Schwab Center for
Financial Research

The Schwab 1000 Index®

26 Years of Battle-Tested Results

charles SCHWAB

Own your tomorrow®

The Original Start of Indexing at Schwab.

A message from
Charles R. Schwab,
Founder and Chairman

I launched the Schwab 1000 Index, and the mutual fund based on it, in 1991 to give investors a simple, low-cost way to track the growth of a broad group of America's largest companies and participate in their growth potential. Now, the Schwab 1000 exchange-traded-fund (ETF) is available.

Twenty-six years ago, it was a pioneering idea, without a track record on which to base its merit. I didn't believe in the validity of back-testing, or using hypothetical data, as a credible way to create a performance record. So I built the index with a deep understanding of how our stock markets progress over time and ample confidence in the outcome . . . but I longed for the day that a true performance track record of results would be available.

Like all investors, I was confident the economy would grow over the long run, and stocks along with it. In an active, dynamic, transparent stock market like ours, growth happens bit by bit, day by day, and year by year as the values of individual stocks move up and down.

I was also confident in our new index because it was designed to track what was going on in a part of our economy where we find many of our most successful businesses: the 1000 largest publicly traded U.S. corporations. The Schwab 1000 Index cast a larger net than the smaller S&P 500® Index or Dow Jones Indexes and would capture a larger collection of dynamic, emerging, growing companies.

The Schwab 1000 Index represents the 1000 largest companies in America each year. Every year we eliminate from the Index those companies whose value drops them below that threshold and replace them with companies whose value takes them over it.

"I didn't believe in the validity of back-testing, or using hypothetical data, as a credible way to create a performance record . . . but I longed for the day that a true performance track record of results would be available."

Today, we can see a track record of how the largest 1000 companies have performed over time. We can look back and see exactly how it performed during every period of the market's long journey forward. Not back-testing—the real record.

In the following pages, we summarize historical data to help investors understand the dynamics of the Schwab 1000 Index. It is timely, because today millions of investors like you are discovering the value of index investing and trying to determine the right approach to reach their investment goals.

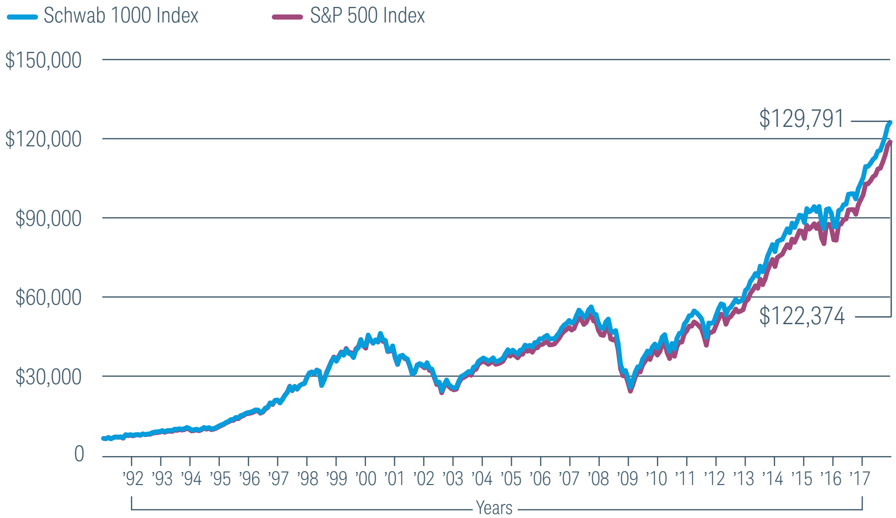
I hope you find this information as inspiring about the long-term power of an idea like the Schwab 1000 Index as I have. Sometimes the journey is worth the wait.

Charles R. Schwab, Founder and Chairman

Battle-tested over the last 26 years, the Schwab 1000 Index and its namesake mutual fund have delivered strong results through multiple market regimes. Based on these results and investor demand, the Schwab 1000 Index® ETF was launched in 2017 following the same index methodology used in the mutual fund.

Hypothetical Growth of $10,000 invested in the Schwab 1000 Index

Performance over 26 years of $10,000 invested



Annualized Returns as of December 31, 2017	1 Year 2017	5 Years 2013–2017	10 Years 2008–2017	15 Years 2003–2017	20 Years 1998–2017	25 Years 1993–2017	Since April 2, 1991
Schwab 1000 Index	21.70%	15.64%	8.59%	10.18%	7.50%	9.84%	10.06%
S&P 500 Index	21.83%	15.79%	8.50%	9.92%	7.20%	9.69%	9.90%

Source: Schwab Center for Financial Research with data provided by Morningstar Direct. Data as of December 31, 2017. Performance shown is based on a hypothetical investment on April 2, 1991, with dividends and capital gains reinvested. Indexes are unmanaged, do not incur management fees, costs and expenses, and cannot be invested in directly. For illustrative purposes only. **Past performance is not a guarantee of future results.**

The Schwab 1000 Index has a strong 26-year track record. As we discussed in *The Elegance of Indexing*, investors often fall into the trap of chasing returns when they're rising, and leaving the markets when things get difficult. One of the benefits of index-based strategies is that they can help remove the emotions that often hinder our ability to make the right move at the right time. Staying in the markets and making disciplined decisions has historically helped investors achieve their long-term objectives.

The mutual fund and ETF that follow the Schwab 1000 Index provide a number of built-in benefits.

- **Diversification**. The Schwab 1000 Index mutual fund and ETF provides broad-based diversification across 1000 securities.
- **Cost-effectiveness.** The Schwab 1000 Index Fund and Schwab 1000 Index ETF both offer cost-effective annual expense ratios (0.05%)
- **Tax-efficiencies.** Because of the relatively low historical turnover, and the creation and redemption process, the Schwab 1000 Index ETF may be more tax efficient than actively managed funds.
- **Discipline.** The Schwab 1000 Index utilizes a transparent and disciplined index methodology to create and adjust the underlying index.

Comparing Indexes.

While many investors track the results of the Dow Jones Industrial Average (DJIA) or the S&P 500® Index, both indexes have their limitations. The S&P 500 Index is market-cap weighted and holds roughly 500 companies, but these companies aren't necessarily selected because they are the largest 500 companies (a common misconception about the S&P 500). The DJIA is a price-weighted index (the higher the price of the stock, the greater the weight in the index), so by definition it overweights high-priced stocks. It also tracks only 30 large-cap companies. This is certainly not representative of the overall market today.

While the S&P 500 Index is more representative of the overall market than the DJIA, it still includes only half the number of companies as the Schwab 1000 Index. In fact, a number of household names that appear in the Schwab 1000 Index today aren't included in the S&P 500, such as Dunkin' Donuts, Domino's Pizza, Tesla, Twitter, Sprint, T-Mobile, and JetBlue. Typically, the Schwab 1000 Index will include a new company before Standard & Poor's Index Committee agrees to include it in the S&P 500 Index. As shown below, the Schwab 1000 Index casts a wide net and may include younger companies, which often grow rapidly in their early years and may see the growth slow somewhat as they mature.

For example, Netflix was added to the Schwab 1000 Index in April 2008 and to the S&P 500 Index in December 2010. From its inclusion in the Schwab 1000 Index, until its inclusion in the S&P 500 Index, Netflix grew at an annualized rate of over 103%. Since its inclusion in the S&P 500 Index in 2010, it has grown at a healthy 32% rate. Impressive—but it pales in comparison to the growth in the earlier time period. Of course there are other factors that would contribute to growth rates, like the economy, sector, competitive landscape, geopolitical events and prevailing market conditions to name a few.

Fun fact: The Dow Jones Industrial Average was created in 1896 by Charles Dow and originally consisted of 12 companies: American Cotton Oil; American Sugar; American Tobacco; Chicago Gas; Distilling & Cattle Feeding; General Electric; Laclede Gas; National Lead; North American; Tennessee Coal, Iron and Railroad; U.S. Leather; and U.S. Rubber. At the time, these companies represented each sector of the market, and thus the Dow Jones represented the overall performance of the U.S. market. General Electric is the only original company still in existence today.

> "... a number of household names that appear in the Schwab 1000 Index today aren't included in the S&P 500, such as Dunkin' Donuts, Domino's Pizza, Tesla, Twitter, Sprint, T-Mobile, and JetBlue."

Company	Schwab 1000 Inclusion Date	S&P 500 Inclusion Date	CAGR Between Inclusion Date	CAGR After S&P 500 Inclusion
Facebook	2/7/2013	12/20/2013	89.74%	33.49%
Netflix	4/23/2008	12/10/2010	103.39%	31.82%
Google	4/30/2005	4/03/2014	20.18%	17.72%
Starbucks	7/20/1994	6/30/2000	34.02%	16.10%

Source: Schwab Center for Financial Research with data provided by Morningstar Direct. CAGR is representative of the Compound Annual Growth Rate. Data as of December 31, 2017 unless otherwise noted. For illustrative purposes only and not representative of a recommendation or indication of whether a particular security is or would have been profitable for any individual investor. **Past performance is no guarantee of future results.**

The Schwab 1000 Index screens and ranks all U.S. stocks based on their market capitalization, or the total stock market value of their shares. It builds a portfolio containing the top 1000 stocks in proportion to their overall value. Then, every year, it adjusts that portfolio to account for stock splits, performance, and other corporate actions, and reranks the top 1000, all to ensure that investors have exposure to the largest publicly traded contributors to the U.S. economy. Because the rankings and weightings shift according to each company's market performance, index fund shareholders are essentially making the market their manager. The Schwab 1000 Index is constructed based on this disciplined, rules-based methodology. It's worth noting that Standard & Poor's uses a committee that applies some judgment and discretion to determine constituents and which companies to include.

Fun fact: Developed in 1957, the original S&P 500 Index comprised 425 industrial stocks, 60 utilities, and 15 railroads. All 500 were listed on the New York Stock Exchange (NYSE). Today, the S&P 500 comprises 11 sectors: Consumer Discretionary, Consumer Staples, Energy, Financials, Health Care, Industrials, Information Technology, Materials, Real Estate, Technology, and Utilities. Technology is now the largest sector, reflecting the change in our economy.

Although indexing sounds pretty simple and straightforward, it is more dynamic than investors may think. Indexes change as new companies come to the market, and others go out of business or merge with larger companies. In fact, if we think of some of the well-known companies today like—Google (Alphabet), Facebook and Netflix—they didn't even exist a mere 25 years ago.

In the early 1990s, companies like Digital Equipment, Sears Roebuck, and Eastman Kodak were some of the top holdings in the Schwab 1000 Index. Today, the market is dominated by companies such as Apple, Facebook, Amazon, and Google, among others. Apple is the largest holding in the Schwab 1000 Index, due in large part to the dominance of iPhones. In 1991, Apple, primarily a PC company, was the 138th-largest holding. It's difficult to know which companies will dominate future markets—but having a broad basket of roughly 1000 companies casts a wider net than either the DJIA or the S&P 500. Owning a broader basket can provide additional diversification benefits, and hopefully the opportunity to participate in the potential growth of the next Apple, Google or Facebook.

Index Comparison

As of December 31, 2017	Dow Jones Industrial Average	S&P 500	Schwab 1000
Inception Date	May 26, 1896	March 4, 1957	April 2, 1991
Number of Holdings	30	500[1]	1000[1]
Average Market Capitalization	$181.7 Billion	$96.4 Billion	$68.4 Billion
Forward P/E	22.50	22.87	20.67
Largest Holding (%)	Boeing Company (8.2%)	Apple (3.4%)	Apple (3.8%)
Assets in Top 10 Holdings	55.2%	19.8%	16.9%
Assets in Top 20 Holdings	85.8%	30.1%	25.9%
Index Methodology	Price Weighted	Market-Cap Weighted	Market-Cap Weighted
Index Annual Turnover	1%	3%	3%
Dividend Yield	2.13%	1.86%	1.82%

Source: Schwab Center for Financial Research, with data provided by Morningstar Direct. Data as of December 31, 2017. For illustrative purposes only.

[1] Number of index holdings may vary over time due to corporate actions. Not a recommendation or guarantee that any company is or has been profitable

Active Versus Passive.

Indexing has grown in popularity over the last several years. The growth has been fueled by the built-in benefits of indexing and the difficulty that active managers have had in outperforming passive benchmarks. In fact, if we compared the Schwab 1000 Index to a universe of active mutual funds, we'd see that few managers would have been able to outperform this passive benchmark. For the 5 year and 10 year time periods, less than 20% of active mutual funds were able to outperform the benchmark (16.21% and 15.14% respectively).

Percentage of Active Managers Underperforming the Schwab 1000 Index

As of Dec. 31, 2017	5 Years	10 Years	20 Years	25 Years
Percentage Underperforming	83.79%	84.86%	72.43%	77.43%
Number of Active Managers Underperforming	1042 out of 1243	932 out of 1088	436 out of 602	319 out of 412

Source: Schwab Center for Financial Research with data provided by Morningstar Direct and Zephyr StyleADVISOR. Data as of December 31, 2017. For illustrative purposes only. Indexes are unmanaged, do not incur management fees, costs and expenses, and cannot be invested in directly. The active managers are represented by the Morningstar U.S. Large Cap Active Manager Universe. **Past performance is no guarantee of future results.**

While there are mutual funds that have outperformed the Schwab 1000 Index over various time periods, the challenge for individual investors is finding those that can outperform consistently over time. Often the winner in one time period is the laggard in the next. According to the SPIVA Persistence Scorecard[1], over the five-year period ending June 2017, 82.38% of large-cap managers, 87.21% of mid-cap managers, and 93.83% of small-cap managers lagged their respective benchmarks. In other words, there is little persistence in repeating strong performance from one period to the next.

“. . . there is little persistence in repeating strong performance from one period to the next.”

Costs Matter.

One of the advantages of index strategies is the attractive cost structure. Active funds tend to have higher costs and turnover than index funds. ETFs have been leading the way in providing low cost exposure to the markets. ETFs are also touted for their tax-efficiency, which stems from their generally lower turnover rates and structural advantages compared to mutual funds. Index investing also allows investors to obtain broad exposure to the market even if they do not have large sums to invest.

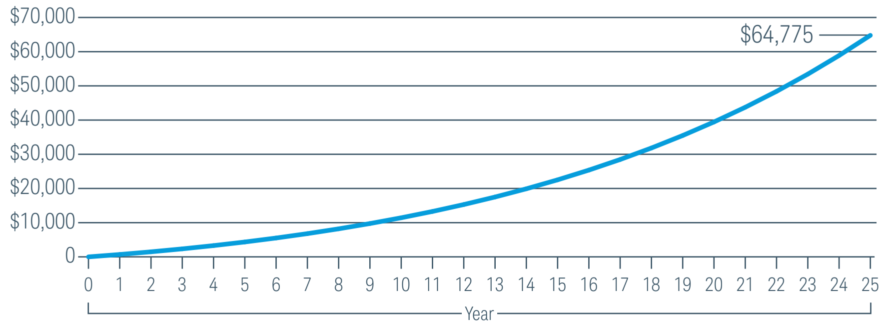
[1] Aye Soe, Ryan Poirier, SPVIA, Does Past Performance Matter? The Persistence Scorecard, June 2017

The typical index fund has lower operating expenses than an actively managed fund. The average cost of an actively managed all-equity mutual fund is roughly 0.75% of assets per year, according to research from Morningstar. Index mutual funds and ETFs range in cost, with broad-based funds now available for as low as 0.03% to 0.05%, of assets. The difference in fees adds up over time. For instance, a hypothetical $100,000 portfolio growing at 6% annually over 26 years would accumulate over $64,000 more if the fees were 0.05% annually instead of 0.75%.

In short, many broad-based index funds have done well on an absolute basis over the long term because equity markets have grown over time, and they have done well on a relative basis because of their lower cost structures.

Fees Can Eat Away at Returns

$100,000 invested in an active equity fund loses over $64,000 to fees over 25 years compared to a low cost index fund



Source: Schwab Center for Financial Research with data as of December 31, 2017. This hypothetical example is for illustrative purposes only, and assumes an annualized return rate of 6%, active equity fund expense of 0.75%, and index fund expense of 0.05% and is not representative of any specific investment or product.

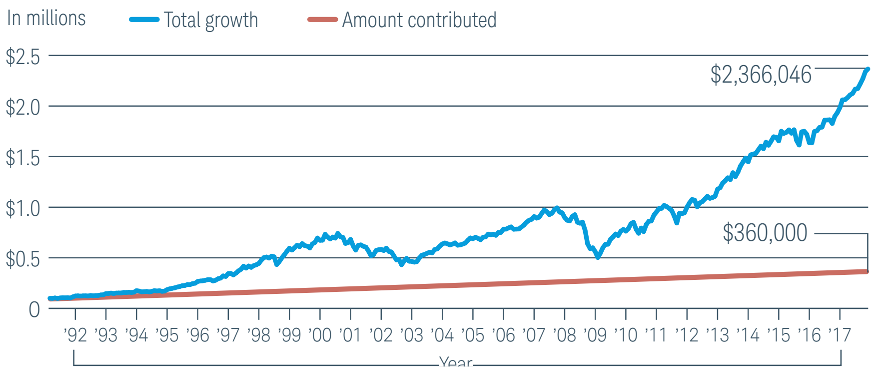
The Power of a Plan.

We have long espoused the value of developing a plan. It's one of our Investing Principles. We know that if investors develop a financial plan and stick to it in good times and bad, they are more likely to achieve their goals. In fact, based on research, investors who develop a financial plan accumulate on average three times the wealth of those who fail to develop a plan.[2]

The following chart shows the hypothetical gains that an investor could have made with an initial contribution of $100,000 in 1991 and subsequent annual investments of $10,000 as part of a systematic investment plan in the Schwab 1000 Index. Over 26 years, the investor would have contributed $260,000, plus the initial $100,000, for a total of $360,000 — and seen this investment grow to over $2,366,046.

Power of a Plan

Hypothetical growth of $100,000 invested in the Schwab 1000 Index with an additional $10,000 invested at the beginning of each year



Source: Schwab Center for Financial Research, with data provided by Morningstar Direct℠. Data is from April 2, 1991–December 31, 2017. This chart represents a hypothetical investment and is for illustrative purposes only. This hypothetical investment doesn't include fees, expenses and taxes. If such item were to be taken into consideration, performance would have been lower. **Past performance is no guarantee of future results.**

[2] Annamaria Lusardi, Olivia S. Mitchell, *Financial Literacy and Planning: Implications for Retirement Wellbeing*, May 29, 2011

> "With so many new index products coming to the marketplace, identify strategies that address your personal goals, with a track record of delivering strong results."

Putting Ideas into Action.

We believe investors would be better served by developing a long-term asset allocation strategy, utilizing multiple index-based strategies (U.S., International, Emerging Markets, Fixed Income, Commodities, etc.), and implementing some form of disciplined savings plan over time. Indexing provides broad-based diversification and removes the emotions that often prevent investors from making the right decisions at the right time. Rather than debating whether to own Apple or Amazon, or when to get into and out of the market, an investor taking an indexing approach may own both Apple and Amazon—and stay invested through market cycles.

With so many new index products coming to the marketplace, identify strategies that address your personal goals, with a track record of delivering strong results. Consider strategies with the built-in benefits of diversification, cost-effectiveness, and potential tax-efficiency delivered in a disciplined approach.

Important Disclosures and Definitions

For mutual funds and ETFs, 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.

All data is as of December 31, 2017 unless otherwise noted.

The Schwab 1000 Index is an index developed and maintained by Charles Schwab & Co., Inc. (Schwab). Charles Schwab Investment Management, Inc. (CSIM), the Schwab 1000 Index Fund's investment adviser, and Schwab are separate but affiliated companies and subsidiaries of The Charles Schwab Corporation. Schwab receives no compensation from CSIM or the]fund for maintaining the index. The index represents]the performance of the largest 1000 publicly traded companies in the United States. As a result of corporate actions, the index may be comprised of more or less than 1000 securities.

Many firms use hypothetical ("back-tested") data as an illustration of how a strategy may have performed over time had it existed during the time period tested. While there can be value for firms using back-tested data to evaluate a new strategy, there are also limitations, including the fact that the data is analyzed with the benefit of hindsight and doesn't include the impact of buying and selling securities, or the effect of fees or expenses. Back-tested data is not representative of any actual investment and results of a live strategy may differ significantly.

All expressions of opinion are subject to change without notice in reaction to shifting market conditions. Data here is obtained from what are considered reliable sources; however, its accuracy, completeness, or reliability cannot be guaranteed.

The information here is for general informational purposes only and should not be considered an individualized recommendation or personalized investment advice.]The type of securities and investment strategies mentioned may not be suitable for everyone. Each investor needs to review a security transaction for his or her own particular situation.

Diversification or automated investment strategies do not ensure a profit and do not protect against losses in declining markets. Indexes are unmanaged, do not incur management fees, costs, and expenses, and cannot be invested in directly.

Schwab 1000: An index that represents the performance of the largest 1000 publicly traded companies in the United States. As a result of corporate actions, the index may comprise more or less than 1000 securities.

Dow Jones Industrial Average (DJIA): A price-weighted average of 30 stocks traded on the NYSE and NASDAQ.

S&P 500: An index that is designed to measure the performance of 500 leading publicly traded companies from a broad range of industries.

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