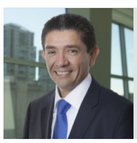
INVESTMENT
MANAGEMENT

May 31, 2016


Biweekly insights on the latest global investment news

## Equities: Mean reversion



**Omar Aguilar, PhD**
Chief Investment Officer,
Equities

### Setting the stage

Global equity markets have rallied over the past two weeks, hinting that the U.S. economy may at last be healthy enough to withstand another interest rate increase by the Federal Reserve. Headwinds that greeted investors in 2016 have been subsiding, with a general rise in oil prices, stabilizing credit conditions, and a notable reduction in overseas market volatility seeming to set the stage for the Fed to resume its efforts to “normalize” rates.

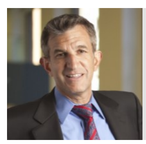
### Reverting to the mean

Mean reversion has been a significant performance driver in 2016, as investors have endeavored to reconcile limited global economic growth, divergent central bank policies, and increased foreign-exchange volatility. Over the first five months of this year, style and market-capitalization leadership have shifted from growth to value and from large- to mid-cap stocks in a meaningful way. Weak corporate earnings have magnified these shifts, leading to increased performance dispersion as companies failing to meet expectations are generally being punished more than companies providing upside surprises are generally being rewarded.

### Focus on the fundamentals

In this environment, we believe that higher-quality stocks with attractive underlying fundamentals should be the primary focus, and we are finding value in select Information Technology, Financials, and Health Care sector stocks in particular.

## Fixed Income: A summertime rate hike?



**Brett Wander, CFA**
Chief Investment Officer,
Fixed Income

### A crazy two weeks

Market expectations have shifted hugely over the past two weeks, thanks in part to stronger-than-expected reports on housing, industrial production, and inflation. Then the Federal Reserve released its minutes from their recent meeting, indicating that they are seriously considering the possibility of a June rate hike. This really blew the market’s mind! As a result, we went from doubts about a possible Fed rate hike this year to a fairly high possibility of a rate hike by the end of the summer.

### Bond yields: Holding steady

A common misconception is that as the Fed raises rates, bond yields have to rise. Not true. Remember back in December 2015 when the Fed finally raised rates? At the time, 10-year Treasury yields were around 2.25%. Two months later they had fallen to 1.75%. This underscores the huge distinction between the federal funds rate, which the Fed directly controls, and longer-term bond yields, which are primarily driven by inflation expectations.

### Don’t panic

For most of this decade investors have asked, “With rates set to rise, shouldn’t I sell my bonds?” But as we know, the Fed could raise rates and bond yields needn’t rise at all. We don’t think that changes in Fed policy should inspire significant changes in long-term investment strategies!

For more insights, visit us at csimfunds.com.

## About the authors

**Omar Aguilar, PhD**

Omar Aguilar is Chief Investment Officer (Equities) of Charles Schwab Investment Management, Inc. (CSIM), a subsidiary of The Charles Schwab Corporation. Aguilar joined CSIM in 2011 and is responsible for equity and asset allocation mutual funds, ETFs, and separately managed accounts. Aguilar has more than 20 years of broad investment management experience in the equity markets, including managing index, quantitative equity, asset allocation, and multi-manager strategies. Aguilar received a BS in actuarial sciences and a graduate degree in applied statistics from the Mexico Autonomous Institute of Technology. He was a Fulbright scholar at Duke University's Institute of Statistics and Decisions Sciences, where he earned his MS and PhD.

**Brett Wander, CFA**

Brett Wander is Chief Investment Officer (Fixed Income) of CSIM, a subsidiary of The Charles Schwab Corporation. Wander joined CSIM in 2011 and is responsible for all aspects of the firm's fixed income and money market portfolios, leading a team of more than a dozen investment professionals. Over his more than 20 years of investment management experience, Wander has been intimately involved in the design, development, and oversight of a wide range of active, indexed, and alternative fixed income strategies. His expertise spans a wide range of global and domestic markets and sectors. He is a frequent industry speaker, presenting at conferences and in various media forums. He has taught MBA-level investment courses at the University of Southern California. Wander earned an MBA from the University of Chicago and a BS in system science engineering from the University of California, Los Angeles. He is a Chartered Financial Analyst® charterholder.

**Charles Schwab Investment Management**

As one of the nation's largest asset managers, our goal is to provide investors with a diverse selection of foundational products that aim to deliver consistent performance at a competitive cost.



charles SCHWAB INVESTMENT MANAGEMENT

For more insights, visit us at csimfunds.com.