Schwab Target-Date Fund Series Report

**Morningstar Analyst Rating**
Neutral

**Key Features**
- Asset-Weighted Expense Ratio: 0.57%
- Active/Passive Exposure: 68% Active
- Open/Closed Architecture: 62% Closed
- Total Net Assets ($M): 3,719

**Executive Summary**
- **Process**: Neutral
  - The team behind this series makes a well-researched, fundamental case for its equity glide path, which roughly matches the norm. However, frequent changes to the sub-asset-class mix and underlying holdings in the past several years suggest a lack of conviction and patience. The series earns a Neutral rating for Process.

- **Price**: Negative
  - This series looks pricey. The median expense ratio of the series’ single share class is significantly above the median for a series’ cheapest share class.

- **Performance**: Positive
  - Despite recent stumbles, this series’ long-term results remain strong. The series’ risk-adjusted returns, on average, land among the top third of all series over the trailing decade through 2018. A home-country bias in the equity sleeve and generally solid underlying fund performance have given results a boost.

- **People**: Neutral
  - The team that oversees this series includes experienced personnel, but it has seen turnover. John Greves heads the portfolio management team but has been at Schwab for less than three years. Also, the subadvisor oversight team hasn’t been stable and is modestly resourced. Proven teams run some of the underlying holdings, but most assets are with Schwab’s quant team and passive strategies.

- **Parent**: Positive
  - Since Marie Chandoha became Schwab’s CEO in 2010, the investment-management arm brought in new executives and portfolio managers, set a focused product agenda, and improved risk oversight and compliance. The firm has also provided low-cost market access for the typical investor. As a result, we upgraded Schwab’s Parent Pillar rating to Positive in early 2017.

**Morningstar Analyst Rating**
Morningstar evaluates mutual funds based on five key pillars, which its analysts believe lead to funds that are more likely to outperform over the long term on a risk-adjusted basis.

**Analyst Rating Spectrum**
- Gold
- Silver
- Bronze
- Neutral
- Negative

**Morningstar Opinion**

The Schwab Target series offers some strong underlying holdings and has performed well. But holdings and management team changes, coupled with a clear cost disadvantage, limit its Morningstar Analyst Rating to Neutral.

The most recent significant change within the team behind this series occurred in June 2016, when Schwab hired John Greves to lead its multi-asset team; he also comanages the collective investment trust version of this series. Greves came from Russell Investment Management and comanaged that firm’s target-date funds.

The subadvisor oversight team, meanwhile, has been unstable and is relatively small. In October 2014, Tracy Pike (who came from Janus) took over the team, and Schwab relocated the group to Colorado from non-U.S. equities (which have substantially lagged U.S. stocks over the past decade) has provided a significant tailwind.

The subadvisor oversight team, meanwhile, has been unstable and is relatively small. In October 2014, Tracy Pike (who came from Janus) took over the team, and Schwab relocated the group to Colorado from Ohio, losing two analysts in the process. Pike hired three analysts in 2015, but one left in 2018. Pike has hired an associate analyst and plans to hire a more experienced person as well. But the team’s current five members (including Pike) averages less than four years’ tenure at the firm.

**Greg Carlson**
02-05-2019

This relatively new cast has made a raft of changes in the past five years. Seven underlying holdings were removed and eight were added (another was added in 2014 and removed in 2018). There are now 22 holdings, excluding money market funds. The lineup includes some proven teams and strategies, including seven Morningstar Medalists, but they constitute just 31% of the series’ assets. Less-proven active funds (including several managed by Schwab’s in-house quantitative equity team) and passive vehicles account for the remainder.

The series’ performance has been solid over the long term on both a total-return and risk-adjusted basis. But a below-average weighting, relative to peers, in non-U.S. equities (which have substantially lagged U.S. stocks over the past decade) has provided a significant tailwind.

The series’ costs are unattractive. It has a single share class, and its median expense ratio of 0.62% is well above the 0.50% median charged by competitors’ cheapest share class.
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The date shown next to the Morningstar Analyst Rating is the date on which the Morningstar Manager
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analyst’s latest review and research report for the target-date fund series.

The Five (5) Pillars

Morningstar has identified five key areas that we believe are crucial to predicting the future success of
funds: People, Parent, Process, Performance, and Price. Each pillar is evaluated when assessing a fund as
worthy of receiving the Morningstar Analyst Rating. The overall quality of a target-date fund series’ invest-
ment team is a significant key to its ability to deliver superior performance relative to its benchmark and/or peers. Evaluating a target-date fund series’ invest-
ment team requires that analysts assess several relevant issues including how key decisions are made.

People
The overall quality of a target-date fund series’ investment team is a significant key to its ability to deliver
superior performance relative to its benchmark and/or peers. Evaluating a target-date fund series’ invest-
ment team requires that analysts assess several relevant issues including how key decisions are made.

Parent
We believe the parent organization is of utmost importance in evaluating a target-date fund series. The target-
date fund series’ management set the tone for key elements of our evaluation, including capacity manage-
ment, risk management, recruitment and retention of talent, and incentive pay. Beyond these operational
areas, we prefer firms that have a culture of stewardship and put investors first to those that are too heavi-

Price
We look for target-date fund series with a performance objective and investment process (for both security
selection and portfolio construction) that is sensible, clearly defined, and repeatable. In addition, the portfo-
lio should be constructed in a manner that is consistent with the investment process and performance ob-
jectives.
Performance
We do not believe past performance is necessarily predictive of future results, and this factor accordingly receives a relatively small weighting in our evaluation process. In particular, we strive not to anchor on short-term performance. However, we do believe that the evaluation of long-term return and risk patterns is vital to determining if a target-date fund series is delivering to our expectations.

Price
To reflect actual investor experience, price is evaluated within the context of the relevant market or cross-border region—for example, the United States, Australia, Canada, or Europe. In recognition of differences in scale and distribution costs in various markets, the level at which a target-date fund series is penalized for high fees or rewarded for low fees can vary with region. In Europe, for example, target-date fund series are penalized if they land in the most expensive quintile of their Morningstar category and are rewarded if they land in the cheapest quintile. The assessment is made using prospectus expense ratios, but in the case of target-date fund series with performance fees, expenses are evaluated excluding any performance fees and then the structure of the performance fee is evaluated separately.

Morningstar Analyst Ratings
Morningstar Analyst Ratings are assigned on a five-tier scale running from Gold to Negative. The top three ratings, Gold, Silver, and Bronze, all indicate that our analysts think highly of a target-date fund series; the difference between them corresponds to differences in the level of analyst conviction in a target-date fund series’ ability to outperform its benchmark and peers through time, within the context of the level of risk taken.

Gold
Represents target-date fund series that our analysts have the highest-confidence in for that given investment mandate. By giving a target-date fund series a Gold rating, we are expressing an expectation that it will outperform its relevant performance benchmark and/or peer group within the context of the level of risk taken over the long term (defined as a full market cycle or at least five years). To earn a Gold rating, a target-date fund series must distinguish itself across the five pillars that are the basis for our analysis.

Silver
Represents target-date fund series our analyst has high-confidence in, but not in all of the five pillars. With those fundamental strengths, we expect these target-date fund series will outperform their relevant performance benchmark and/or peer group within the context of the level of risk taken over the long term (defined as a full market cycle or at least five years).

Bronze
Represents target-date fund series that have advantages that clearly outweigh any disadvantages across the pillars, giving analyst the conviction to award them a positive rating. We expect these target-date fund series to beat their relevant performance benchmark and/or peer group within the context of the level of risk taken over the long term (defined as a full market cycle or at least five years).

Neutral
Represents target-date fund series in which our analysts don’t have a strong positive or negative conviction. In our judgment, these target-date fund series are not likely to deliver standout returns, but they aren’t likely to seriously underperform their relevant performance benchmark and/or peer group either.

Negative
Represents target-date fund series that possess at least one flaw that our analysts believe is likely to significantly hamper future performance, such as high fees or an unstable management team. Because of these faults, we believe these target-date fund series are inferior to most competitors and will likely underperform their relevant performance benchmark and/or peer group, within the context of the level of risk taken, over a full market cycle.

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Under Review
This designation means that a change that occurred with the target-date fund series or at the target-date fund series company requires further review to determine the impact on the rating.

Not Ratable
This designation is used only where we are providing a Report on a new strategy or on a strategy where there are no relevant comparators, but where investors require information as to suitability.

For more information about our Analyst Rating methodology please go to http://corporate1.morningstar.com/Research/Library/

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Equity-Related Data Points
The Report lists the top ten holdings in the target-date fund series as of the dated noted. For each underlying holding, a series of data points is provided including, where applicable, that security’s Economic Moat rating as of the date noted.

Economic Moat
The concept of an economic moat plays a vital role in our equity analyst’s qualitative assessment of a firm’s long-term investment potential, but also in the actual calculation of its fair value estimate. An economic moat is a structural feature that allows a firm to sustain excess profits over a long period of time. We define economic profits as returns on invested capital (or ROC) over and above our estimate of a firm’s cost of capital, or weighted average cost of capital (or WACC). Without a moat, profits are more susceptible to competition. We have identified five sources of economic moats: intangible assets, switching costs, network effect, cost advantage, and efficient scale.

Companies with a narrow moat are those we believe are more likely than not to achieve normalized excess returns for at least the next 10 years. Wide-moat companies are those in which we have very high confidence that excess returns will remain for 10 years, with excess returns more likely than not to remain for at least 20 years. The longer a firm generates economic profits, the higher its intrinsic value. We believe low-quality, no-moat companies will see their normalized returns gravitate toward the firm’s cost of capital more quickly than companies with moats.

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