

## BEST ETFs 2018

### Q & A

# Schwab Focuses On The ETFs Serving Investors' Biggest Needs

## 'Client-First Approach'

Fifth-biggest U.S. ETF provider since entering market nine years ago

BY NANCY GONDO  
INVESTOR'S BUSINESS DAILY

Since entering the exchange traded fund market nine years ago, Charles Schwab Investment Management has experienced rapid growth to become the fifth biggest ETF provider in the U.S.

And it continues to swell in the exchange traded fund industry, which will mark its 26th anniversary next year. Schwab's ETF assets have grown more than twice as fast as the total size of the U.S. ETF industry over the last four quarters, according to CSIM President Jonathan de St. Paer.

The secret? Putting the client first, he says.

"At Charles Schwab, our strategy is pretty simple: to see everything 'through clients' eyes.' And this holds true at Charles Schwab Investment Management (CSIM), as well," de St. Paer told IBD. "We are laser focused on providing a limited number of products that serve investors' biggest needs."

De St. Paer has led CSIM's Strategy, Product Management and Product Development team for seven years. At the end of March, he will become CEO of CSIM, when current chief Marie Chandoha retires. De St. Paer worked at McKinsey and Bear Stearns before joining Schwab



Jonathan de St. Paer will become CEO of Charles Schwab Investment Management at the end of March.

### Jonathan de St. Paer

- President
- Charles Schwab Investment Management
- de St. Paer says Schwab's international equity ETF has seen the strongest demand this year

in 2003.

We got in touch with de St. Paer to get an update on what's new with Schwab ETFs. The full interview with him follows:

**IBD:** Please review the strategy for Schwab ETFs and what sets them apart from the competition.

**Jonathan de St. Paer:** At Charles Schwab, our products are straightforward by design, and meant to help build the core

of investment portfolios at a cost that is among the lowest anywhere. Because we serve investors' biggest needs, our products scale well. This, combined with our ruthless focus on low costs, enables us to pass the benefits of both directly on to investors.

However, we believe that having great pricing is necessary, but not sufficient. Investors should not be forced to make trade-offs between cost, quality and service. That is why we are committed to delivering very high quality products, and supporting our investors with great service. An example of how this approach really sets us apart is securities lending. We do not pay ourselves to manage our program. Instead, 100% of securities lending income, net

of program costs, are kept by the funds for the benefit of shareholders.

We're proud of our approach and investors seem to like it. Our 22 ETFs have attracted \$122 billion in assets since they launched nine years ago.

**IBD:** Schwab launched its first ETFs in 2009. How has it grown to the fifth largest ETF provider in terms of assets in such a short time?

**De St. Paer:** It's all about our client-first approach. We are keenly focused on understanding our clients' needs and serving them, rather than launching dozens or even hundreds of products based on unproven strategies that can be costly and confusing for investors. Our investors tell us that

they really appreciate this focus on their needs, and not having to make trade-offs between price and quality. We know that costs matter, so we consistently use our scale to deliver value to clients. When we launched our ETFs in 2009, we were among the lowest fees in the industry and were the first to offer ETFs commission-free. And while we have continually cut costs and reduced pricing over the last nine years, we don't compete on cost alone. We provide investors with high-quality, low-cost products alongside exceptional service and support. It has become a winning combination for us.

The asset growth rate of Schwab ETFs continues to exceed that of its competitors. To put it into perspective, the total size of the U.S. ETF industry has increased by nearly 18% over the last four quarters, while Schwab ETF assets have grown by 42% over the same time period. That is more than double the comparable growth rates of our peers.

**IBD:** What's changed in Schwab's ETF lineup or business since we last touched base in August 2017?

**De St. Paer:** We launched the Schwab 1000 Index ETF<sup>SCHK</sup> in October 2017. SCHK is one of the cheapest ways that individuals can invest in the 1,000 largest U.S. stocks. It tracks the tenured Schwab 1000 Index, which launched in 1991, and has a mutual fund cousin with a 27-year track re-

cord and \$7.9 billion in AUM.

SCHK has grown faster out of the gate than any other ETF we've launched. It reached \$200 million in assets more quickly than any of our other ETFs, and today has more than \$590 million in AUM. We continue to see steady inflows, suggesting widespread market adoption. This type of organic growth is notable in today's environment, as very few ETFs hit \$500 million in their first year anymore.

**IBD:** Which of your ETFs have seen the strongest demand so far this year by flows and assets?

**De St. Paer:** In terms of year-to-date flows, Schwab International Equity ETF<sup>SCHF</sup> has had the strongest demand with \$3.9 billion, followed by Schwab U.S. TIPS ETF<sup>SCHP</sup> with \$3.1 billion and then Schwab U.S. Large-Cap ETF<sup>SCHX</sup> with \$2.8 billion.

In terms of overall growth in assets under management through Nov. 30, 2018, Schwab U.S. Large-Cap ETF<sup>SCHX</sup> grew the most, by \$3.2 billion, followed by Schwab U.S. TIPS ETF, which grew by \$3 billion and then Schwab International Equity ETF<sup>SCHF</sup> which grew by \$2.4 billion.

**IBD:** Have there been any major outflows from/inflows into any particular Schwab ETFs with the recent correction?

**De St. Paer:** Though markets have been volatile in 2018, Schwab ETFs didn't experience a single period of monthly outflows as a provider — even

during the months of February, March and June, when the industry saw overall outflows.

Despite the recent correction in October and November, Schwab ETFs had \$3.7 billion in inflows. In October alone, Schwab ETFs flows accounted for 37% of all industry net inflows (\$1.5 billion Schwab ETFs vs. \$4 billion industry inflows).

Notably, in October and November, Schwab Short-Term U.S. Treasury ETF<sup>SCHO</sup> saw \$857 million in inflows, Schwab International Equity ETF saw \$721 million in inflows, and Schwab U.S. Broad Market ETF<sup>SCHB</sup> saw \$448 million in inflows.

**IBD:** Do you think many clients have been shaken out or are most of them long-term investors?

**De St. Paer:** We think of our products as “bread and milk” since Schwab ETFs are straightforward funds designed to serve as the foundational building blocks of a diversified investment portfolio. Investors typically use them more strategically in the core allocation of their portfolios. As a result, the assets in our ETFs tend to be “stickier” and our flows tend to be less volatile than some of our competitors.

**IBD:** Schwab is one of the lowest-cost ETF providers with expense ratios as low as 0.03%. Do you think there's still room for costs to decline?

**De St. Paer:** We know that low costs matter a lot to investors, and we believe they

should not have to sacrifice transparency and great service to get them. Our costs are already very low, and we are constantly seeking ways to continue improving our value proposition to investors. As far as how low pricing will go — the jury is still out.

On the mutual fund side, we are seeing a partial test taking place now, as a handful of new funds with zero operating expense ratios have been launched — with very limited availability. We see that some investors like the idea, while others tell us they remain skeptical of the concept and prefer to have greater transparency into how they pay their asset manager and their brokerage account provider.

At CSIM, we will continue to talk with investors to learn about their preferences, and monitor market activity to inform any future steps we may take — all while making sure we put clients first.

**IBD:** Any advice for ETF investors who are worried about the current volatility in the market?

**De St. Paer:** At CSIM, we believe that time in the market is a better strategy than trying to time the market. We recommend sticking to your long-term investment plan, but if you feel uncertain or uncomfortable, talk to your financial professional about reassessing your risk tolerance in case volatility continues to rise.

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

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