company by market capitalization has the largest weight in the index. The primary appeal of market-cap strategies is their ability to provide cost-effective exposure to the broad market.

- **Active management:** Active managers of mutual funds generally seek to outperform their funds’ benchmarks. For example, a large-cap manager may be benchmarked to the S&P 500, which tracks large-cap companies. Active managers have greater flexibility and adaptability in responding to changing market conditions, so investors may benefit from increased returns and/or reduced risks. However, most managers have not been successful in outperforming their benchmarks over multiple and varying time periods, particularly after accounting for fees.

- **Fundamental strategies:** Like market-cap strategies, fundamental strategies can provide broad-based market exposure, but they select and weight securities based on financial metrics that assess some aspect of a company’s business or payout to shareholders—like sales, cash flow and dividends.

How to allocate

The Schwab Center for Financial Research has identified four key levers to consider if you’d like to allocate amongst active, market-cap and fundamental strategies.

- **Tracking error**—the difference between a fund’s return and that of the benchmark selected for comparison purposes.

- **Loss aversion**—your desire to avoid losses. Academic research has shown that investors react far more strongly to losses than gains.
In fact, the pain of loss is about twice as intense as the euphoria of gain.1 (For more on this phenomenon, see Greg Forsythe’s “Loss Aversion: Friend or Foe?” on page 14.)

- **Alpha**—a measure of excess return. Comparing an investment’s risk-adjusted performance to that of a benchmark index yields its alpha.
- **Expenses**—or total costs—an important consideration for investors.

Now let’s apply these levers to our three types of strategies—market-cap, fundamental and active management.

- **Market-cap strategies** are primarily used to gain low-cost exposure to the market. They generally experience little or no tracking error, although fees would incur a small drag. However, they do not offer the potential for either downside protection or alpha.
- **Fundamental strategies** can also provide cost-effective exposure to the markets, plus they have historically delivered alpha. However, they tend to have a higher tracking error relative to market-cap strategies.
- **Active managers** claim skill and insights not readily available in the marketplace. For example, they may point to their abilities to analyze companies’ financial statements and find an edge in understanding a company’s growth potential. They seek to deliver alpha as well as downside protection, but they may not accomplish their goals and they are also likely to exhibit tracking error.

Depending on your sensitivity to each lever, you might overweight or underweight your allocations across active management, market-cap or fundamental strategies.

### HOW TO PERSONALIZE YOUR PORTFOLIO

Depending on your sensitivity to these four levers, you may want to overweight or underweight these three strategies.

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<th>Market-cap</th>
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Source: Schwab Center for Financial Research.

### Ask yourself:
- **Are you just concerned with tracking a common market index?** If yes, then a larger allocation to market-cap may be for you.
- **Do you have time to devote to finding superior active managers?** If yes, then you could allocate a larger percentage to active management.
- **Are you looking for cost-effective market exposure with the potential for alpha?** If yes, then you could allocate more to fundamental strategies.

### Tailor your portfolio

Schwab believes that portfolio construction should incorporate elements of art and science. So keep in mind the four levers—tracking error, loss aversion, alpha and expenses—and your sensitivity to them, when reviewing your portfolio. 

Anthony B. Davidow, CIMA®, is Vice President of Alternative Beta and Asset Allocation Strategist at the Schwab Center for Financial Research.

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See page 2 for important information.

Investors should consider carefully information contained in the prospectus, including investment objectives, risks, charges and expenses. You can request a prospectus by calling Schwab at 800-435-4000. Please read the prospectus carefully before investing.

Some specialized exchange-traded funds can be subject to additional market risks. Investment returns will fluctuate and are subject to market volatility, so that an investor’s shares, when redeemed or sold, may be worth more or less than their original cost. Unlike mutual funds, shares of ETFs are bought and sold at market price, which may be higher or lower than the net asset value.

Past performance is no guarantee of future results.

Fundamental Index is a registered trademark of Research Affiliates, LLC.

(1113-5660)
Loss Aversion: Friend or Foe?

Can attempting to limit losses actually result in more losses?

BY GREG FORSYTHE

Warren Buffett, perhaps the greatest investor of our time, once advised investors, “Rule number one: Never lose money. Rule number two: Never forget rule number one.” Investing always involves the risk of loss, so never losing money is unrealistic. I take Buffett’s quote to mean that conducting thoughtful research before making an investment decision may help reduce the probability of subsequent losses. But can too much focus on losses potentially lead to poor investment decisions?

What is risk?

In the investment world, risk is generally measured in terms of price volatility. By contrast, Webster’s dictionary defines risk as “the chance of injury, damage or loss.” While seemingly different, these definitions of risk have some overlap. Investments with more volatile prices, such as stocks, are more likely to generate losses than investments with more stable prices, such as bonds. This risk tends to be particularly acute for short periods of time.

But measuring risk as volatility has its drawbacks: Volatility ignores trend. Buffett also once said, “I’d rather have a lumpy 15% return on capital than a smooth 12%.” He meant to emphasize the fact that an average return of 15% compounds to far more wealth over time than does a 12% average return.

But more importantly, volatility ignores direction. Up and down price changes are treated equally in computing volatility, so a stock that steadily falls in price would be deemed no more risky than a stock that steadily rises in price. Not only does this “equal” risk assessment defy common sense, it’s also inconsistent with human behavior.

Gains vs. losses

Finance theory accepts that investors may have different risk tolerances, but assumes that investors prefer more return per unit of risk or less risk per unit of return. Behavioral finance research has found that people weigh the prospect of loss much more heavily than they do the prospect of gain. Investors aren’t just risk-averse—they are extremely loss-averse.

In his best-selling book, Thinking, Fast and Slow, Nobel Prize winner Daniel Kahneman offers many examples of loss aversion at work. Let’s take a look at two of these scenarios.

First, imagine you are offered the opportunity to flip a coin one time. You win $150 if you call heads or tails correctly, but you pay $100 if you are wrong. Would you flip the coin? If you said no, you’re in good company. Despite equal odds, most people refuse to play because the prospective pain of losing $100 outweighs the potential thrill of winning $150.1

Second, let’s look at how loss aversion can influence our perception of a situation. Consider the following two gambles. The first requires you to pay $5 for a lottery ticket with a 10% chance of winning $100 and a 90% chance of winning nothing. The second offers you a 10% chance to win $95 and a 90% chance of losing $5. Note that these two gambles are equivalent—you’ll end up either $95 richer or $5 poorer. But far more people are willing to take the first gamble than the second because the second gamble more vividly describes what we often sell winners too soon because we’re afraid they might drop and become losers.

“Friends” vs “foes”

Loss aversion can be a powerful friend or foe. It encourages investors to hold on to losing investments too long and to sell winners too quickly. The “disposition effect” and is attributable to excessive loss aversion. In his best-selling book, The Psychology of Money, Dr. Barbera offers many examples of loss aversion at work. Let’s take a look at two of these scenarios.

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equivalent—you’ll end up either $95 richer or $5 poorer. But far more people are willing to take the first gamble than the second because the second gamble more vividly describes what they might lose.  

The truth about loss aversion
Given Buffett’s admonition to “never lose money,” you might conclude that having a strong sense of loss aversion would make you a better investor. Maybe, and maybe not. Although successful investing requires thoughtful consideration of downside risk relative to upside potential, excessive loss aversion might deter an investor from venturing beyond bonds or certificates of deposit, even though both have historically underperformed stocks over time.

A subtler—but still dangerous—threat to long-term wealth accumulation is being unaware of how loss aversion can repeatedly trigger sub-optimal decisions. For example, researchers have found that investors tend to sell too quickly those stocks that have gone up in price and hold on too long to stocks that have dropped in price. This behavior is called the “disposition effect” and is attributable to excessive loss aversion.

We often sell winners too soon because we’re afraid they might drop and become losers. Conversely, we hold losers too long because we hate to realize losses and cling to the hope that the stock might eventually become a winner. Taking gains quickly might seem like a reasonable strategy, but researchers have found that the stocks investors sell significantly outperform those that they buy over the following year.

Rules of engagement
Limiting losses is a key element of any successful investment strategy. But so is avoiding mistakes that stem from loss aversion. Here are some suggestions to help avoid mistakes:
Have realistic risk expectations. Understand that no investment is risk-free and that you will lose money some of the time. If the stock market falls 20%, your equity portfolio almost certainly will be down, too. Even investments with little price risk, such as Treasury bills, expose you to the risk of not keeping up with inflation.

Develop a sound strategy. Whether you use an advisor or invest on your own, employ an investment strategy that is consistent with your goals and risk tolerance. A strategy that you fully understand and believe in is much easier to stick with through those inevitable losing periods.

Avoid volatile investments. Securities with volatile prices are more likely to show large short-term losses, potentially triggering emotions that lead you to “buy high and sell low,” or to hang on to a losing investment whose fundamentals have deteriorated. Some good news for stock investors: Research has shown that less-volatile stocks have historically provided higher long-term returns than more-volatile stocks.4

Have a sell discipline. Before making an investment, decide what events would make you want to sell that investment in the future. If one of those events occurs, sell the investment regardless of whether you have a gain or loss. Also consider getting some independent advice.

For example, stocks rated D or F by Schwab Equity Ratings® have historically underperformed the average-rated stock by a wide margin, so selling poorly rated stocks could be a sound strategy.

Focus on portfolio performance, not individual positions. A diversified portfolio is designed to hold investments that zig and zag at different times, which means you’ll almost always have some losing positions. For example, a solid stock selection strategy in which 60% of the individual stock picks outperform in an average one-year period also means 40% of the stock picks underperform. That may sound like a lot of underperformance, but our research shows that, due to the effects of diversification, a portfolio of 20 such stocks has less than a 25% probability of underperforming in the average year.5

Don’t evaluate your investment portfolio every day. The more often you look at your portfolio, the more likely you’ll see something going down in price and expose yourself to loss-driven emotions. During the past 75 years, the S&P 500® Index has been down in 46.2% of all days, but that falls to 40.0% when you look at all months and only 29.8% when you look at all years.6

Greg Forsythe, CFA, is Senior Vice President of Schwab Equity Ratings at the Schwab Center for Financial Research.

See page 2 for important information.
Past performance is no guarantee of future results.
(0913-3083)
How Investors Can Learn From Schwab’s Trading Coaches

Want to learn more about trading tools or concepts? Schwab’s Trading Solutions Regional Managers can help.

As an engineer, Jerry Morrow spent much of his life concerned with the structure of things. So when he retired eight years ago and became focused on trading, it surprised him to find that his buy-and-sell discipline wasn’t much of a discipline at all, but rather a series of emotional decisions. If he was interested in a particular stock, he would continue to buy it into a downtrend, convinced that it would soon turn the corner. “I gave away a lot of money by making the wrong decisions,” Jerry says.

That was before he met with Christophe Levasseur, a Schwab Trading Solutions Regional Manager (TSRM) at a Schwab trading seminar near Jerry’s home in Houston.
The two have met at least 10 times since then to delve deeper into trading strategies and technical analysis indicators. Christophe taught Jerry how to set up trades so he could position himself to buy into a potential uptrend, and how to loosen his trailing stop orders to prevent being pushed out of a position too soon.

“One of the first things he told me was, ‘You have to stop using emotion in your investing,’” Jerry recalls. “I wasn’t making much money for all the effort I put in. Without Christophe’s suggestions, I would not be trading today.”

Christophe is one of 16 TSRMs who canvas the country, helping clients understand advanced trading concepts and the tools available to them through Schwab. TSRMs come from diverse backgrounds—their ranks include Chartered Financial Analysts®, Chartered Market Technicians®, Certified Financial Planners® and Accredited Asset Manager Specialists®—which means they’re ready to assist clients with a multitude of trading subjects.

**One-on-one time**

TSRMs visit most branches in their region every four to six weeks, leading seminars on subjects that include stock selection strategies, technical analysis, income generation and risk management.

After each seminar, TSRMs set aside time to meet with clients individually. The team conducts more than 3,000 one-on-one consultations each year, either in the branches or at clients’ homes or offices.

Virginia Benzier, a retired marketing executive living in the Atlanta area, has continued to call on TSRM Michael McCrary since she attended one of his training seminars on technical analysis eight years ago.

“My background was as a buy-and-hold investor, and I wanted to learn technical aspects to help me decide when to sell and take profits,” Virginia says. “Michael helped me better understand trading, which is why I have stayed in touch with him all these years.”

Sample questions TSRMs can answer for you

- What are the elements of a sound risk management strategy?
- What technical analysis indicators make sense for my investing time horizon?
- How do I adjust a trailing stop order to account for the volatility of an individual stock or the market?
- How can the tools available in StreetSmart Edge® help speed up my workflow processes?
- What’s the best way to organize my StreetSmart Edge layout based on my specific needs?
“In today’s world, if you’re not getting better, then you’re probably falling behind. I needed help from someone who could get me up to speed in a hurry.”

—HARRY ABERNATHY, SCHWAB TRADING CLIENT

Michael’s meetings with Virginia have since addressed other topics such as selecting exchange-traded funds (ETFs). Virginia was so impressed with Michael’s input on ETFs that she recently asked him to give a presentation on the subject at her women’s investment club. “I haven’t been able to find this level of support anywhere else,” she says.

**Getting up to speed**

Being a trader can sometimes feel like being alone on an island. Although you might enjoy the autonomy and freedom from distraction, sometimes you could use assistance. The tools and guidance TSRMs provide can help traders tackle the challenges involved in striking out on their own.

Sometimes, this guidance can be very technical in nature. Harry Abernathy of Plano, Texas, needed help customizing his screen layout in StreetSmart Edge. He had just migrated from StreetSmart.com® and was unfamiliar with the more sophisticated tools available in StreetSmart Edge. His Schwab Financial Consultant referred him to Christophe.

“In today’s world, if you’re not getting better, then you’re probably falling behind,” Harry says. “I needed help from someone who could get me up to speed in a hurry.”

Christophe met with Harry at the Schwab branch in Plano, focusing first on Harry’s trading habits before helping him design a customized layout and loading it into the Edge software on his laptop. “Christophe was interested in what my goals were and specifically addressed my needs,” Harry says.

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Schwab StreetSmart Edge is available to Schwab Active Trading clients. This offer may be subject to additional restrictions or fees, and may be changed at any time.

The testimonials herein may not be representative of the experience of other clients and are not a guarantee of future performance or success.

(1113-5462)
When did you last evaluate your investments and performance?

GEARING UP FOR THE NEW YEAR

Just as your car needs routine maintenance to keep it running smoothly, your finances also can benefit from a regular tune-up. The end of the year is the time when most of us sit down to make any adjustments to our portfolios to address our tax liability. It’s also a good time to review the performance of your investments.

But don’t wait until the holiday crunch to get started, cautions Rande Spiegelman, Vice President of Financial Planning at the Schwab Center for Financial Research. “Investors stressed about tax time can take heart in the fact that there is plenty they can do before the end of the year to help minimize the pain of April 15,” Rande says. “But the earlier you begin the process, the better.”

He offers four areas to focus on, and some of them go hand in hand.
1 TAX-SMART PORTFOLIO PLANNING

Start your financial review by considering any changes that took place during the year that could affect your tax situation. Maybe you got a new job, refinanced your mortgage or had some additional income from a side business. If so, you might need to adjust your W-4. The IRS website has worksheets you can use to help determine if you’re withholding enough.

Investments also should be part of your tax review, and the end of the year is a good time to revisit your portfolio and decide whether to sell and redeploy the cash. If you have any depreciated assets, you might be able to deduct some of those losses through a process known as “loss harvesting,” which offsets any investment gains with losses and could potentially reduce your tax bill.

“No one likes a losing investment, but at tax time, losses can be blessings in disguise,” Rande says.

In some cases, the money freed up from selling a losing position can help you buy something else. You’re selling lower than you bought, but you also might be buying low, and getting a tax break in the process. The goal is to reposition your portfolio to match your risk tolerance and time horizon.

When harvesting losses, Rande says investors need to beware the “wash sale” rule. If you sell a security at a loss and buy the same or a “substantially identical” security within 30 days, you generally won’t be able to claim that loss for income tax purposes in the current period.

As you decide which positions to hold or sell, keep your long-term asset allocation in mind. Stick to your strategy and maintain the balance of investments that best meets your investment needs.

Selling a losing position may put your portfolio off balance, so you’ll need to consider other purchases or sales to bring it back in line with your long-term targets.

Loss harvesting aside, retirees should also consider combining cash flow planning for the year ahead with their current year-end portfolio rebalancing. Consider taking some or all of the cash you’ll need for the next year as you adjust your asset allocation.

WHAT YOU CAN DO
Use the Portfolio Checkup tool to determine if your portfolio is in line with your target asset allocation. Log in to schwab.com/Portfoliочeckup to get started.

2 RETIREMENT SAVINGS

If you’re enrolled in a 401(k) or other workplace-sponsored retirement plan and are eligible to contribute but haven’t done so this year, you have until December 31. The deadline for 2013 IRA contributions is April 15, 2014, but Rande says it’s best to get your money working for you as soon as possible.

If you’re self-employed and you haven’t started a retirement plan, you have until year’s end to set up a one-participant (“solo”) 401(k), or until your business’s 2013 tax return due date (including extensions) to set up a SEP-IRA. Contributions are tax-deductible, and savings grow tax-deferred. You can make this year’s contribution at any time up until the due date for your 2013 tax return next year, plus extensions.

For investors 70½ or older, don’t forget your required minimum distributions (RMDs), which must be taken from your IRA by the end of the year. If you miss this deadline, you could end up paying a penalty equivalent to 50% of the amount you were supposed to take out. For those who turned 70½ in 2013, you have until April 1, 2014, to take your first distribution, but delaying means you’ll need to take two distributions in 2014, which could potentially increase your total income for the year and affect your tax status.

A donor’s ability to claim itemized deductions is subject to a variety of limitations depending on the donor’s specific tax situation. Consult your tax advisor for more information.

2013 retirement plan contribution limits

- 401(k), 403(b) and 457(b) plans: $17,500, plus an additional $5,500 “catch-up” contribution if you’re 50 or older (if permitted by the plan).
- Solo 401(k): The business owner is both the employee and employer, and can contribute to the plan in both capacities.
- Traditional and Roth IRAs: $5,500, plus an additional $1,000 catch-up contribution if you’re 50 or older.
- SEP-IRA: 20% of your net adjusted self-employment income,* with a net-adjusted maximum contribution limit of $51,000.

*See the IRS website for more information.
For investors 70½ or older, don’t forget your required minimum distributions (RMDs), which must be taken from your IRA by the end of the year, plus extensions. If you're enrolled in a workplace-sponsored retirement plan and are eligible to contribute but haven’t started a retirement plan, do so this year. You can make this year's contribution tax-deductible, and savings grow tax-deferred. You can make this year's contribution at any time up until your business's 2013 tax return next year, plus extensions. If you haven't started a retirement plan, setting one up is a good idea to compare state plans, especially if you live in a state with no deduction or one with no state income tax, Rande says.

People saving for a child's education should consider two tax-advantaged plans as part of their year-end tax planning: Coverdell Education Savings Accounts (ESAs) and state-sponsored 529 plans.

A Coverdell ESA allows you to contribute as much as $2,000 annually for a child's educational expenses, depending on your income. There's no tax deduction, but contributions qualify for the annual gift-tax exemption. Plus, you have until April 15 of next year to make this year's contribution. Like a Coverdell ESA, a 529 college savings plan doesn't come with a federal tax deduction, although some states allow you to deduct contributions from your state income tax. Additionally, the annual contribution limit for a 529 is much higher than an ESA. Also like a Coverdell, 529 contributions are eligible for the gift-tax exemption. However, not all 529 plans are alike and some provide additional benefits to in-state residents.

"It’s a good idea to compare state plans, especially if you live in a state with no deduction or one with no state income tax," Rande says.

WHAT YOU CAN DO
Schwab offers several college savings accounts to fit your needs. Learn more at schwab.com/collegesavings.

WHAT YOU CAN DO
Learn more about tax-smart giving with a Schwab Charitable donor-advised fund account at schwab.com/schwabcharitable.

YEAR-ROUND VS. YEAR-END
After you decide what to do this year, resolve to make financial planning a year-round exercise going forward. "The earlier you start, the easier it will be to check your progress, update your plan, and, if necessary, take action," Rande says.

See page 2 for important information.

Schwab Charitable is the name used for the combined programs and services of Schwab Charitable Fund, an independent nonprofit organization. The Fund has entered into service agreements with certain affiliates of The Charles Schwab Corporation. A donor's ability to claim itemized deductions is subject to a variety of limitations depending on the donor's specific tax situation. Consult your tax advisor for more information.

(1113-5453)
How much risk would you be willing to take in exchange for a 5% return? It’s a question investors didn’t need to worry about just a few years ago. Back in 2007, before the most recent financial crisis, investors could get a 5% return on a 10-year US Treasury bond. As recently as 2010, an investor could have realized a 5% yield in an investment-grade corporate bond.
But these relatively low-risk investment choices lost their luster after the Federal Reserve took measures to reduce short-term interest rates to near zero. Since then, investors have been waiting for any sign that the Fed might allow rates to drift upward.

That sign came this spring when Fed officials announced that they would begin to "taper" their bond purchases. Yields on Treasuries shot up, with the 10-year Treasury rising to 2.74% in August, its highest level since July 2011 and an increase of nearly one percentage point from four months earlier.¹

As a result of the big move, many investors are wondering if those 5% yield levels of yesteryear could be coming back.

"One of the most common questions I get is, 'Where can bond investors find 5% yield without assuming too much risk?'" says Kathy Jones, Fixed Income Strategist at the Schwab Center for Financial Research. "Unfortunately, I don't think they can."

Kathy says that for fixed income investors to get 5% yields now, they’d have to buy sub-investment grade bonds (also called "high-yield" or "junk" bonds) or move into riskier sectors of the market. And, while it does seem likely that interest rates will rise some during the next few years, it could take much longer before they climb back to the 5% level.

"We believe the road to higher rates is going to be long and winding," Kathy says. She delineates three distinct phases for bond yields as they begin to climb.

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**Investments worth considering in today’s low-rate environment**

Kathy Jones believes that rather than staying out of the bond market entirely, it may make sense for investors to limit their exposure to long-term bonds, consider using bond ladders, and look at adding high-quality, investment-grade corporate bonds and municipal bonds.

- **A bond ladder** allows an investor to earn interest income regularly but offers the flexibility to reinvest the proceeds of maturing bonds if rates increase. By spreading out maturities, the ladder keeps the average duration—a bond’s price sensitivity to changing interest rates—in the intermediate range while still including some longer-term bonds that generate more income.

- **Adding investment-grade corporate bonds** to your portfolio can be another way to diversify and potentially generate incremental yield. Kathy says that the corporate sector appears to be in good shape, with less debt relative to earnings and higher levels of cash than in the past. The risk is that investment-grade corporate bonds tend to underperform Treasuries when the economy weakens. Additionally, the performance of some individual bonds may be negatively affected by corporate events such as mergers and acquisitions.

- **Current valuations on municipal bonds** are reasonable, says Kathy. The average yield on investment-grade muni bonds is more than that of Treasuries—meaning, on an after-tax basis, investors are typically getting more income from quality munis than from Treasuries with comparable maturities.

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TAPERING

In the first phase, Kathy expects the Fed to begin paring back its bond-buying program. Many analysts believed this would start as early as September, and were surprised by the Fed’s announcement to “await more evidence that progress will be sustained before adjusting the pace of its purchases.” However, in June, just the hint of the Fed shifting its policy was enough for yields to increase, suggesting that, once the Fed does begin to pull back on its bond purchases, yields will trend higher.

How high can rates go in the first phase? Kathy thinks that 3% is a pretty safe guess.

RISING RATES

In the second phase, the Fed will begin raising short-term interest rates gradually, though this could take a while to develop. In fact, Kathy believes it could be 2015 before we see the first increase in interest rates. Once the Fed starts raising rates, it will set additional increases based on how quickly the economy is growing and whether inflation is accelerating. Assuming both factors increase gradually, it could take a few years to bring rates up to the 4% level.

SUMMITING

The third phase on the road to higher rates will likely occur when the Fed begins to sell the bonds it has accumulated in recent years. The central bank doesn’t have to sell these bonds—like any investor, it can hold the bonds in its portfolio until they mature. But Kathy thinks the Fed will at least reduce its holdings if economic growth accelerates, which should spark a rise in long-term rates—perhaps back to the elusive 5% level.

It’s worth noting, Kathy says, that 10-year Treasury yields of 5% are fairly uncommon. Since 2003, 10-year Treasury yields have exceeded 5% only twice: in 2006 and 2007. And in those two years, 5% Treasury yields lasted only a few weeks.

While it may be several years before we see 5% yields on 10-year Treasuries, a move up to 3% or even 4% during the next few years would not be out of line with historical valuations. “Don’t sit on the sidelines waiting for the 5% plateau,” she says. “Staying sidelined means missing out on the potential to earn income and reinvest it over time.”

NEXT STEPS

Need help reviewing your bond portfolio? Call 877-908-1072 to speak with a Schwab Fixed Income Specialist.


See page 2 for important information. Past performance is no guarantee of future results.

(1113-5521)
Retirees have always feared outliving their savings, which raises the question: How much can you safely spend in retirement? William Bengen, a financial planner, tried to answer that question in the early 1990s, and in studying 30-year retirement periods since 1926, he created the “4% rule,” which works like this:

**TIPS FOR MAKING YOUR PRECIOUS RETIREMENT SAVINGS LAST.**

**Year one:** Withdraw 4% of your portfolio.

**Each year thereafter:** Withdraw the previous year’s dollar amount, plus enough to account for inflation.

If you do this, and stay invested in an appropriate mix of stocks, bonds and cash, it’s likely that your money will last for 30 years or more in retirement. Bengen’s 4% rule quickly became a cornerstone of retirement planning. But recently it has come under fire.
We've been in a prolonged period of low interest rates. Even if rates continue to inch up, we're likely to remain in a low-yielding environment in the near term, given the slowly growing economy and low rate of inflation. Also, expectations for future stock and bond returns are lower.

**When the 4% rule makes sense**
The 4% rule is most helpful as a target for how much you need to save for a comfortable retirement. That is, we believe you should save enough so that you could comfortably spend 4% of your portfolio in the first year of retirement, after accounting for other income sources like Social Security or a pension. Another way to think about this is to aim for a portfolio that's approximately 25 times the amount of money you'll need in the first year of a 30-year retirement. (For more on this, see “4 steps to using the 4% rule as a target for savings” below.)

Calculating your retirement spending, however, requires a more nuanced approach. “The 4% rule is a good starting point for how much you can safely withdraw from your portfolio in the first year of retirement,” says Rob Williams, Director of Income Planning at the Schwab Center for Financial Research. “But you should adjust your spending strategy based on current economic conditions, as well as your age and unique circumstances.”

This is particularly true for people nearing and in retirement, says Rob, because retirees may face lower investment returns in the coming years. Schwab projects that stocks and bonds will have lower returns during the next 20 years than they did in the previous 20 years. As a result, a lower spending rate may be more appropriate. “But that's only if you want a rigid rule for spending,” says Rob, “and require a high degree of confidence that your money will last.”

**The confidence factor**
“It's all about confidence, and how you balance spending early in retirement with needs later in retirement,” says Rob. How confident do you want to be that you won't outlive your savings? The 4% rule is generally described as giving you a 90% likelihood that your assets will last as long as you do. This probability is another one of the criticisms of the rule. “Ninety percent is a very high likelihood of success—so high that you could end up overestimating your needs,” says Rob. “For planning purposes, you may be comfortable with a lower confidence level.”

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**4 Steps to Using the 4% Rule as a Target for Savings**

1. **Determine how much you'll need to spend in the first year of retirement, including taxes.**

2. **Figure out if you will have other sources of income, such as Social Security or a pension.**

3. **Subtract this figure from how much you'll need, in total. This is the amount you'll need from your portfolio.**

4. **Multiply that figure by 25 to come up with your target portfolio size for a 30-year retirement:**

   
   $75,000 - $30,000 = $45,000
   
   $45,000 x 25 = $1,125,000

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For help creating a more detailed retirement plan, consult our Retirement Savings Calculator at schwab.com/OIretirementcalculator.
Plan, but stay flexible

“The best approach to retirement spending is to stay flexible and not adhere to a rigid rule of thumb,” says Rob. Then consider these three steps:

➔ Create a retirement plan and update it regularly. To help you get started, Schwab offers a complimentary retirement consultation with one of our experienced investment professionals. You’ll leave your consultation with a plan that provides you with a personalized rate of spending that fits your situation, age, life expectancy and other factors. Review the plan regularly to see whether you’re on track.

➔ Adjust discretionary spending based on portfolio performance. If your portfolio is down significantly, especially early in retirement, consider reducing your spending rather than selling long-term investments. Conversely, if your portfolio performs better than expected over time, you may be able to spend a little more. Don’t take this too far, though. Your plan is for a long retirement, and the good days in the market tend to even out the bad days over time. Make sure you also have the right mix of investments to manage these ups and downs, and to provide income. Consider dividend-paying stocks, along with cash and bonds, to meet your income needs.

➔ Consider annuities to help cover essential expenses. Look at a variable annuity, possibly with an optional living benefit (or “income” benefit), or a single premium “fixed” immediate annuity. Some investors may not need or want a guaranteed lifetime source of income, either due to the complexity or additional costs. Annuities are one of the few investments that offer an income you can’t outlive (subject to the financial strength and claims-paying ability of the issuing insurance company).

WHAT’S CHANGED SINCE THE 4% RULE WAS DEVELOPED?

Economic conditions are different now than they were in the early 1990s, when 4% became the rule of thumb for first-year withdrawals. Stock returns had an annual average gain of 18.2% in the ’90s, while they’ve averaged only 2.6% since 2000. In the ’90s, the 10-year Treasury averaged a 6.7% yield; as of September 11, 2013, it is yielding 2.9%. Still, the underlying principles of the 4% rule hold true.

NEXST STEPS

Visit schwab.com/OIretirement for practical guidance and answers to your retirement planning questions.

See page 2 for important information.

Variable annuities are sold by prospectus only. You can request a prospectus by calling 888-311-4887 or by visiting schwab.com/annuity. Before purchasing a variable annuity, you should carefully read the prospectus and consider the annuity’s investment objectives and all risks, charges, and expenses associated with the annuity and its investment options.

The contract value of a variable annuity may be more or less than the premiums paid and it is possible to lose money. Variable annuities are long-term investment vehicles designed for retirement purposes and offer tax deferral on potential growth; however, withdrawals prior to age 59½ may be subject to a 10% federal tax penalty in addition to applicable income taxes. Variable annuities are also subject to a number of fees, including mortality and risk expense charges, administrative fees, premium taxes, investment management fees, and charges for additional optional features. Although there are no surrender charges on the variable annuities offered by Schwab, such charges do apply in the early years of many contracts. Charles Schwab & Co., Inc., a licensed insurance agency, distributes certain life insurance and annuity contracts that are issued by non-affiliated insurance companies. Not all products are available in all states.

Schwab does not provide the insurance guarantees on the annuities it offers. The consultation is complimentary although the implementation of any recommendations made during the consultation may result in trade commissions or other fees, charges or expenses. During the consultation, specific advice and recommendations are limited to assets held at Schwab by clients with an existing Schwab retail brokerage account. Examples may be provided of the advice and recommendations that might be offered if outside assets were transferred to Schwab, however such information is for educational purposes only.

Past performance is no guarantee of future results.

(1113-5512)
Celebrating 40 Years

Our name has changed, our look is different, and we have a range of products and offerings that we couldn’t have dreamed up when we started. But the core of who we are hasn’t budged. We’re still advocating for you—to ensure you have better access and service, all at a great value. We pioneered discount brokerage. We led the way in online investing. We created a new, convenient way to invest through a variety of mutual funds and ETFs. And we’re still working to discover better ways for you to invest. Here are some highlights from our first 40 years.

1971
First Commander Corporation is incorporated to conduct a conventional broker-dealer securities business and to publish the Investment Indicator newsletter.

1973
The corporate name changes to Charles Schwab & Co., Inc.

1975
The Securities and Exchange Commission mandates negotiated commission rates for all securities transactions. While many brokerages raise commissions, Chuck seizes the opportunity to create a new kind of brokerage—a discount brokerage.

1981
Announcing a new service from Charles Schwab...

NO-LOAD MUTUAL FUNDS!

"How you can buy
and sell mutual
funds as easily
as you do stocks,
in one phone
call to Charles
Schwab.

1983
Bank of America acquires the company.

1984
Schwab introduces Mutual Fund MarketPlace® with 140 no-load funds.

1987
In July, management leads a buyback from Bank of America. In September, The Charles Schwab Corporation completes its initial public offering.

1992
Schwab introduces the no-annual-fee IRA and the Schwab Mutual Fund OneSource® service, which offers one-stop shopping for mutual funds from multiple fund families.

1995
Schwab activates its first website at schwab.com.

See page 2 for important information.

All funds are subject to management fees and expenses. Please see Charles Schwab Pricing Guide for additional information.

1Investment management, commissions, transaction and other fees may apply.

2Conditions apply: Trades in ETFs available through Schwab ETF OneSource (including Schwab ETFs™) are available without commissions when placed online in a Schwab account. Service charges apply for trade orders placed through a broker ($25) or by automated phone ($5). An exchange processing fee applies to sell trades as available. Please see Charles Schwab Pricing Guide for additional information.
I created this company because I believed investors deserved better. They still do. In that regard, nothing has changed. –CHARLES R. SCHWAB, FOUNDER & CHAIRMAN

2002
Schwab launches a proprietary stock-rating system, Schwab Equity Ratings®, and two new advisory services for affluent investors, Schwab Advisor Network® and Schwab Private Client®.

Schwab Private Client provides ongoing customized advice and service delivered by a dedicated team of professionals.

2003
Charles Schwab Bank® launches with the goal of offering bank products designed with investors in mind.

2011
Schwab announces mobile deposit capabilities, enabling clients to deposit checks with their smartphone cameras. Trading on tablets and smartphones is also introduced, and Schwab debuts StreetSmart Edge®, a new trading platform designed to simplify trading and provide a more intuitive experience.

2012
Schwab Retirement Plan Services launches Schwab Index Advantage®—a one-of-a-kind 401(k) plan offer that combines low-cost index funds, built-in independent third-party investment advice services, and a personalized savings strategy.

2013
Schwab ETF OneSource™ platform launches, offering commission-free online trading of more than 100 ETFs from Schwab and other leading ETF providers.

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See next page for additional disclosures. »

transactions. Certain types of Schwab ETF OneSource transactions are not eligible for the commission waiver, such as short sells and buys to cover (not including Schwab ETFs). Schwab reserves the right to change the ETFs we make available without commissions. All ETFs are subject to management fees and expenses. Please see Charles Schwab Pricing Guide for additional information.

See next page for additional disclosures.»

LEARN MORE
For more highlights and an interactive timeline, go to schwab.com/0140th.

WINTER 2013 • ON INVESTING 33
Schwab Retirement Planner®, and Schwab Bank Savings, an interest-bearing, operating expenses, built-in independent professional advice available through Schwab Index Advantage provides a combination of index funds with low services may vary depending on which advisor an investor chooses. Schwab also may receive remuneration from transaction fee fund companies for certain administrative services.

Trades in no-load funds available through Mutual Fund OneSource service (including Schwab Funds), as well as certain other funds, are available without transaction fees when placed through schwab.com or our automated phone channels. Schwab's short-term redemption fee of $49.95 will be charged on redemption of funds purchased through Schwab's Mutual Fund OneSource service (and certain other funds with no transaction fee) and held for 90 days or less. Schwab reserves the right to exempt certain funds from this fee, including Schwab Funds®, which may charge a separate redemption fee, and funds that accommodate short-term trading.

Schwab Advisor Network member advisors are independent and are not employees or agents of Charles Schwab & Co., Inc. (“Schwab”). Schwab prescreens advisors and checks their experience and credentials against criteria Schwab sets, such as years of experience managing investments, amount of assets managed, professional education, regulatory licensing, and business experience. Schwab provides potential advisors access to Schwab’s resources and checks their experience and credentials against criteria Schwab sets, such as years of experience managing investments, amount of assets managed, professional education, regulatory licensing, and business experience. Schwab pays fees to Schwab in connection with referrals. Schwab does not supervise advisors and does not prepare, verify, or endorse information of Schwab. Advisors pay fees to Schwab in connection with referrals. Schwab does not supervise advisors and does not prepare, verify, or endorse information distributed by advisors. Investors must decide whether to hire an advisor and what authority to give the advisor. Investors are responsible for monitoring and evaluating an advisor’s service, performance, and account transactions. Services may vary depending on which advisor an investor chooses.

Schwab Index Advantage provides a combination of index funds with low operating expenses, built-in independent professional advice available through Schwab Retirement Planner®, and Schwab Bank Savings, an interest-bearing, FDIC-insured savings feature through Charles Schwab Bank. Schwab Retirement Planner provides participants with a fee-based retirement savings and investment strategy, a major component of which is a discretionary investment management service furnished by independent registered investment advisors GuidedChoice Asset Management, Inc. (“GuidedChoice®”) or Morningstar Associates, LLC, a wholly owned subsidiary of Morningstar, Inc. GuidedChoice and Morningstar Associates are not affiliated with or an agent of Schwab Retirement Plan Services, Inc., Charles Schwab & Co., Inc., or their affiliates. Schwab Index Advantage, including the Schwab Bank Savings and Schwab Retirement Planner features, is only available in select retirement plans serviced by Schwab Retirement Plan Services, Inc.

Portfolio management provided by Schwab Private Client Investment Advisory, Inc., a registered investment advisor and affiliate of Charles Schwab & Co., Inc. Access to electronic services may be limited or unavailable during periods of peak demand, market volatility, systems upgrade, maintenance or for other reasons. Charles Schwab & Co., Inc., and Charles Schwab Bank are separate but affiliated companies and subsidiaries of The Charles Schwab Corporation. Brokerage products are offered by Charles Schwab & Co., Inc., Member SIPC. Deposit and lending products and services are offered by Charles Schwab Bank, Member FDIC and an Equal Housing Lender.

Brokerage Products: Not FDIC-Insured · No Bank Guarantee · May Lose Value
Investors should consider carefully information contained in the prospectus, including investment objectives, risks, charges and expenses. You can request a prospectus by calling Schwab at 800-435-4000. Please read the prospectus carefully before investing.

Investment returns will fluctuate and are subject to market volatility, so that an investor’s shares, when redeemed or sold, may be worth more or less than their original cost. Unlike mutual funds, shares of ETFs are bought and sold at market price, which may be higher or lower than the net asset value.

Charles Schwab & Co., Inc., receives remuneration from third-party ETF companies participating in Schwab ETF OneSource for recordkeeping, shareholder services and other administrative services, including program development and maintenance.

Charles Schwab & Co., Inc., (Member SIPC) receives remuneration from fund companies in the Mutual Fund OneSource program for recordkeeping and shareholder services, and other administrative services. Schwab also may receive remuneration from transaction fee fund companies for certain administrative services.

Many traditional bond funds have been losing money. Yields today are near record lows and if the bond markets remain volatile, your once low-risk bond investments could lose even more ground.

“SO WHAT DO I DO WITH MY MONEY?”
BlackRock Strategic Income Opportunities Fund (BASIX) can adapt as markets change and move freely in search of the best returns, while seeking to protect against rising rates.

Explore a more adaptable approach to bond investing at SIchart.com/rethink.

Before investing, carefully consider the fund's investment objectives, risks, charges, and expenses. Call 1-800-435-4000 or visit www.schwab.com for a prospectus containing this and other information. Read it carefully. Fixed income securities are subject to increased loss of principal during periods of rising interest rates. Fixed income investments are subject to various other risks including changes in credit quality, market valuations, liquidity, prepayments, early redemption, corporate events, tax ramifications and other factors. Prepared by BlackRock Investments, LLC. ©2013 BlackRock, Inc. All rights reserved. BLACKROCK, SO WHAT DO I DO WITH MY MONEY, and INVESTING FOR A NEW WORLD are registered and unregistered trademarks of BlackRock, Inc. or its subsidiaries in the United States and elsewhere. User-2794. Charles Schwab & Co., Inc., receives remuneration from fund companies and/or their affiliates in the Mutual Fund OneSource® service for recordkeeping, shareholder services and other administrative services. Charles Schwab & Co., Inc. Member SIPC (1113-6562)
Mutual Fund OneSource Select List® and Income Mutual Fund Select List™

Analysis and Commentary on Actively Managed Mutual Funds by Charles Schwab Investment Advisory, Inc.

With thousands of mutual funds available, finding the right funds for your portfolio can seem more time-consuming and difficult than ever. The Mutual Fund OneSource Select List, consisting only of OneSource funds available without a load or transaction fee, is a smart solution that can help you make confident investment decisions.

How Funds Are Selected
To build the Schwab Mutual Fund OneSource Select List and the Schwab Income Mutual Fund Select List, Charles Schwab Investment Advisory, Inc. (CSIA) starts by analyzing the funds tracked by Morningstar using quantitative and qualitative selection criteria described below. Then, based on its analysis, CSIA builds the Mutual Fund OneSource Select List and Income Select List by selecting the most favorably evaluated OneSource funds, including Schwab Funds and Laudus Funds ("Schwab Affiliate Funds"), within each Morningstar category.

Only actively managed OneSource funds are included in this version of the OneSource Select List. CSIA includes up to two index funds for each of the large-cap, small-cap, international and taxable bond asset classes on the electronic version of the OneSource Select List available on schwab.com. Index funds have separate selection criteria. Visit the OneSource Select List on schwab.com to view index funds and to learn more about how index funds are selected.

Eligibility Requirements
Each OneSource Select List and Income Select List fund must:

Be no-load and open to new investors at Schwab in all 50 states.

Have a minimum three-year performance track record (except funds that are listed below the "Leading Schwab Affiliate Funds" sections of the lists, which are eligible if they have a minimum 12 months performance track record under their current management and/or current investment objectives and strategy).

Have at least $40 million in assets (except for small-cap value, high yield, multisector bond, world bond, emerging market equity and bond, diversified Pacific Asia, Pacific Asia ex-Japan, Europe, Japan, Latin America, convertibles, retirement income, target date and specialty funds, which require at least $20 million in assets). To meet this requirement, assets in multiple share classes of the same fund may be aggregated.

Additionally, each Income Select List fund must:

Demonstrate a track record of making income distributions in each of the prior five calendar years (or during every full calendar year since inception in the case of funds with less than a five-year track record, including Schwab Affiliate Funds which may have a 12-month track record).

For fixed income funds, make income distributions on at least a quarterly basis; and—with the exception of the high-yield, multisector and emerging markets bond categories—not allocate in excess of 30% to issues rated below investment grade.

For equity funds, offer a current yield in excess of their category average; and for equity funds with “dividend” or “income” in their name, make income distributions at least quarterly.

With the exception of specialty sector (REITs) and fixed income funds, not allocate in excess of 33% to any single sector.

For fixed income funds, make income distributions on at least a quarterly basis; and—with the exception of the high-yield, multisector and emerging markets bond categories—not allocate in excess of 30% to issues rated below investment grade.

For equity funds, offer a current yield in excess of their category average; and for equity funds with “dividend” or “income” in their name, make income distributions at least quarterly.

Selection Criteria
Actively Managed OneSource Funds, including Schwab Affiliate Funds, are evaluated by CSIA based on a quantitative analysis of risk, performance, expenses, active share (when meaningful), assets under management and asset flows. CSIA also may apply additional qualitative factors to its analysis to enhance its overall evaluation of a fund, including, for example, changes in a fund’s investment strategy or management structure, portfolio manager tenure, whether a fund’s investment style and portfolio holdings are representative of its investment category, portfolio composition and turnover rates, consistency of a fund’s performance and CSIA’s evaluation of the fund over time, and other risk and diversification considerations.

In addition, for the Income Select List, those funds with the best capital preservation attributes and investment strategies that focus on selecting income-generating securities will receive preference when selecting from similarly rated funds with comparable yield characteristics.

“Leading Schwab Affiliate Funds” sections of the Select List and Income Select List feature eligible actively managed Schwab Affiliate Funds that generally fall into the top 35 percent of all CSIA-evaluated funds (including OneSource and non-OneSource funds) in their respective Morningstar categories. If two or more Schwab Affiliate Funds that fit this criteria also have similar investment styles, CSIA may determine that only the most favorably evaluated fund(s) be included in the list. Because Schwab Affiliate Funds included in the “Leading Schwab Affiliate Funds” section of the OneSource Select List and Income Select List are selected independently from other actively managed funds on the list, they may have a less favorable evaluation overall than the funds listed in the “Leading Third-Party Funds” section of the list.

“Leading Third-Party Funds” sections of the OneSource Select List and Income Select List feature eligible actively managed third-party OneSource funds that generally fall within the top 35 percent of all CSIA-evaluated funds within a given Morningstar category and that receive the most favorable evaluations in their respective categories.

For the OneSource Select List, CSIA generally includes the five most-favorably evaluated funds in each of the large-cap, small-cap, intermediate-term bond, municipal national intermediate and foreign large blend asset categories and the two most favorably evaluated funds in all other asset categories. If two or more of the most favorably evaluated funds within an asset category have similar investment styles, CSIA may substitute a less-favorably evaluated fund for one or more of those funds to provide a more diverse selection of fund investment strategies.

For the Income Select List, CSIA generally includes no more than the two most favorably evaluated funds in each asset category, except for the intermediate-term bond category, which may feature up to five funds.

(continued on page 36)
(continued from page 35)

The Index Fund section of the Select List features up to two index funds for each of the large-cap, small-cap, international, and taxable bond asset classes. Index funds have similar selection criteria to actively managed OneSource funds. These funds are evaluated by CSIA based on a quantitative analysis of risk, performance, expenses, active share (when meaningful), and assets under management. CSIA also may apply additional qualitative factors to its analysis to enhance its overall evaluation of an index fund, including, for example, the breadth of the index tracked by the fund, the index construction methodology, and the tracking error of the fund to its underlying index.

The third-party index fund and Schwab affiliate index fund that receives the most favorable evaluation by CSIA in each asset class is included on the Select List. If two index funds receive equal evaluations, CSIA will generally include the fund that has the lower expense ratio.

**Important Considerations when Building a Portfolio for Growth and Income**

Schwab developed the Income Mutual Fund Select List to help investors in or approaching retirement build or modify an investment portfolio that addresses their growth and income needs. Here are some things to consider as you develop or fine-tune your portfolio:

- **Asset Allocation**: As always, your portfolio’s asset allocation should be driven by your investment goals, time horizon and risk tolerance. As your goals shift from accumulation to income, you can use the funds on this list to help address your income and growth needs from both bond and equity funds.

- **Diversification**: Investors in or nearing retirement often believe that they should be exclusively in bonds and other fixed income assets. While for some investors this might be an appropriate strategy, you may want to consider keeping some percentage of your portfolio in equities for the capital appreciation potential they provide.

- **Risk vs. Return**: Evaluate yields within the context of risk: different categories or asset classes will reflect differing risk/reward trade-offs. Consider a mix of bond funds: government, municipal and corporate. Also, a fund’s exposure to below-investment grade bonds is important to keep in mind. One of the selection criteria for fixed-income funds on the Income Select List is relatively low exposure to these types of securities, except for the high yield, multisector and emerging bond categories. (To see a fixed-income fund’s credit rating, click on the fund name, then the Portfolio tab.)

- **Maturity**: Bond funds with longer maturities can leave investors exposed to greater inflation and credit risk, so consider a balance of maturities, from ultrashort to long.

- **Distribution Frequency**: Different funds provide payouts on different schedules. Check the frequency of distributions to determine when you’ll receive income, if any, from the fund.

- **Taxes**: Remember tax implications. Income on investments in nonretirement accounts is generally taxable; in tax-protected retirement accounts, such as IRAs and 401(k)s, it’s less of a concern. Where appropriate, consider tax-free bond funds.

Schwab provides a range of easy-to-use tools, resources and guidance at schwab.com for investors in or nearing retirement.

**Additional Important Information**

More than 3,500 funds participate in the Mutual Fund OneSource service. Only these funds, including Schwab Affiliate Funds, are eligible for the Select Lists. Schwab receives remuneration from fund companies, and/or their affiliates, in the Mutual Fund OneSource service, including Schwab Affiliate Funds, for record keeping, shareholder services and other administrative services. Schwab and its affiliates also receive fees from Schwab Affiliate Funds for investment advisory and fund administration services. The aggregate fees Schwab or its affiliates receive from Schwab Affiliate Funds (see fund prospectuses for more details) are greater than the remuneration Schwab receives from other fund companies participating in Schwab's Mutual Fund OneSource service. The amount of fees Schwab or its affiliates receive from funds participating in the Mutual Fund OneSource service is not considered in the Select Lists selection, nor does any fund pay Schwab to be included in the Select Lists. Eligible funds are selected based solely on the quantitative and qualitative criteria described on page 35 and 36.

Schwab Affiliate Funds include Schwab Funds and Laudus Funds. Schwab Funds and Laudus Funds are advised by Charles Schwab Investment Management, Inc. Schwab Funds and the Laudus MarketMasters Funds are distributed by Charles Schwab & Co., Inc. and Laudus Funds (except Laudus MarketMasters Funds) are distributed by ALPS Distributors, Inc.

**Investing in Mutual Funds at Schwab**

Investors should consider carefully information contained in the prospectus, including investment objectives, risks, charges and expenses. You can obtain a prospectus by calling Schwab at 800-435-4000. Please read the prospectus carefully before investing.

Investment value will fluctuate and shares, when redeemed, may be worth more or less than the amount originally invested.

Trades in no-load mutual funds participating in the Mutual Fund OneSource service (including Schwab Funds), as well as certain other funds, are available without loads or transaction fees when placed through schwab.com or one of our automated phone channels. However, for each of these trades placed through a broker, a $25 service charge applies. Additionally, Schwab will charge a short-term redemption fee (STR) if you sell shares of OneSource funds held for 90 days or less. Schwab reserves the right to exempt some funds from the STR fee, including certain Schwab Funds, which may charge a separate redemption fee, and funds that accommodate short-term trading. Certain funds may charge a redemption fee separate, and in addition to, the OneSource STR. All other funds available at Schwab are subject to a transaction fee when bought and sold and may be subject to fees assessed by the fund itself. Schwab reserves the right to change the funds it makes available without transaction fees and reinstate fees on any funds.

**Information on the Mutual Fund OneSource Select List**

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Charles Schwab Investment Advisory (CSIA) is a separately registered investment advisor and an affiliate of Charles Schwab & Co., Inc. Among other functions, CSIA oversees the selection of investments and ongoing monitoring of the Select List and produces market commentary and other investment advice for Schwab clients and financial consultants. (1111-7437)
Our bullish longer-term view for U.S. stocks remains intact due to both the liquidity that continues to flood the market, and leading indicators pointing higher for the economy. The Federal Reserve appears fiercely committed to ensuring the economy is healthy enough to withstand a deceleration of its stimulus measures. Global growth has improved; including Europe, Japan and China, which could help cushion the equity markets from the potential impact of the U.S. fiscal standoff. Volatility is likely to be elevated in the near-term but we remain optimistic that stocks can move higher once we get past domestic policy risks.

Domestic equity experienced strong performance for the quarter, as the Federal Reserve signaled that it would delay the tapering of the quantitative easing program, and concerns around a pullback in China and world markets faded.

As compared to small- and mid-cap stocks, large-cap U.S. stocks modestly underperformed, although they still maintained solid positive returns. The large-cap growth category had the best relative performance, returning gains of 9.34%, while large blend and large value were relatively lower with returns of 5.74% and 4.43%, respectively.

All perspectives are as of September 27, 2013

For the latest up-to-date perspectives, please visit schwab.com

<table>
<thead>
<tr>
<th>FUND NAME (FUND INCEPTION DATE)</th>
<th>MORNINGSTAR CATEGORY</th>
<th>QUOTE SYMBOL</th>
<th>LOW, HIGH, RISK LEVEL</th>
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<th>AVERAGE ANNUALIZED TOTAL RETURN</th>
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<th>NET EXPENSE RATIO</th>
<th>TOTAL ASSETS ($M)</th>
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**PERFORMANCE BENCHMARKS**

| Schwab 1000 Index® (Dividends Reinvested) | 5.90 | 20.69 | 16.45 | 10.46 | 8.01 | — |
| S&P 500 Index® (Dividends Reinvested) | 5.24 | 19.34 | 16.27 | 10.02 | 7.57 | — |

**Asset Class and Performance Benchmark Definitions**

Large-cap U.S. stock funds invest primarily in stocks that fall in the top 70% of the U.S. market capitalization range as defined by Morningstar, Inc. Growth funds invest in companies that may be experiencing rapid growth in earnings, sales or return on equity. Value funds invest in companies that may have share prices below estimated fair market value, undervalued assets, an opportunity to “turnaround” or lower price-to-earnings or price-to-book ratios. Blend funds invest in a combination of value and growth stocks.

The S&P 500® Index includes common stocks of 500 widely held companies. S&P 500 is a registered trademark of The McGraw-Hill Co., Inc. If an expense waiver was in place during the period, the net expense ratio was used to calculate fund performance. A net expense ratio lower than the gross expense ratio may reflect a cap on or contractual waiver of fund expenses. Please read the fund prospectus for details on limits or expiration dates for any such waivers.

Performance quoted is past performance and is no guarantee of future results. Current performance may be lower or higher. Visit schwab.com for month’s end performance information. Investment value will fluctuate, and shares, when redeemed, may be worth more or less than original cost.
MID- AND SMALL-CAP U.S. STOCK FUNDS

Perspectives and Third Quarter 2013 Summary
The factors contributing to our bullish outlook for U.S. stocks should hold true for the small- and mid-cap arena, which could benefit from increased investor risk appetites and the barrage of liquidity in the market. We believe that business capital spending will help to fuel the next leg higher in the market as companies have been sitting on record-high levels of cash. Meanwhile, confidence surveys and new orders data may be signaling companies will start to put some of that money to work in longer-term investments as the replacement cycle is extended. Although near-term volatility may lay ahead amid the U.S. fiscal issues, we believe these are the times when keeping long-term goals in mind is most important, and do not recommend making market cap bets.

- The mid- and small-cap fund categories experienced strong returns for the quarter, with the largest gains found in small-cap growth at 12.26%, followed by mid-cap growth at 10.13%, and small blend which returned 9.19%. Mid-cap value at 8.68% had the lowest returns relative to the small- and mid-cap universe, followed by mid-cap blend with a return of 7.54%, and small-cap value at 8.09%.

All perspectives are as of September 27, 2013
For the latest up-to-date perspectives, please visit schwab.com

FOR THE QUARTER ENDED SEPTEMBER 30, 2013

Asset Class and Performance Benchmark Definitions
Mid-cap U.S. stock funds invest primarily in stocks that fall in the next 20% of the U.S. market capitalization range following large-cap stocks. Small-cap U.S. stock funds generally invest in stocks falling in the bottom 10% of the range. Definitions based on Morningstar, Inc.

Growth funds invest in companies that may be experiencing rapid growth in earnings, sales or return on equity. Value funds invest in companies that may have share prices below estimated fair market value. Undervalued assets, an opportunity to “turnaround” or lower price-to-earnings or price-to-book ratios. Blend funds invest in a combination of value and growth stocks.

Performance quoted is past performance and is no guarantee of future results. Current performance may be lower or higher. Visit schwab.com for month’s end performance information. Investment value will fluctuate, and shares, when redeemed, may be worth more or less than original cost.
INTERNATIONAL STOCK FUNDS

Q3 2013 YEAR 2012 YEAR 2011

Perspectives and Third Quarter 2013 Summary

Overseas, we are neutral on Chinese-related investments, including emerging markets, despite their Q3 rally on the Chinese government’s willingness to achieve near-term economic stabilization, though longer-term trends remain concerning. Meanwhile, we believe improving economic conditions, continued European Central Bank support, and a smaller fiscal drag, could buoy eurozone stocks. Finally, we feel Japanese stocks on a currency-hedged basis could benefit investors, as policy accommodation from the Bank of Japan could increase even further if economic downside risks appear.

- Reflecting a growing optimism that the worst of their financial and political crisis has subsided, the Europe Stock category (11.79%) witnessed a strong rebound in Q3, providing the strongest relative performance out of the International Equity categories.
- China also experienced a strong rebound from its poor Q2 performance, posting a strong 10.41% return, as fears of a severe economic slowdown in that country failed to materialize.
- Foreign fund investors had strong gains across all categories, with Foreign Small/Mid Value recording the best performance with returns of 12.13%. This was followed by Foreign Small/Mid Growth with 11.12%, while Foreign Large Value and Foreign Large Blend had lower relative returns of 10.68% and 9.93%, respectively.

All perspectives are as of September 27, 2013.

For the latest up-to-date perspectives, please visit schwab.com

FOR THE QUARTER ENDED SEPTEMBER 30, 2013

<table>
<thead>
<tr>
<th>FUND NAME (FUND INCEPTION DATE)</th>
<th>MORNINGSTAR CATEGORY</th>
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<th>AVERAGE ANNUALIZED TOTAL RETURN</th>
<th>3 YR</th>
<th>10 YR</th>
<th>5 YR</th>
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<th>INCEPTION</th>
<th>GROSS EXPENSE RATIO</th>
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<td><strong>LEADING SCHWAB AFFILIATE FUNDS</strong></td>
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<td>-</td>
<td>1.87</td>
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<td>11.15</td>
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<td>10.83</td>
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<td>15.81</td>
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PERFORMANCE BENCHMARKS

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<th>MSCI EAFE Index (Dividends Reinvested)</th>
<th>New to the Select List this quarter</th>
<th>* $50,000 initial minimum investment</th>
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<tr>
<td>MSCI EAFE Index (Dividends Reinvested)</td>
<td>New to the Select List this quarter</td>
<td>* $50,000 initial minimum investment</td>
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</tbody>
</table>

Asset Class and Performance Benchmark Definitions

Foreign stock funds typically have less than 20% of assets invested in the United States. Funds that do not have a specific growth or value orientation compared to a benchmark are classified as blend funds. World Stock funds invest primarily in equity securities of issuers located throughout the world and generally invest at least 20% of assets in the United States. Regional funds generally hold high concentrations of securities from one specific geographic region. Emerging markets funds generally invest in securities from less developed countries.

International investments are subject to risks such as currency fluctuations and political instability. Investing in emerging markets can accentuate these risks.

Performance quoted is past performance and is no guarantee of future results. Current performance may be lower or higher. Visit schwab.com for month's end performance information. Investment value will fluctuate, and shares, when redeemed, may be worth more or less than original cost.
### Perspectives and Third Quarter 2013 Summary

Against the backdrop of the improving global economic sentiment, an elongated capital replacement cycle and lots of cash on companies’ balance sheets, we believe sectors more exposed to improving conditions such as industrials, information technology, and consumer discretionary may stand to benefit. We believe the moderation in the housing market, which led to the pullback in real estate stocks, is a temporary pause in the recovery, with the Fed intent on keeping momentum moving in the right direction. Finally, the materials sector may find support from the increased global economic outlook and still highly-accommodative global central banks, but headwinds could come from a strengthening U.S. dollar if the Fed begins to rein in its stimulus efforts, as well as a possible slowing of Chinese demand for commodities.

The Specialty categories had strong returns across almost all categories, with Health (13.11%) and Technology (12.17%) taking a lead in performance. Notably, the Equity Precious Metals (9.88%) and Natural Resources (9.49%) experienced a significant turnaround from the strongly negative performance experienced in Q2. Real Estate (-2.54%) had the only negative returns.

All perspectives are as of September 27, 2013. For the latest up-to-date perspectives, please visit schwab.com.

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### For the Quarter Ended September 30, 2013

<table>
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<th>FUND NAME (FUND INCEPTION DATE)</th>
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<th>3YR</th>
<th>5YR</th>
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<td>19.55</td>
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<td></td>
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<td>11.47</td>
<td>32.05</td>
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<td>12.98</td>
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<td>DWS RREEF Real Estate Securities A (09/03/02)**</td>
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<td>-2.01</td>
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<td>Manning &amp; Napier Real Estate S (11/10/09)</td>
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<td><strong>TECHNOLOGY FUNDS (CATEGORY AVERAGE)</strong></td>
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<td>Janus Global Technology T (12/31/98)</td>
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<td>24.45</td>
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<td>Red Oak Technology Select (12/31/98)</td>
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<td>1.30</td>
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New to the Select List this quarter  ❌ Reflects load-adjusted returns

### Asset Class and Performance Benchmark Definitions

Sector funds concentrate investments in firms that fall into specific industries that produce related products or services. Sector funds, in general, have a low correlation to market indices, such as the S&P 500 Index, so they tend to perform differently than broader market measures. Because of their unique investment objectives, it’s unfair to compare sector funds with broader market indices as they will seldom correlate. When evaluating sector fund performance, it’s more appropriate to compare an individual fund’s returns with the average performance of funds in its category. Due to the concentrated nature of sector funds, they can be more volatile than broadly diversified equity funds.

An expense waiver was in place during the period, the net expense ratio was used to calculate fund performance. A net expense ratio lower than the gross expense ratio may reflect a cap on or contractual waiver of fund expenses. Please read the fund prospectus for details on limits or expiration dates for any such waivers.

Performance quoted is past performance and is no guarantee of future results. Current performance may be lower or higher. Visit schwab.com for month's end performance information. Investment value will fluctuate, and shares, when redeemed, may be worth more or less than original cost.
Perspectives and Third Quarter 2013 Summary
Most sectors of the taxable bond market saw positive returns for the quarter, as Treasury yields finished only slightly higher than where they started. At its September meeting, the Fed announced that its $85 billion per month bond buying program, known as quantitative easing, will continue. Many market participants had expected the Fed to reduce the amount of its monthly purchases. After rising to nearly 3% in early September in anticipation of a possible tapering of purchases, 10-year Treasury yields moved lower, finishing the quarter at 2.6%. Most fixed income investors should focus on a core portfolio of intermediate-term, high quality mutual funds, and we think that those reaching for yield in the lower-rated segments of the bond market should consider moving up in quality.

With the exception of those categories with longer duration exposure, the Taxable Fixed Income categories were modestly positive. The High Yield Bond category was the top performer with a positive return of 2.20%. World Bond returned 1.46% followed by returns of 1.24%, 1.12% and 0.64% for the Bank Loan, Multi-sector, and Inflation-Protected Bond categories. Largely due to their long duration exposure, the Long Government (-2.35%) and Long-Term Bond (-0.62%) category returns were moderately negative due to increasing rates throughout the quarter.

All perspectives are as of September 27, 2013
For the latest up-to-date perspectives, please visit schwab.com

<table>
<thead>
<tr>
<th>FUND NAME (FUND INCEPTION DATE)</th>
<th>MORNINGSTAR CATEGORY</th>
<th>QUOTE SYMBOL</th>
<th>LEVERAGE</th>
<th>AVG. MGT. EXPENSE RATIO</th>
<th>AVG. WEIGHTED MATURITY (YRS)</th>
<th>TOTAL ASSETS ($M)</th>
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<tr>
<td>Schwab GNMA Fund (03/03/03)</td>
<td>Interm Gov't</td>
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<td>Schwab Intermediate-Term Bond Fund (10/31/07)</td>
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<th>QUOTE SYMBOL</th>
<th>LEVERAGE</th>
<th>AVG. MGT. EXPENSE RATIO</th>
<th>AVG. WEIGHTED MATURITY (YRS)</th>
<th>TOTAL ASSETS ($M)</th>
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<td>Federated US Govt 2-5 Yr Ystl (02/18/83)</td>
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<td>2.44 3.78 5.19 3.41 4.40 0.57 0.57 2.70 1,784</td>
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<td></td>
</tr>
<tr>
<td>PIMCO Short-Term D (04/08/98)</td>
<td>Ultrashort Bond</td>
<td>PSDKX</td>
<td>0.49</td>
<td>0.70 1.18 2.39 2.48 3.23 0.71 0.70 1.20 529</td>
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<tr>
<td>RidgeWorth US Gov Sec Ultra-Short Bd I (04/11/02)</td>
<td>Ultrashort Bond</td>
<td>SIGDX</td>
<td>-0.18</td>
<td>-0.32 1.01 2.08 2.77 2.73 0.38 0.38 3.50 2,252</td>
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<tr>
<td>American Century International Bd Inv (01/07/92)</td>
<td>World Bond</td>
<td>BEGBX</td>
<td>3.70</td>
<td>-4.54 0.58 3.30 4.28 5.61 0.80 0.80 9.50 644</td>
<td></td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>PERFORMANCE BENCHMARKS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Barclays U.S. Aggregate Bond Index (Dividends Reinvested)</td>
</tr>
<tr>
<td>New to the Select List this quarter</td>
</tr>
</tbody>
</table>

Asset Class and Performance Benchmark Definitions
Bond funds invest in corporate, municipal or government debt obligations of different maturities and interest rates. Taxable bond funds generally invest in the debt obligations issued by the U.S. Treasury, other U.S. government agencies and U.S. corporations. They also may invest in high-yield and foreign (non-U.S.) bonds.

The Barclays U.S. Aggregate Bond Index tracks the total U.S. bond market, which includes U.S. Treasury, government agency, investment-grade corporate bond and mortgage-backed securities with maturities of at least one year. The index includes reinvestment of interest.

If an expense waiver was in place during the period, the net expense ratio was used to calculate fund performance. A net expense ratio lower than the gross expense ratio may reflect a cap on contractual waiver of fund expenses. Please read the fund prospectus for details on limits or expiration dates for any such waivers.

Performance quoted is past performance and is no guarantee of future results. Current performance may be lower or higher. Visit schwab.com for more recent performance information. Investment value will fluctuate, and shares, when redeemed, may be worth more or less than original cost.
Perspectives and Third Quarter 2013 Summary

It was a roller-coaster quarter for the tax-free bond market, as negative headlines in a few municipalities and rising interest rates led to a broad sell-off. Many municipal budgets have improved, but the Detroit bankruptcy and negative Puerto Rican headlines have spooked the market, pushing municipal yields higher and prices lower. The relative illiquidity of the municipal market exacerbated the price declines. Rise in rates may offer an opportunity for investors who have been sitting on the sidelines and looking for income rather than price appreciation. Use short-term funds if you have a lower risk tolerance.

Most Tax Free categories had a challenging quarter as investor concerns around the health of municipal regions took center stage. Participants appear to be taking a more critical and cautious stance in these categories.

Muni California Intermediate provided the highest relative performance at 0.68%, while the only other positive category performance came from Muni National Intermediate (0.20%) and Muni New York Intermediate (0.11%).

Reflecting the broad concerns around financial stability, the High Yield Muni category experienced the worst relative performance at -2.40%. Other hit by poor performance included Muni Single State Long (-1.91%), Muni New Jersey (-1.74%), and Muni New York Long (-1.59%).

All perspectives are as of September 27, 2013

For the latest up-to-date perspectives, please visit schwab.com

Asset Class and Performance Benchmark Definitions

Tax-exempt bond funds primarily invest in municipal bonds generally issued by state and local governments to fund general expenditures and public projects. Investment income may be subject to certain state and local income taxes and a portion of income may be subject to the alternative minimum tax (AMT). Capital gains are not exempt from federal income tax.

The Barclays Municipal Bond Index is a total-return performance benchmark for the investment-grade tax-exempt bond market. The index includes reinvestment of interest.

Performance quoted is past performance and is no guarantee of future results. Current performance may be lower or higher. Visit schwab.com for month’s end performance information. Investment value will fluctuate, and shares, when redeemed, may be worth more or less than original cost.

NOTES: ALL DATA SHOWN IS AS OF SEPTEMBER 30, 2013

a. Definitions: Gross Expense Ratio—actual expense as stated in the fund’s prospectus. Net Expense Ratio—net amount after any expenses are waived and/or partially absorbed by fund management.

b. Fund has an initial minimum investment greater than $2,500.

c. Three-month (3-mos.) total return is not annualized.

d. Investor Shares™ are available at a lower minimum but with higher operating expenses than Select Shares®.

e. Schwab Affiliate Funds include Schwab Funds and Laudus Funds. Schwab Funds and Laudus Funds are advised by Charles Schwab Investment Management, Inc.

Schwab Funds and the Laudus MarketMasters Funds are distributed by Charles Schwab & Co., Inc. Laudus Funds, except the Laudus MarketMasters Funds, are distributed by ALPS Distributors, Inc.

f. This fund is available without a load through Schwab. The performance figures shown reflect the performance with the load. Please see the Fund Summary on schwab.com for performance without load.
ADDITIONAL FUND CATEGORIES

FOR THE QUARTER ENDED SEPTEMBER 30, 2013

<table>
<thead>
<tr>
<th>FUND NAME (FUND INCEPTION DATE)</th>
<th>MORNINGSTAR CATEGORY</th>
<th>QUOTE SYMBOL</th>
<th>emph</th>
<th>RISK LEVEL</th>
<th>3 MDS.1</th>
<th>AVERAGE ANNUALIZED TOTAL RETURN</th>
<th>NET EXPENSE RATIO</th>
<th>TOTAL ASSETS ($M)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Schwan Balanced Fund (11/18/06)</td>
<td>Moderate Allocation</td>
<td>SBWOBX</td>
<td></td>
<td>—</td>
<td>4.90</td>
<td>11.16 10.95 7.72 6.21 36.3 0.81</td>
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<td>169</td>
</tr>
<tr>
<td>Schwan Balanced Fund (03/28/04)</td>
<td>Moderate Allocation</td>
<td>SWFBX</td>
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<td>—</td>
<td>4.40</td>
<td>8.95 10.95 10.72 6.21 36.3 0.81</td>
<td>0.65</td>
<td>169</td>
</tr>
<tr>
<td>Schwan Balanced Fund (09/30/01)</td>
<td>Moderate Allocation</td>
<td>SBWOBX</td>
<td></td>
<td>—</td>
<td>4.90</td>
<td>11.16 10.95 7.72 6.21 36.3 0.81</td>
<td>0.65</td>
<td>169</td>
</tr>
<tr>
<td>Schwan Balanced Fund (05/30/03)</td>
<td>Moderate Allocation</td>
<td>SWFBX</td>
<td></td>
<td>—</td>
<td>4.40</td>
<td>8.95 10.95 10.72 6.21 36.3 0.81</td>
<td>0.65</td>
<td>169</td>
</tr>
</tbody>
</table>

Asset Class Definitions

Balanced funds invest in a mix of stocks, bonds and cash within one fund and are classified into two categories. Conservative Allocation funds may invest 50% to 70% of assets in equities, with the balance invested in fixed income and cash. Convertible funds invest primarily in bonds and preferred stocks that can be converted into common stocks. Target maturity or “Lifecycle” funds are managed for investors planning to retire (or to begin withdrawing substantial portions of their investments) in a particular year. These funds provide both asset allocation and rebalancing for investors following an investment strategy that grows more conservative as the target date approaches.

Additional Fund Categories

<table>
<thead>
<tr>
<th>FUND NAME (FUND INCEPTION DATE)</th>
<th>MORNINGSTAR CATEGORY</th>
<th>QUOTE SYMBOL</th>
<th>emph</th>
<th>RISK LEVEL</th>
<th>3 MDS.1</th>
<th>AVERAGE ANNUALIZED TOTAL RETURN</th>
<th>NET EXPENSE RATIO</th>
<th>TOTAL ASSETS ($M)</th>
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</thead>
<tbody>
<tr>
<td>FUND NAME (FUND INCEPTION DATE)</td>
<td>MORNINGSTAR CATEGORY</td>
<td>QUOTE SYMBOL</td>
<td>emph</td>
<td>RISK LEVEL</td>
<td>3 MDS.1</td>
<td>AVERAGE ANNUALIZED TOTAL RETURN</td>
<td>NET EXPENSE RATIO</td>
<td>TOTAL ASSETS ($M)</td>
</tr>
<tr>
<td>Diamond Hill Long-Short A (06/30/01)</td>
<td>Long/Short Equity</td>
<td>DIAMX</td>
<td>-2.20</td>
<td>10.27 8.75 4.03 7.61 6.32 1.75 1.41</td>
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<td>Wasatch Long/Short Investor (08/01/03)</td>
<td>Long/Short Equity</td>
<td>FMLSLX</td>
<td>4.15</td>
<td>16.09 10.56 8.48 6.96 6.88 1.51 1.27</td>
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<tr>
<td>Goldman Sachs Commodity Strategy A (03/30/07)</td>
<td>Commodity Broad Basket</td>
<td>GSCAX</td>
<td>-0.22</td>
<td>-9.82 8.88 -9.55 — 4.78 1.13 0.98</td>
<td>348</td>
<td>348</td>
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<tr>
<td>• PIMCO CommoditiesPLUS Strategy D (05/25/10)</td>
<td>Commodity Broad Basket</td>
<td>PCLDX</td>
<td>5.25</td>
<td>3.83 4.53 — — 7.76 1.49 1.24</td>
<td>61</td>
<td>61</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• JPMorgan Multi-Cap Market Neutral A (05/23/03)</td>
<td>Market Neutral</td>
<td>ONGNX</td>
<td>-6.51</td>
<td>-4.26 -1.78 -1.87 0.35 0.51 3.34 1.52</td>
<td>15</td>
<td>15</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Merger (01/31/89)</td>
<td>Market Neutral</td>
<td>MRFX</td>
<td>1.89</td>
<td>3.58 2.79 3.70 3.68 6.83 1.87 1.32</td>
<td>4803</td>
<td>4803</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Performance Benchmarks

| S&P 500 Index® (Dividends Reinvested) | 5.24 | 19.34 16.27 10.02 7.57 — |
| Barclays U.S. Aggregate Bond Index (Dividends Reinvested) | 0.57 | -1.68 2.86 5.41 4.59 — |
| New to the Select List this quarter | — | — |

Performance quoted is past performance and is no guarantee of future results. Current performance may be lower or higher. Visit schwab.com for month's end performance information. Investment value will fluctuate, and shares, when redeemed, may be worth more or less than original cost.

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### INCOME MUTUAL FUND SELECT LIST™

Schwab’s Income Mutual Fund Select List was developed and is managed by the Charles Schwab Investment Advisory, Inc. (CSIA) experts and includes mutual funds that have met their rigorous criteria, including both quantitative and qualitative factors. All are no-loads and no-transaction fee and are selected based on their ability to generate income in their respective asset classes. The list is designed to help you achieve income and growth. For more information on how funds are selected, see pages 35 and 36.

#### Definitions

- **30-day SEC Yield:** Based on a fund’s most recently reported portfolio holdings, this measure shows the income an investor would earn if invested in that fund for the subsequent 30 days. Although a fund’s holdings are likely to change over that time, the SEC yield provides a yardstick for comparing the income potential across funds within the same category.

- **Annual Dividend Return:** This measure looks back at the actual payouts of an equity fund over the past 12 months. It provides an accurate picture of the fund’s recent short-term distributions without forward anticipation. The Income Select List shows the 12-month dividend return for each equity fund in the form of a percentage of its share price (also known as “payout ratio”).

<table>
<thead>
<tr>
<th>FUND NAME</th>
<th>(FUND INCEPTION DATE)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Schwab International Core Equity Fund (05/30/08)</td>
<td>Foreign Large Blend</td>
</tr>
<tr>
<td>Laudus Mondrain International Equity Fund—Select (06/17/08)*</td>
<td>Foreign Large Value</td>
</tr>
<tr>
<td>Schwab GNMA Fund (03/03/03)</td>
<td>Intermediate Government</td>
</tr>
<tr>
<td>Schwab Intermediate-Term Bond Fund (10/31/07)</td>
<td>Intermediate-Term Bond</td>
</tr>
<tr>
<td>Schwab Dividend Equity Fund (09/02/03)</td>
<td>Large Value</td>
</tr>
<tr>
<td>Schwab Tax-Free Bond Fund (09/11/92)</td>
<td>Muni National Intern</td>
</tr>
<tr>
<td>Schwab Monthly Income Fund—Enhanced Payout (03/28/08)</td>
<td>Retirement Income</td>
</tr>
<tr>
<td>Schwab Monthly Income Fund—Max Payout (03/28/08)</td>
<td>Retirement Income</td>
</tr>
<tr>
<td>Laudus Mondrain International Fixed Income Fund (11/02/07)</td>
<td>World Bond</td>
</tr>
</tbody>
</table>

#### LEADING SCHWAB AFFILIATE FUNDS

- **Parnassus Equity Income—Inv (09/01/92)**
- **TIAA-CREF Social Choice Eq Retail (03/31/06)**
- **Jensen Quality Growth J (08/30/92)**
- **JP Morgan Equity Income A (02/16/92)**
- **Principal Equity Income A (05/31/96)**
- **TIAA-CREF Mid-Cap Value Retail (10/01/02)**
- **Royce Total Return Svc (01/03/02)**

#### LEADING 3RD PARTY FUNDS

- **Acadian Emerging Markets Intl (06/17/93)**
- **Harbor International Inv (11/01/92)**
- **Brandes International Equity I (12/27/96)**
- **Perkins Global Value T (06/29/01)**
- **Third Avenue Real Estate Value Investor (12/31/09)**
- **DWS RREEF Real Estate Securities A (09/03/02)**

#### TAXABLE BOND

- **TCW Emerging Markets Income N (03/01/04)**
- **RidgeWorth Seix High Yield I (12/29/09)**
- **American Century Infl-Adj Bond Inv (02/10/97)**
- **Baron Core Plus Bond Inv (09/29/09)**
- **DoubleLine Total Return Bond N (04/06/10)**
- **Metropolitan West Total Return Bond M (03/31/97)**
- **PMCO Total Return D (04/08/98)**
- **RidgeWorth Total Return Bond I (12/30/97)**
- **PMICO Income D (03/30/07)**
- **Federated Adjustable Rate Secs Inv (12/30/85)**
- **Federated Short-Term Income Inv (07/01/86)**
- **Metropolitan West Low Duration Bond M (03/31/97)**
- **RidgeWorth US Gov Sec Ultra-Short Bd I (04/11/02)**

#### TAX-FREE BOND

- **BMO Intermediate Tax-Free Y (02/01/94)**
- **American Century InternTerm Tr-Fr Bd Inv (03/02/87)**
- **Northern Tax-Exempt (03/31/94)**
- **Federated Shrt-Interm Duri Muni Inv (09/04/81)**

#### RETIREMENT INCOME

- **American Century One Choice In Ret Inv (08/31/04)**
- **New to the Select List this quarter**

---

**$50,000 initial minimum investment**
Whether you need income monthly, quarterly or annually, you have a number of fund choices. The funds on the Income Select List provide different types of income: fixed-income funds generally pay interest measured by yield; equity funds pay dividends measured by dividend return or payout ratio.

FOR THE QUARTER ENDED SEPTEMBER 30, 2013

<table>
<thead>
<tr>
<th>NET EXPENSE RATIO</th>
<th>AVG. WEIGHTED MATURITY (YRS)</th>
<th>TOTAL ASSETS ($M)</th>
<th>PAYMENT DATE</th>
<th>FREQUENCY</th>
<th>ANNUAL DIVIDEND RETURN</th>
<th>MOST RECENT DIVIDEND PAYMENT</th>
<th>30-DAY SEC YIELD</th>
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</thead>
<tbody>
<tr>
<td>0.87</td>
<td>—</td>
<td>122</td>
<td>12/6/12</td>
<td>Annually</td>
<td>2.28</td>
<td>0.21</td>
<td>2.45</td>
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<tr>
<td>1.12</td>
<td>—</td>
<td>1</td>
<td>12/6/12</td>
<td>Annually</td>
<td>2.92</td>
<td>0.24</td>
<td>2.45</td>
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<tr>
<td>0.55</td>
<td>6.60</td>
<td>364</td>
<td>9/30/13</td>
<td>Monthly</td>
<td>2.84</td>
<td>0.02</td>
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<tr>
<td>0.45</td>
<td>4.30</td>
<td>353</td>
<td>9/30/13</td>
<td>Monthly</td>
<td>1.92</td>
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<tr>
<td>0.89</td>
<td>—</td>
<td>1,668</td>
<td>9/30/13</td>
<td>Quarterly</td>
<td>1.81</td>
<td>0.07</td>
<td>1.79</td>
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<tr>
<td>0.49</td>
<td>6.10</td>
<td>602</td>
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<td>0.02</td>
<td>2.18</td>
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<tr>
<td>0.57</td>
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<td>92</td>
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<td>Monthly</td>
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<td>0.69</td>
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<td>Quarterly</td>
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<td>0.90</td>
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<tr>
<td>0.81</td>
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<td>1.31</td>
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<td>1,292</td>
<td>12/28/12</td>
<td>Annually</td>
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<td>Annually</td>
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<td>1.05</td>
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<td>1.00</td>
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<td>1.12</td>
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<td>12/20/12</td>
<td>Annually</td>
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<td>0.28</td>
<td>—</td>
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<tr>
<td>1.34</td>
<td>—</td>
<td>114</td>
<td>12/18/12</td>
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<td>0.84</td>
<td>—</td>
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<tr>
<td>0.99</td>
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<td>—</td>
</tr>
<tr>
<td>1.11</td>
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<td>5.01</td>
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<td>0.05</td>
<td>5.22</td>
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<td>6/28/13</td>
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<td>2.37</td>
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<tr>
<td>0.47</td>
<td>6.10</td>
<td>911</td>
<td>9/30/13</td>
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<td>1.96</td>
<td>0.02</td>
<td>1.27</td>
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<tr>
<td>0.55</td>
<td>6.80</td>
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<td>0.03</td>
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<tr>
<td>0.73</td>
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<td>9/30/13</td>
<td>Monthly</td>
<td>4.90</td>
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<td>4.35</td>
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<tr>
<td>0.61</td>
<td>7.80</td>
<td>10,465</td>
<td>9/30/13</td>
<td>Monthly</td>
<td>3.12</td>
<td>0.03</td>
<td>2.76</td>
</tr>
<tr>
<td>0.75</td>
<td>6.50</td>
<td>16,532</td>
<td>9/30/13</td>
<td>Monthly</td>
<td>3.46</td>
<td>0.02</td>
<td>1.89</td>
</tr>
<tr>
<td>0.41</td>
<td>8.10</td>
<td>1,109</td>
<td>9/30/13</td>
<td>Monthly</td>
<td>1.73</td>
<td>0.02</td>
<td>2.14</td>
</tr>
<tr>
<td>0.75</td>
<td>6.90</td>
<td>4,328</td>
<td>9/30/13</td>
<td>Monthly</td>
<td>5.90</td>
<td>0.05</td>
<td>3.83</td>
</tr>
<tr>
<td>0.64</td>
<td>—</td>
<td>789</td>
<td>9/30/13</td>
<td>Monthly</td>
<td>0.59</td>
<td>—</td>
<td>0.46</td>
</tr>
<tr>
<td>0.53</td>
<td>1.60</td>
<td>746</td>
<td>9/30/13</td>
<td>Monthly</td>
<td>1.77</td>
<td>0.01</td>
<td>1.27</td>
</tr>
<tr>
<td>0.57</td>
<td>2.70</td>
<td>1,784</td>
<td>9/30/13</td>
<td>Monthly</td>
<td>2.30</td>
<td>0.01</td>
<td>1.32</td>
</tr>
<tr>
<td>0.38</td>
<td>3.50</td>
<td>2,252</td>
<td>9/30/13</td>
<td>Monthly</td>
<td>0.67</td>
<td>—</td>
<td>0.56</td>
</tr>
<tr>
<td>0.55</td>
<td>5.90</td>
<td>841</td>
<td>9/30/13</td>
<td>Monthly</td>
<td>2.62</td>
<td>0.02</td>
<td>2.60</td>
</tr>
<tr>
<td>0.47</td>
<td>9.20</td>
<td>1,823</td>
<td>9/30/13</td>
<td>Monthly</td>
<td>2.50</td>
<td>0.03</td>
<td>2.11</td>
</tr>
<tr>
<td>0.47</td>
<td>18.70</td>
<td>927</td>
<td>9/24/13</td>
<td>Monthly</td>
<td>3.06</td>
<td>0.03</td>
<td>3.63</td>
</tr>
<tr>
<td>0.47</td>
<td>—</td>
<td>542</td>
<td>9/30/13</td>
<td>Monthly</td>
<td>1.58</td>
<td>0.01</td>
<td>1.23</td>
</tr>
<tr>
<td>0.77</td>
<td>—</td>
<td>214</td>
<td>9/24/13</td>
<td>Q</td>
<td>1.67</td>
<td>0.03</td>
<td>1.62</td>
</tr>
</tbody>
</table>

If an expense waiver was in place during the period, the net expense ratio was used to calculate fund performance. A net expense ratio lower than the gross expense ratio may reflect a cap or contractual waiver of fund expenses. Please read the fund prospectus for details on limits or expiration dates for any such waivers. Performance quoted is past performance and is no guarantee of future results. Current performance may be lower or higher. Visit schwab.com for month’s end performance information. Investment value will fluctuate, and shares, when redeemed, may be worth more or less than original cost.

For asset class and performance benchmark definitions, please see footnotes on pages 37–43.

A smart approach to help you generate income from your investments

As you plan for retirement, you want to build a portfolio to sustain you with regular income, but you don’t want to sacrifice the potential for growth. One solution is to build a portfolio that incorporates both fixed-income funds that generate regular income and equity funds that pay dividends as well as provide growth potential.

For a few ideas on how to build an income generating portfolio of more than one fund from the Schwab Income Mutual Fund Select List, view a sample portfolio online within the Income Select List pages, by going to www.schwab.com/incomelist. Portfolios are provided for conservative, moderately conservative or moderate investors seeking income from a portfolio consisting of taxable bond funds or municipal bond funds.

If you have questions about your retirement, Schwab can help. Get answers to questions like:

- Can I afford to retire?
- How are my expenses likely to change?
- When should I take Social Security?

at schwab.com/realliferetirement

Or talk to us about the retirement you want by calling 888-445-4515.
ETF Select List™
A List of Prescreened Low-Cost Exchange-Traded Funds

The ETF Select List provides you with a list of prescreened, low-cost ETFs representing one ETF from approximately 65 asset categories. This makes it easier for you to find the right ETFs to fit your investment needs and goals. The List was developed by the experts at Charles Schwab Investment Advisory, Inc.; and is updated quarterly.

How ETFs are Selected
To build the Schwab ETF Select List, Schwab analyzes all eligible ETFs using the quantitative and qualitative selection criteria described below. This includes both Schwab ETFs™ and ETFs from third-party providers. Schwab accepts no payments for inclusion of any ETF on this List, and all ETFs are evaluated using the same criteria.

Because the ETFs featured typically seek to track their index as closely as possible (not outperform, as actively-managed mutual funds seek to do), the List highlights just one ETF per category. Each ETF that makes the List has earned its spot based upon a combination of qualitative and quantitative variables such as cost of ownership, risk, fund structure and fit within a given category rather than outperforming its peers.

Eligibility Requirements
To be eligible for the ETF Select List, an ETF must meet certain minimum requirements to ensure a basic standard of liquidity, viability and structural stability among eligible ETFs. Eligibility criteria include:

- assets under management
- bid-ask spread
- number of competitive market makers
- length of track record

Selection Criteria
From among these eligible funds, one is selected for each ETF Select List category on the basis of its low cost of ownership, assuming a $5,000 purchase into the ETF is made online on schwab.com, held for one year, then sold.

Estimated total cost of ownership as an annual percentage of invested assets including:

- net operating expenses
- bid-ask spreads
- trade commissions (buy and sell)

Commissions can add significantly to the cost of ownership, particularly smaller positions with shorter holding periods. Schwab does not charge a commission for online trades of ETFs in Schwab ETF OneSource™, giving them a cost advantage in the selection process. Investing different amounts, trading more or less frequently, trading through brokers with commission structures different from Schwab’s, or trading at Schwab through a trading channel like a live representative or automated phone, or through a Schwab fee-based service that waives commissions, would affect cost of ownership estimates and could favor an ETF other than the one selected by Schwab for the List.

Other criteria are also considered, such as risk, fund structure and other qualitative factors. For example, a fund may be excluded if its investment style or portfolio holdings are not representative of its asset category; its bid-ask spread reflects a history of occasional large spikes; or its structure makes it more susceptible to adverse tax consequences.

To show a broader sampling of ETF providers on the List, no single ETF provider, including Schwab, may represent more than one-third of the ETFs on the ETF Select List. If any ETF provider, including Schwab, has more than one-third of the most favorably evaluated funds on the List, one or more of the second-most favorably evaluated ETFs will be substituted as necessary to limit that ETF provider’s representation. ETFs are evaluated and selected quarterly for the List using quarter-end data.

Investors should consider carefully information contained in the prospectus, including investment objectives, risks, charges and expenses. You can obtain a prospectus by calling 800-435-4000. Please read the prospectus carefully before investing.

1 Charles Schwab Investment Advisory, Inc., a registered investment advisor, is an affiliate of Charles Schwab & Co., Inc.
2 The $5,000 investment size is representative of historical Schwab independent retail client trading activity. The one-year holding period is an estimate based on industry averages and Schwab’s general view regarding the benefits of annual portfolio rebalancing.

Conditions Apply: Trades in ETFs available through Schwab ETF OneSource™ (including Schwab ETFs™) are available without commissions when placed online in a Schwab account. Service charges apply for trade orders placed through a broker ($25) or by automated phone ($5). An exchange processing fee applies to sell transactions. Certain types of Schwab ETF OneSource transactions are not eligible for the commission waiver, such as short sells and buys to cover (not including Schwab ETFs). Schwab reserves the right to change the ETFs we make available without commissions. All ETFs are subject to management fees and expenses. Please see pricing guide for additional information.

The Select List excludes leveraged ETFs, inverse ETFs, ETNs, actively-managed ETFs, muni bond ETFs with underlying holdings subject to AMT, and unmanaged baskets of securities.
**EXCHANGE-TRADED FUNDS**

**FOR THE QUARTER ENDED SEPTEMBER 30, 2013**

<table>
<thead>
<tr>
<th>ETF SELECT LIST CATEGORY</th>
<th>QUOTE SYMBOL</th>
<th>FUND NAME</th>
<th>INDEX</th>
<th>GROSS EXPENSES</th>
<th>ONLINE COMMISSION</th>
<th>DESCRIPTION</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. EQUITY ETFs</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Large Core</td>
<td>SCHX</td>
<td>Schwab U.S. Large-Cap ETF</td>
<td>Dow Jones U.S. Total Stock Market Large Cap</td>
<td>0.04%</td>
<td>$0†</td>
<td>Index covers over 700 largest US firms which comprise about 80% of the US market (by capitalization)</td>
</tr>
<tr>
<td>Large Growth</td>
<td>SCHG</td>
<td>Schwab U.S. Large-Cap Growth ETF</td>
<td>Dow Jones U.S. Total Stock Market Large Cap Growth</td>
<td>0.07%</td>
<td>$0†</td>
<td>ETF has diversified exposure to large growth names such as Apple, Microsoft, and Google</td>
</tr>
<tr>
<td>Large Value</td>
<td>SCHV</td>
<td>Schwab U.S. Large-Cap Value ETF</td>
<td>Dow Jones U.S. Total Stock Market Large Cap Value</td>
<td>0.07%</td>
<td>$0†</td>
<td>ETF has diversified exposure to large value names such as ExxonMobil, GE, IBM, and Pfizer</td>
</tr>
<tr>
<td>Mid Core</td>
<td>SCHM</td>
<td>Schwab U.S. Mid-Cap ETF</td>
<td>Dow Jones U.S. Mid-Cap Total Stock Market Index</td>
<td>0.07%</td>
<td>$0†</td>
<td>Over 500 holdings providing US equity exposure to the mid-cap portion of the broader US stock market</td>
</tr>
<tr>
<td>Mid Growth</td>
<td>MDYG</td>
<td>SPDR S&amp;P 400 Mid Cap Growth ETF</td>
<td>S&amp;P 400 Mid Cap Growth</td>
<td>0.25%</td>
<td>$0†</td>
<td>U.S. growth stocks with market caps between $850M and $3.8B selected based on sales growth, earnings growth, and momentum</td>
</tr>
<tr>
<td>Mid Value</td>
<td>MDYV</td>
<td>SPDR S&amp;P MidCap 400 Value</td>
<td>S&amp;P MidCap 400 Value Index</td>
<td>0.28%</td>
<td>$0†</td>
<td>Focuses on over 1700 small-cap companies; index excludes the smallest micro-cap stocks</td>
</tr>
<tr>
<td>Small Core</td>
<td>SCHA</td>
<td>Schwab U.S. Small-Cap ETF</td>
<td>Dow Jones U.S. Total Stock Market Small Cap</td>
<td>0.08%</td>
<td>$0†</td>
<td>Holds small-cap stocks with value characteristics based on: book value to price, earnings to price, and sales to price ratios</td>
</tr>
<tr>
<td>Small Growth</td>
<td>SLYG</td>
<td>SPDR S&amp;P 600 Small Cap Growth ETF</td>
<td>S&amp;P 600 Small Cap Growth</td>
<td>0.31%</td>
<td>$0†</td>
<td>Holds small-cap stocks with growth characteristics and market caps ranging from $250M to $1.2B</td>
</tr>
<tr>
<td>Small Value</td>
<td>SLVY</td>
<td>SPDR S&amp;P SmallCap 600 Value</td>
<td>S&amp;P SmallCap 600 Value Index</td>
<td>0.31%</td>
<td>$0†</td>
<td>Holds stocks with value characteristics selected from the S&amp;P SmallCap 600 Index</td>
</tr>
<tr>
<td>Total Stock Market</td>
<td>SCHB</td>
<td>Schwab U.S. Broad Market ETF</td>
<td>Dow Jones U.S. Broad Stock Market Index</td>
<td>0.04%</td>
<td>$0†</td>
<td>Over 1500 large to small-cap firms; covers virtually the entire US stock market (by capitalization)</td>
</tr>
<tr>
<td>Dividend-focused</td>
<td>SCHD</td>
<td>Schwab U.S. Dividend Equity ETF</td>
<td>Dow Jones U.S. Dividend 100 Index</td>
<td>0.07%</td>
<td>$0†</td>
<td>Holds U.S. companies that consistently pay dividends and have strong relative fundamental strength based on financial ratios</td>
</tr>
</tbody>
</table>

**INTERNATIONAL EQUITY ETFs**

<table>
<thead>
<tr>
<th>ETF SELECT LIST CATEGORY</th>
<th>QUOTE SYMBOL</th>
<th>FUND NAME</th>
<th>INDEX</th>
<th>GROSS EXPENSES</th>
<th>ONLINE COMMISSION</th>
<th>DESCRIPTION</th>
</tr>
</thead>
<tbody>
<tr>
<td>Developed Core</td>
<td>SCHF</td>
<td>Schwab International Equity ETF</td>
<td>FTSE Developed ex U.S. Index</td>
<td>0.09%</td>
<td>$0†</td>
<td>Canada included in this index which highlights large and mid-cap stocks from 20 developed countries excluding Canada</td>
</tr>
<tr>
<td>Developed Growth</td>
<td>EFG</td>
<td>iShares MSCI EAFE Growth Index</td>
<td>MSCI EAFE Growth</td>
<td>0.40%</td>
<td>$8.95</td>
<td>Developed stock markets excl. US and Canada. Top index weights are U.K., Japan, and Switzerland</td>
</tr>
<tr>
<td>Developed Value</td>
<td>EFV</td>
<td>iShares MSCI EAFE Value Index</td>
<td>MSCI EAFE Value</td>
<td>0.40%</td>
<td>$8.95</td>
<td>Developed stock markets excl. US and Canada. Index heavy in Japan, U.K., and financial services</td>
</tr>
<tr>
<td>Developed Small</td>
<td>SCHC</td>
<td>Schwab International Small-Cap Eq ETF</td>
<td>FTSE Developed Small Cap Ex U.S. Liquid Index</td>
<td>0.20%</td>
<td>$0†</td>
<td>Canada included in this index featuring approximately 1200 small-cap firms from over 20 developed markets</td>
</tr>
<tr>
<td>Emerging Market Stock</td>
<td>SCHE</td>
<td>Schwab Emerging Markets Equity ETF</td>
<td>FTSE Emerging Index</td>
<td>0.15%</td>
<td>$0†</td>
<td>Large and mid-cap stocks from over 20 emerging markets. Financials are over 25% of the holdings</td>
</tr>
<tr>
<td>All World ex-US Stock</td>
<td>CWI</td>
<td>SPDR MSCI ACWI (ex-US)</td>
<td>MSCI ACWI Ex USA Index</td>
<td>0.34%</td>
<td>$0†</td>
<td>Tracks a cap-weighted index of developed and emerging market countries excluding the US</td>
</tr>
<tr>
<td>Global Stock</td>
<td>VT</td>
<td>Vanguard Total World Stock Index ETF</td>
<td>FTSE Global All Cap Index</td>
<td>0.19%</td>
<td>$8.95</td>
<td>Holds over 5000 stocks spanning the investable global stock markets, including emerging markets</td>
</tr>
<tr>
<td>Europe Stock</td>
<td>FEU</td>
<td>SPDR STOXX Europe 50</td>
<td>STOXX Europe 50 Index</td>
<td>0.29%</td>
<td>$0†</td>
<td>Holds 50 of the largest companies in Europe, including Nestle, HSBC, and Royal Dutch Shell</td>
</tr>
<tr>
<td>Pacific Asia Stock</td>
<td>VPL</td>
<td>Vanguard FTSE Pacific ETF</td>
<td>FTSE Developed Asia Pacific Index</td>
<td>0.12%</td>
<td>$8.95</td>
<td>Features about 600 stocks, approximately 60% from Japan; also includes Australia, Hong Kong and Singapore</td>
</tr>
<tr>
<td>Pacific Asia ex-Japan Stock</td>
<td>EPP</td>
<td>iShares MSCI Pacific ex-Japan Index</td>
<td>MSCI Pacific ex-Japan Index</td>
<td>0.50%</td>
<td>$8.95</td>
<td>Includes publicly traded stocks from Australia, Hong Kong, and Singapore</td>
</tr>
<tr>
<td>Japan Stock</td>
<td>NKY</td>
<td>MAXIS Nikkei 225 Index ETF</td>
<td>Nikkei 225 Index</td>
<td>0.53%</td>
<td>$8.95</td>
<td>Holds 225 stocks traded on the Tokyo Stock Exchange; largest sectors are consumer discretionary, industrials and IT</td>
</tr>
<tr>
<td>China Stock</td>
<td>GXC</td>
<td>SPDR S&amp;P China</td>
<td>S&amp;P China Broad Market Index</td>
<td>0.59%</td>
<td>$8.95</td>
<td>Largest index sectors are financials, technology and energy</td>
</tr>
</tbody>
</table>

---

"Gross expenses" reflect a fund’s total annual operating expenses as stated in the fund’s prospectus and do not reflect any expense reimbursements or waivers that may exist. Some ETFs appearing on this list may be subject to expense reimbursements and waivers, and less such reimbursements and waivers may have lower total annual operating expenses (i.e., "net expenses") than indicated herein. Please read the fund prospectus carefully to determine the existence of any expense reimbursements or waivers and details on their limits and termination dates.

Charles Schwab & Co., Inc. receives remuneration from third-party ETF companies participating in Schwab ETF OneSource™ for record keeping, shareholder services and other administrative services, including program development and maintenance. Investment returns will fluctuate and are subject to market volatility, so that an investor’s shares, when redeemed or sold, may be worth more or less than their original cost. Unlike mutual funds, shares of ETFs are not individually redeemable directly with the ETF. Shares are bought and sold at market price, which may be higher or lower than the net asset value ("NAV").

No mention of particular funds or fund families here should be construed as a recommendation or considered an offer to sell or a solicitation of an offer to buy any securities. This information provided here is for general informational purposes only and should not be considered an individualized recommendation or personalized investment advice. The securities listed may not be suitable for everyone. Each investor needs to review a securities transaction for his or her own particular situation. Schwab or its employees may sometimes hold positions in the securities listed here. Data contained here is obtained from what are considered reliable sources; however, its accuracy, completeness or reliability cannot be guaranteed.

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

Small-cap funds are subject to greater volatility than those in other asset categories.

High-yield funds invest in lower-rated securities. This subjects these funds to greater credit risk, default risk and liquidity risk.

Commodity-related products, including futures, carry a high level of risk and are not suitable for all investors. Commodity-related products may be extremely volatile, illiquid and can be significantly affected by underlying commodity prices, world events, import controls, worldwide competition, government regulations, and economic conditions, regardless of the length of time shares are held. Investments in commodity-related products may subject the fund to significantly greater volatility than investments in traditional securities and involve substantial risks, including risk of loss of a significant portion of their principal value.

Some specialized exchange-traded funds can be subject to additional market risks. Investment returns will fluctuate and are subject to market volatility, so that an investor’s shares, when redeemed or sold, may be worth more or less than their original cost. Unlike mutual funds, shares of ETFs are not individually redeemable directly with the ETF.
### Exchange-Traded Funds

#### For the Quarter Ended September 30, 2013

<table>
<thead>
<tr>
<th>ETF Select List Category</th>
<th>Quote Symbol</th>
<th>Fund Name</th>
<th>Index</th>
<th>Gross Expenses</th>
<th>Online Commission</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Bond ETFs</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Short Term Broad Market</td>
<td>BSV</td>
<td>Vanguard Short-Term Bond ETF</td>
<td>Barclays U.S. 1–5 Year Government/ Credit Float Adjusted Index</td>
<td>0.10%</td>
<td>$8.95</td>
<td>Invests in U.S. government and investment grade corporate bonds with durations from one to five years</td>
</tr>
<tr>
<td>Short Term Corporate</td>
<td>VCSH</td>
<td>Vanguard Short-Term Corp Bond Index ETF</td>
<td>Barclays U.S. 1–5 Year Corporate Bond Index</td>
<td>0.12%</td>
<td>$8.95</td>
<td>Holds over 1000 short-term, investment grade U.S. corporate bonds</td>
</tr>
<tr>
<td>Short Term Muni</td>
<td>SHM</td>
<td>SPDR Nuveen Barclays Short Term Municipal Bond</td>
<td>Barclays Managed Money Municipal Short Term Bond Index</td>
<td>0.20%</td>
<td>$0†</td>
<td>Holds short-term tax exempt bonds (includes: state and local general obligation, revenue, insured and pre-refunded bonds)</td>
</tr>
<tr>
<td>Short Term Treasury</td>
<td>SCHD</td>
<td>Schwab Short-Term U.S. Treasury ETF</td>
<td>Barclays U.S. 1–3 Year Treasury Bond Index</td>
<td>0.08%</td>
<td>$0†</td>
<td>ETF features 42 Treasuries which mature by August 2016</td>
</tr>
<tr>
<td>Intermediate Broad Market</td>
<td>SCHZ</td>
<td>Schwab U.S. Aggregate Bond ETF</td>
<td>Barclays U.S. Aggregate Bond Index</td>
<td>0.05%</td>
<td>$0†</td>
<td>Holds securities that are fixed rate, non-convertible with at least $250 million of outstanding face value.</td>
</tr>
<tr>
<td>Intermediate Corporate</td>
<td>VCI†</td>
<td>Vanguard Intermediate-Term Corp Bond Index ETF</td>
<td>Barclays U.S. 5–10 Year Corporate Bond Index</td>
<td>0.12%</td>
<td>$8.95</td>
<td>Tracks the US long term tax-exempt bond market and includes general obligation, revenue, pre-refunded and insured issues.</td>
</tr>
<tr>
<td>Intermediate Muni</td>
<td>TFI</td>
<td>SPDR Nuveen Barclays Municipal Bond</td>
<td>Barclays Municipal Managed Money Index</td>
<td>0.30%</td>
<td>$0†</td>
<td>Includes general obligation, revenue, pre-refunded and insured issues.</td>
</tr>
<tr>
<td>Intermediate Treasury</td>
<td>SCHR</td>
<td>Schwab Intermediate-Term U.S. Treasury ETF</td>
<td>Barclays U.S. 3–10 Year Treasury Bond Index</td>
<td>0.10%</td>
<td>$0†</td>
<td>Tracks the US long term tax-exempt bond market and includes general obligation, revenue, pre-refunded and insured issues.</td>
</tr>
<tr>
<td>Long Term Broad Market</td>
<td>BLV</td>
<td>Vanguard Long-Term Bond Index ETF</td>
<td>Barclays U.S. Long Government/ Credit Float Adjusted Index</td>
<td>0.10%</td>
<td>$8.95</td>
<td>Provides diversified exposure to the long-term, investment-grade segment of the U.S. bond market</td>
</tr>
<tr>
<td>Long Term Corporate</td>
<td>VCL†</td>
<td>Vanguard Long-Term Corp Bond Index ETF</td>
<td>Barclays U.S. 10+ Year Corp Index</td>
<td>0.12%</td>
<td>$8.95</td>
<td>Invests in high-quality investment-grade corporate bonds; maintains a dollar-weighted average maturity of 10–25 years.</td>
</tr>
<tr>
<td>Long Term Treasury</td>
<td>TLT†</td>
<td>Shares Barclays 20+ Year Treasury Bond</td>
<td>Barclays U.S. 20+ Year Treasury Bond Index</td>
<td>0.15%</td>
<td>$8.95</td>
<td>Tracks the U.S. Treasury with at least 20 years until maturity.</td>
</tr>
<tr>
<td>High Yield</td>
<td>PHB†</td>
<td>PowerShares Fundamental High Yield Corp Bond</td>
<td>RFI® Bonds U.S. High Yield 1–10 Year Index</td>
<td>0.50%</td>
<td>$0†</td>
<td>Tracks an index of high-yield, U.S. bonds that are selected based on the Research Affiliates Fundamental Index methodology.</td>
</tr>
<tr>
<td>TIPS</td>
<td>SCHP</td>
<td>Schwab U.S. TIPS ETF</td>
<td>Barclays US Treasury Inflation Protected Securities – Series L</td>
<td>0.07%</td>
<td>$0†</td>
<td>Tracks Treasuries which are designed to adjust for and help protect against inflation.</td>
</tr>
<tr>
<td>Emerging Markets</td>
<td>PCY†</td>
<td>PowerShares Emerging Mkts Sovereign Debt</td>
<td>DB Emerging Market USD Liquid Balanced</td>
<td>0.50%</td>
<td>$0†</td>
<td>Tracks developing and emerging market sovereign debt.</td>
</tr>
<tr>
<td>International</td>
<td>BWX†</td>
<td>SPDR Barclays International Treasury Bond</td>
<td>Barclays Global Treasury Ex U.S.</td>
<td>0.50%</td>
<td>$0†</td>
<td>ETF features bond issued by foreign governments.</td>
</tr>
<tr>
<td>Preferred Stock</td>
<td>PGX†</td>
<td>PowerShares Preferred Portfolio</td>
<td>BofA Merrill Lynch Core Plus Fixed Rate Preferred Securities</td>
<td>0.50%</td>
<td>$0†</td>
<td>Dividends on preferreds may appeal to income seekers; Top 10 holdings are financial firms.</td>
</tr>
</tbody>
</table>

#### Sector ETFs

<table>
<thead>
<tr>
<th>ETF Select List Category</th>
<th>Quote Symbol</th>
<th>Fund Name</th>
<th>Index</th>
<th>Gross Expenses</th>
<th>Online Commission</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consumer Discretionary</td>
<td>VCR</td>
<td>Vanguard Consumer Discretionary ETF</td>
<td>MSCI U.S. Investable Market Consumer Discretionary 25/50</td>
<td>0.14%</td>
<td>$8.95</td>
<td>跟踪美国可选消费行业，指数成分股包括但不限于：汽车、服装、酒店、餐饮等。</td>
</tr>
<tr>
<td>Consumer Staples</td>
<td>VDC</td>
<td>Vanguard Consumer Staples ETF</td>
<td>MSCI U.S. Investable Market Consumer Staples 25/50</td>
<td>0.14%</td>
<td>$8.95</td>
<td>跟踪美国消费品行业，指数成分股包括但不限于：食品、饮料、烟草等相关公司。</td>
</tr>
<tr>
<td>Energy</td>
<td>VDE</td>
<td>Vanguard Energy ETF</td>
<td>MSCI U.S. Investable Market Energy 25/50 Index</td>
<td>0.14%</td>
<td>$8.95</td>
<td>跟踪美国能源行业，指数成分股包括但不限于：电力、石油、天然气等。</td>
</tr>
<tr>
<td>Clean Energy</td>
<td>QCLN</td>
<td>First Trust NASDAQ Clean Edge Green Energy</td>
<td>NASDAQ® Clean Edge® Green Energy Index</td>
<td>0.98%</td>
<td>$8.95</td>
<td>跟踪美国清洁能源行业，指数成分股包括但不限于：可再生能源、清洁能源等。</td>
</tr>
<tr>
<td>Financial</td>
<td>XLF</td>
<td>Financial Select SPDR</td>
<td>S&amp;P 500 Sector / Financials</td>
<td>0.18%</td>
<td>$8.95</td>
<td>跟踪美国500指数，成分股包括但不限于：金融、银行、保险等行业。</td>
</tr>
<tr>
<td>Health Care</td>
<td>VHT</td>
<td>Vanguard Health Care ETF</td>
<td>MSCI U.S. Investable Market Health Care 25/50</td>
<td>0.14%</td>
<td>$8.95</td>
<td>跟踪美国医疗保健行业，指数成分股包括但不限于：医院、药品、医疗器械等。</td>
</tr>
<tr>
<td>Industrials</td>
<td>VIS</td>
<td>Vanguard Industrials ETF</td>
<td>MSCI U.S. Investable Market Industrials 25/50</td>
<td>0.14%</td>
<td>$8.95</td>
<td>跟踪美国制造业，指数成分股包括但不限于：工业、机械、建筑等。</td>
</tr>
<tr>
<td>Materials</td>
<td>MAV</td>
<td>Vanguard Materials ETF</td>
<td>MSCI U.S. Investable Market Materials 25/50 Index</td>
<td>0.14%</td>
<td>$8.95</td>
<td>跟踪美国材料行业，指数成分股包括但不限于：钢铁、铝、水泥等。</td>
</tr>
<tr>
<td>Technology</td>
<td>VGT</td>
<td>Vanguard Information Technology ETF</td>
<td>MSCI U.S. Investable Market Information Technology 25/50</td>
<td>0.14%</td>
<td>$8.95</td>
<td>跟踪美国信息技术行业，指数成分股包括但不限于：半导体、软件、云计算等。</td>
</tr>
<tr>
<td>Telecommunications</td>
<td>VOX</td>
<td>Vanguard Telecommunications ETF</td>
<td>MSCI U.S. Investable Market Telecommunications Services 25/50</td>
<td>0.14%</td>
<td>$8.95</td>
<td>跟踪美国电信服务行业，指数成分股包括但不限于：通信、互联网等。</td>
</tr>
<tr>
<td>Utilities</td>
<td>VPU</td>
<td>Vanguard Utilities ETF</td>
<td>MSCI U.S. Investable Market Utilities 25/50 Index</td>
<td>0.14%</td>
<td>$8.95</td>
<td>跟踪美国公用事业行业，指数成分股包括但不限于：电力、燃气、水务等。</td>
</tr>
</tbody>
</table>

*New to the Select List this quarter

† Conditions Apply: Trades in ETFs available through Schwab ETF OneSource™ (including Schwab ETFs™) are available without commissions when placed online in a Schwab account. Service charges apply for trade orders placed through a broker ($25) or by automated phone ($5). An exchange processing fee applies to sell transactions. Certain types of Schwab ETF OneSource transactions are not eligible for the commission waiver, such as short sells and buys to cover (not including Schwab ETFs). Schwab reserves the right to change the ETFs we make available without commissions. All ETFs are subject to management fees and expenses. Please see pricing guide for additional information.

Many fixed-income securities are subject to increased loss of principal during periods of rising interest rates. Fixed-income investments are subject to various other risks, including changes in credit quality, market valuations, liquidity, prepayments, early redemption, corporate events, tax ramifications and other factors. The lower-rated securities in which some bond funds invest are subject to greater credit risk, default risk and liquidity risk. Government bond fund shares are not guaranteed. Their price and investment return will fluctuate with market conditions and interest rates. Shares, when redeemed, may be worth more or less than their original cost. Risks of REITs are similar to those associated with direct ownership of real estate, such as changes in real-estate values and property taxes, interest rates, cash flow of underlying real-estate assets, supply and demand, and the management skill and creditworthiness of the issuer. Since a sector fund is typically not diversified and focuses its investments on companies involved in a specific sector, the fund may involve a greater degree of risk than an investment in other mutual funds with greater diversification.
## Exchange-Traded Funds

For the quarter ended September 30, 2013

<table>
<thead>
<tr>
<th>ETF Select List Category</th>
<th>Quote Symbol</th>
<th>Fund Name</th>
<th>Index</th>
<th>Gross Expenses</th>
<th>Online Commission</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Real Assets</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Commodities Broad</td>
<td>USC1</td>
<td>United States Commodity Index</td>
<td>SummerHaven Dynamic Commodity Index</td>
<td>1.03%</td>
<td>$0†</td>
<td>14 futures contracts on precious metals, industrial metals, energy and agricultural products. Investors will receive K-1s. Uses futures contracts to access a cornucopia of coffee, sugar, livestock, grain, cocoa. Investors will get K-1s at tax time. Each share backed by gold bullion held in a Swiss vault; provides direct exposure to gold price movements.</td>
</tr>
<tr>
<td>Agriculture</td>
<td>DBA</td>
<td>PowerShares DB Agriculture</td>
<td>DBIQ Diversified Agriculture Index Excess Return</td>
<td>0.85%</td>
<td>$8.95</td>
<td></td>
</tr>
<tr>
<td>Gold</td>
<td>SGOL</td>
<td>ETF Physical Swiss Gold Shares</td>
<td>London PM Fix Price of Gold</td>
<td>0.39%</td>
<td>$0†</td>
<td></td>
</tr>
<tr>
<td>Broad Precious Metals</td>
<td>GLTR</td>
<td>ETF Physical PM Basket Shares</td>
<td>London PM Fix Price of Gold, Silver, Platinum and Palladium</td>
<td>0.60%</td>
<td>$0†</td>
<td></td>
</tr>
<tr>
<td>Industrial Metals</td>
<td>DBB</td>
<td>PowerShares DB Base Metals</td>
<td>DBIQ Optimum Yield Industrial Metals Index Excess Return</td>
<td>0.75%</td>
<td>$8.95</td>
<td></td>
</tr>
<tr>
<td>Oil</td>
<td>USL</td>
<td>United States 12 Month Oil</td>
<td>West Texas Intermediate light, sweet crude</td>
<td>0.88%</td>
<td>$0†</td>
<td></td>
</tr>
<tr>
<td>Broad Energy Commodities</td>
<td>DBE</td>
<td>PowerShares DB Energy</td>
<td>DBIQ Optimum Yield Energy Index Excess Return</td>
<td>0.75%</td>
<td>$8.95</td>
<td></td>
</tr>
<tr>
<td>Real Estate</td>
<td>SCHH</td>
<td>Schwab US REIT ETF</td>
<td>Dow Jones U.S. Select REIT Index</td>
<td>0.07%</td>
<td>$0†</td>
<td></td>
</tr>
<tr>
<td><strong>Specialty ETFs</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Multi-Asset Income</td>
<td>CVY</td>
<td>Guggenheim Multi-Asset Income</td>
<td>Zacks Multi-Asset Income Index</td>
<td>0.86%</td>
<td>$0†</td>
<td></td>
</tr>
</tbody>
</table>

### Alternative Weighted ETFs

<table>
<thead>
<tr>
<th>ETF Select List Category</th>
<th>Quote Symbol</th>
<th>Fund Name</th>
<th>Index</th>
<th>Gross Expenses</th>
<th>Online Commission</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. Large Weighted Equal</td>
<td>RSP</td>
<td>Guggenheim S&amp;P 500 Equal Weight</td>
<td>Standard and Poor’s 500 Equal Weight</td>
<td>0.40%</td>
<td>$0†</td>
<td>Compared to market cap weighted indexes, this ETF has lower exposure to the largest companies, index is rebalanced quarterly.</td>
</tr>
<tr>
<td>U.S. Large Weighted Fundamental</td>
<td>SPOH</td>
<td>PowerShares S&amp;P 500 High Quality Rankings Index</td>
<td>Standard and Poor’s High Quality Rankings Index</td>
<td>0.43%</td>
<td>$8.95</td>
<td>Holds stocks ranked highest by S&amp;P for having long-term growth and stability in earnings and dividends.</td>
</tr>
<tr>
<td>U.S. Small Weighted Fundamental</td>
<td>PRF2</td>
<td>PowerShares FTSE RAFI US 1500 Small-Mid</td>
<td>FTSE RAFI US 1500 Small-Mid</td>
<td>0.43%</td>
<td>$8.95</td>
<td></td>
</tr>
<tr>
<td>International Weighted Fundamental</td>
<td>PXF</td>
<td>PowerShares FTSE RAFI Div Mks Ex-US</td>
<td>FTSE RAFI Developed Markets ex-U.S.</td>
<td>0.45%</td>
<td>$8.95</td>
<td></td>
</tr>
<tr>
<td>U.S. Large Weighted Low Volatility</td>
<td>SPLV</td>
<td>PowerShares S&amp;P 500 Low Volatility</td>
<td>S&amp;P 500® Low Volatility Index</td>
<td>0.25%</td>
<td>$0†</td>
<td>Holds 100 stocks from the S&amp;P 500® Index with the lowest realized volatility over the past 12 months. Includes stocks from Europe, Australasia, the Middle and Far East; stocks with the lowest volatility have the highest weights.</td>
</tr>
<tr>
<td>International Weighted Low Volatility</td>
<td>EFAV</td>
<td>iShares MSCI EAFE Min Volatility</td>
<td>MSCI EAFE Minimum Volatility</td>
<td>0.34%</td>
<td>$8.95</td>
<td></td>
</tr>
</tbody>
</table>

### Traditional Indexes

These ETFs track indexes that are mostly weighted by market capitalization; that is, they give the most weight to companies whose outstanding stock is worth the most money. The advantages of ETFs that track market capitalization or traditional weighted indexes are that they require very little rebalancing (which keeps costs low) and that they reflect the way the market itself is weighted. In some cases a different weighting scheme may be traditional, such as commodity indexes that are weighted by the liquidity of various commodities.

### Alternative Weighted ETFs

There are three Alternative Weighted ETF categories on the ETF Select List. Each category has a specific approach to building an index so you can consider which ETFs are best for your situation.

- **Equal-Weighted Indexes:** Most indexes are weighted by market capitalization, where companies with the highest stock market value get the most weight. Equal-weighted indexes give an equal amount of weight to each stock in the index. If an ETF tracks an equal-weighted index with 100 stocks, it would generally put about 1% of the fund’s assets into each of the stocks.

- **Fundamental-Weighted Indexes:** Rather than relying on stock market values for weights, a fundamental index uses criteria such as companies’ profits, dividends, book value, cash flow or number of employees to assign weight to the stocks in the index. The theory is to put more weight into stocks that have a larger economic footprint rather than just a large market value.

- **Low Volatility-Weighted Indexes:** In these funds, the lower the volatility of a stock, the more weight it receives in the index. The goal is to arrive at a group of stocks whose overall volatility is lower than the market as a whole, which means that the index may gain less than the market during rallies but lose less than the market during declines.
Navigating the Market as the Fed Backs Off
Stock strategies to consider in an environment of rising interest rates.
BY JOHN M. EADE

After five years of setbacks and swerves in strategy, the Federal Reserve has finally indicated it may soon have the confidence in the economy necessary to taper its quantitative easing program and ultimately raise short-term interest rates.

Despite the Fed announcing in September that its tapering plan would not begin as soon as expected,1 we believe the next few quarters will be influenced by several macro factors as the Fed prepares to back off:

- **Stronger dollar.** After hitting record lows in summer 2011, the dollar has been on a steady rise, further strengthened by the improving US economy. But the dollar remains about 15% below its peak value on a trade-weighted basis. We expect it to advance an additional 5–7% over the next few quarters as the Fed’s balance sheet strengthens.

- **Weaker commodity prices.** A strong dollar will impact commodity pricing, which, in turn, will impact the economies of developing countries with a resource basis. Already this year, the combination of a strong dollar and emerging-economy malaise has hit resource-based economies hard.

- **Higher long-term rates.** The 10-year Treasury yield appreciated by more than one full percentage point between April and early September, to 2.93%.2 As the Fed adjusts its policies during the next 12 months, we anticipate that the 10-year Treasury yield will continue to climb, and could reach 3.5% by the end of 2014.

Based on these near-term factors, we are recommending several equity strategies for diversified investors:

- **Go domestic.** A stronger US economy will be the key reason the Fed steps back from its aggressive monetary stance. We anticipate gross domestic product (GDP) to grow at a rate between 2.5–3.5% through 2014, well ahead of the average 1.4% growth rate in the first half of 2013. Equity sectors likely to benefit include retailers, restaurants, media companies and banks.

- **Consider industrials.** Lower commodity prices—and potentially lower oil prices in 2014 as the United States continues to increase its domestic oil production—should reduce costs and raise margins for industrial companies such as automakers and aerospace firms. Oilfield services companies with heavy exposure to North American fields and wells should also benefit.

- **Favor dividend growth over dividend yield.** High-yield sectors, such as telecommunications and utilities, are likely to be under pressure as long-term Treasury rates rise and entice investors with the relative safety and security of government debt. But financially strong companies in a host of industries should benefit from the recovering economy and, with little need to pay down debt, are likely in a position to boost their dividend payouts. We think stocks with current dividend yields between 1.5–3.0% could be the sweet spot.

Looking ahead, we believe investors can expect a different financial landscape in 2014, with a Fed led by a different chairman. Now is the time to adjust portfolios to prepare for the changes.

John M. Eade is President of Argus Research Co.

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2US Department of the Treasury, as of September 5, 2013.
Looking ahead, we believe investors can expect a
Debt, are likely in a position to boost their dividend
and security of government debt. But financially strong
A stronger US economy will be the key
High-growth companies such as automakers and aerospace firms.
Potential lower oil prices in 2014 as the United States
Lower commodity prices—and
to climb, and could near 3.5% by the end of 2014.
Fed adjusts its policies during the next 12 months, we

THE ARGUS MODEL PORTFOLIOS

Equity Income

Growth & Income

Mid-Cap Growth

See page 2 for important information.
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On your side ©Schwab Photo Library

Knowing When to Ask for Help

Even the savviest investors draw on help from time to time.

Over the years, I’ve met thousands of people who share my passion for investing. They enjoy the satisfaction that comes with doing things their way. They value the importance of carefully researched choices. And they are proud of their knowledge of the markets.

It’s often these same investors who recognize that their investment needs are too great to manage on their own. Maybe they’re short on time, or they don’t have expertise in a certain area. Or maybe their investment interests just lie elsewhere. Whatever the case, even some of the most sophisticated investors seek professional assistance now and then.

And that’s where we come in. No single investor can know everything, nor should they be expected to. But asking for help doesn’t mean you have to hand over control of your investments. At Schwab, our guidance is a spectrum. You can call us up for something as straightforward as a stock quote or something as complex as a discussion of the international markets. We can give you answers to basic portfolio questions or provide you with ongoing professional portfolio management.

Advice doesn’t have to be all or nothing, either. We can oversee a specific area of your investments or manage your entire portfolio for you. So no matter how you prefer to invest or how your needs change over time, we’re ready to help.

I truly believe investing is something we can all do. Yes, it can take a lifetime of study and practice, as well as professional help every so often. But the reward isn’t just having a plan that can help meet your financial goals. It’s being able to navigate the journey.

Charles R. Schwab
Founder & Chairman

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schwabcharitable.org

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1. **Monthly income.** Seeks to provide income whether the market goes up or down.
2. **Annual income growth.** Seeks to offset inflation with dividend income intended to grow every year.
3. **Capital appreciation.** Seeks to deliver competitive total returns over time.

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The ThomasPartners Dividend Growth Strategy is provided through Charles Schwab.

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There are risks associated with any investment approach and the ThomasPartners Dividend Growth Strategy has its own set of risks. First, there are the risks associated with investing in dividend-paying stocks, including but not limited to the risk that stocks in the strategy may reduce or stop paying dividends, affecting the strategy’s ability to generate income. Second, investor sentiment could cause dividend-paying equities to fall out of favor or price-earnings multiples to compress. Please discuss these and other potential risks with your Financial Consultant prior to investing.

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