MANAGING
AN INTERNATIONAL EQUITY PORTFOLIO

USING SCHWAB EQUITY RATINGS INTERNATIONAL™

charles SCHWAB

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PART 1

PLANNING YOUR PORTFOLIO

The purpose of this Guide is to describe a systematic, disciplined process that utilizes the power of Schwab Equity Ratings International™ (the "Ratings") to create and manage a portfolio of international equities. The Ratings represent a tool that can potentially improve portfolio performance, reduce research time, and avoid common mistakes in constructing and managing your international stock portfolio.

In this document, "global" refers to investments in both the U.S. and foreign countries. "International" refers specifically to investments outside the U.S. Schwab recommends that you consider your total investment portfolio on a global basis. As such, your portfolio should include stocks (or an equity component such as a stock mutual fund or exchange-traded fund) headquartered and traded outside the U.S. This guide's intended use is by investors interested in creating and managing a portfolio of international equities (representing the stocks of companies headquartered outside the U.S.).[1]

[1] Some international equities may be purchased as American Depositary Receipts or on the U.S. over-the-counter (OTC) securities markets.

LAYING THE FOUNDATION:

A Five-Step Approach to Planning

Let's focus on a critical first stage: planning your investment program. If you can understand the rationale for international investing, confirm that active investing is suitable for you, know how many stocks to hold, set portfolio expectations, and know how to evaluate performance, you may be ready to begin investing internationally.

STEP 1 The Rationale for International Equity Investing

Schwab believes there are four primary reasons to invest internationally:

- Potentially reduce risk by diversifying into other markets.
- Potentially reduce risk by diversifying into investments denominated in currencies other than the U.S. dollar.
- Potentially find higher rates of economic growth in foreign nations.
- Foreign markets may provide more opportunities to pursue investment themes or approaches.

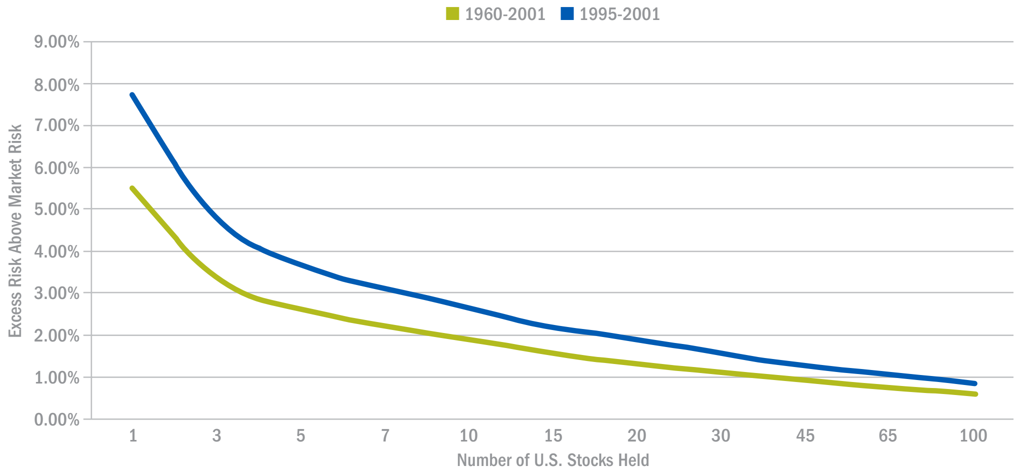
A key aspect of equity investing is that investors should try to reduce, as much as possible, sources of risk that **can** be reduced at relatively low cost. This is true whether your portfolio invests globally or only in U.S. equities.

Financial theory divides a stock's (or other equity security's) risk into two general categories: "firm-specific risk" (the risk related to an individual stock) and "market risk" (the risk of investing in stocks in general, rather than other asset classes such as cash or bonds). You can generally reduce firm-specific risk by holding a diversified portfolio. But market risk cannot be reduced in this way. In fact, trying to attain higher expected returns requires taking higher market risk—a strategy best achieved not by picking riskier stocks, but by increasing your portfolio's allocation to stocks versus other, less risky asset classes. A broadly diversified index fund that attempted to replicate the performance of an equity market index would generally exhibit only market risk.

REDUCE RISK BY DIVERSIFYING INTERNATIONALLY

Now compare the market risk of a broadly diversified index fund to the risk of a portfolio holding between 1 and 100 individual stocks. How would this portfolio's risk, which includes both market risk and firm-specific risk, be changed by holding more stocks? Figure 1 illustrates the result. The number of randomly selected U.S. stocks in the portfolio is shown on the horizontal axis, and the portfolio's firm-specific risk (as measured by "tracking error"—its risk in excess of market risk) is shown on the vertical axis. The chart shows that for investors in U.S. stocks, firm-specific risk drops significantly as the number of stocks held increases.

Figure 1: The Relationship Between Portfolio Size and Excess Risk (Above Market Risk)



Source: Daniel J. Burnside, Donald R. Chambers, and John S. Zdanowicz. "How Many Stocks Do You Need to Be Diversified?" *AAII Journal*, July 2004, 16–19. 1987:22, 353-363.

Why? According to the study, poor returns for some stocks will generally be offset by good returns for others—if you hold more stocks! In contrast, a portfolio with only a few stocks generally means higher risk without any reward in the form of higher expected returns. Market cycles or other macroeconomic events can lead to broad drops across a market, even though individual company performance differs.

The chart also illustrates that the benefits of diversification still apply even though stocks may move more closely together. The green line is based on average portfolio risk as calculated over the period 1960–2001, while the blue line is calculated over the period 1995–2001, a period in which financial researchers have observed an increasing tendency for stocks to move together.

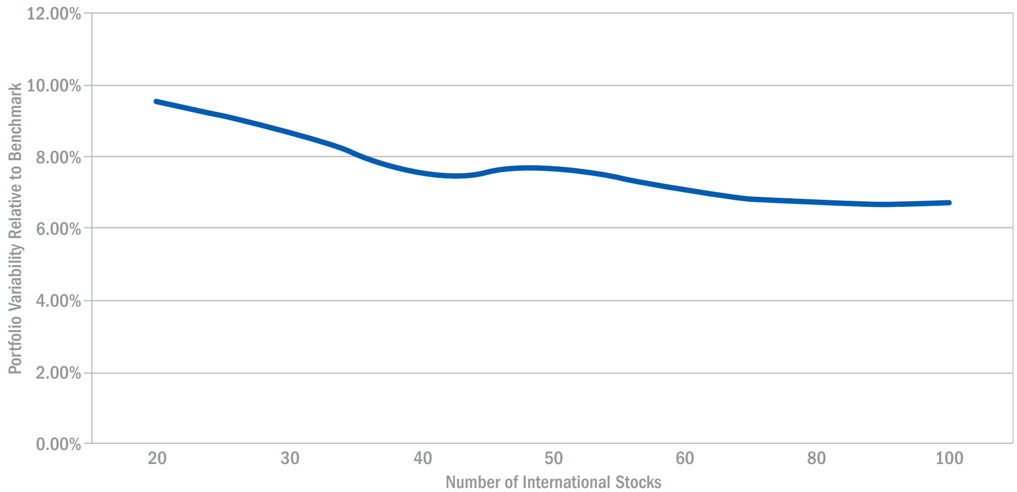
International diversification may reduce risk even further, in part because individual foreign stocks are like U.S. stocks in that they do not all move together and in part because foreign stock markets generally don't move in unison with the U.S. market. Schwab research, as summarized in Figure 2, has found that most of the benefit of diversification in an international portfolio can be achieved with a portfolio of 40 stocks.

Holding fewer than 40 stocks results in higher firm-specific risk. Holding more than 40 stocks can reduce firm-specific risk further, but the gains are relatively small. Other researchers have found that combining U.S. and international stocks in a portfolio can reduce risk relative to a U.S.-only stock portfolio.[2] The combination of holding more stocks and holding international stocks has led some observers to describe the diversification benefits of international investing as not merely a "free lunch," but as "a bigger free lunch."[3]

[2] Christopher B. Phillips. "Considerations for Investing in Non-US Equities," Vanguard Funds, March 2011.

[3] John Y. Campbell. "Diversification: A Bigger Free Lunch," *Canadian Investment Review*, Winter 2000, Vol. 13, Issue 4.

Figure 2: Portfolio Variability and the Number of Stocks Held



Source: Schwab Center for Financial Research. Benchmark is the MSCI All Country World Investable Market ex USA Index.

The academic and practitioner research cited above suggests that you need to hold a large number of **randomly selected** stocks (40 or more) to significantly reduce the firm-specific risk of a domestic portfolio, and that including international stocks in that number may potentially reduce both firm-specific and market risk. Schwab believes that following our guidelines and using the Ratings may improve on random selection and generally improve your international stock portfolio's risk-return trade-off as well.

The portion of your portfolio invested in international equities should vary with your risk tolerance and investment objectives. We will discuss Schwab's guidance regarding international equity investing in greater detail in Part II. For Schwab's general guidance on how you should allocate your stock selections, please review the ***Allocation Guidelines*** provided on Schwab.com.[4]

STEP 2 Is Active Equity Investing Right for You?

Schwab generally recommends that equity investors consider starting with passive or active investing via mutual funds or exchange-traded funds. This means selecting a core of diversified, low-cost mutual funds as a cost-effective way to participate in the various styles, sectors, and size categories of the world's equity markets. Once that's accomplished, you might then seek to become an active individual-stock investor, with a goal that might be stated as:

To construct a well-diversified portfolio of international stocks that seeks to outperform an international "total market index" benchmark.

Before adopting such a goal, you should determine whether active investing in individual international stocks is truly an appropriate investment strategy for you,

[4] After logging in, click on **Research**, **Markets**, **International**, and **Allocation Guidelines**.

as opposed to passive or active investing via mutual funds or exchange-traded funds. Are you up to the task of active stock management on an international basis? The answer is key to long-term success, and can help avoid disappointment, poor decisions, and frustration.

Ask yourself four straightforward questions:

- **Do you believe in the premise of active management?** The premise is that some stocks are incorrectly priced, and that buying or selling those stocks, either individually or through actively managed mutual funds or exchange-traded funds (ETFs), can potentially boost returns. A corollary is that you can correctly identify those incorrectly priced stocks, which is the goal of Schwab Equity Ratings International.™

  Passive investors believe stock prices reflect all relevant information about a stock's intrinsic value, so efforts to beat the market will likely fail. A passive investor may be better served by diversified index funds or ETFs that seek to match the risk/return profile of investing in the broader global equities market.

- **Do you have sufficient financial capital?** We recommend starting with a minimum of $100,000 to assemble an international equity portfolio with minimum diversification. Schwab research has found that to be adequately diversified and improve the probability of utilizing the predictive power of Schwab Equity Ratings International, you need a portfolio of at least 40 stocks. Starting with less capital means you'll have smaller positions in each stock and higher transaction costs, which act as a drag on performance relative to the size of your positions. Actively managed mutual funds or ETFs may be a better alternative if you start with less than our suggested minimum.

- **Will you make the personal commitment?** Building a diversified, thoroughly researched international stock portfolio can take as many as 40 hours of careful work initially, plus at least one to two hours per week to monitor and maintain on an ongoing basis. If you lack the time and discipline to effectively manage your portfolio, mutual fund or ETF investing may be more appropriate.

TABLE 1: MAXIMUM AND MINIMUM ONE-YEAR RETURNS FOR SELECTED INDEXES, 2001–2010

Index	Maximum 2001–2010 (Year)	Minimum 2001–2010 (Year)
Standard & Poor's 500®	28.7% (2003)	–37.0% (2008)
Morgan Stanley Capital International EAFE® (Europe, Americas, Far East) Index	38.6% (2003)	–43.4% (2008)
Morgan Stanley Capital International Emerging Markets Index	79.0% (2009)	–53.2% (2008)

Source: Schwab Center for Financial Research, based on data from Ibbotson Associates/Morningstar, Inc. Returns are measured from year-end to year-end. Returns will differ when measured over other year-long periods. Indexes are not professionally managed and do not incur fees and expenses. Actual portfolios incur fees and expenses, which reduce returns.

- **How much risk can you tolerate?** Many investors overestimate their tolerance for risk. One consequence is that they overreact to losses, often selling at the worst time. Table 1 shows that even index funds representing both domestic and international stocks can fluctuate greatly in the short term. Individual stocks often exhibit even more volatility. It's crucial to keep your portfolio diversified in terms of its overall composition, rather than focusing on the volatility of the individual stocks.

You may choose to invest in international equities primarily through mutual funds or ETFs and use individual stocks only infrequently. Even so, the process described in Parts II and III of this Guide can improve your chances of investment success.

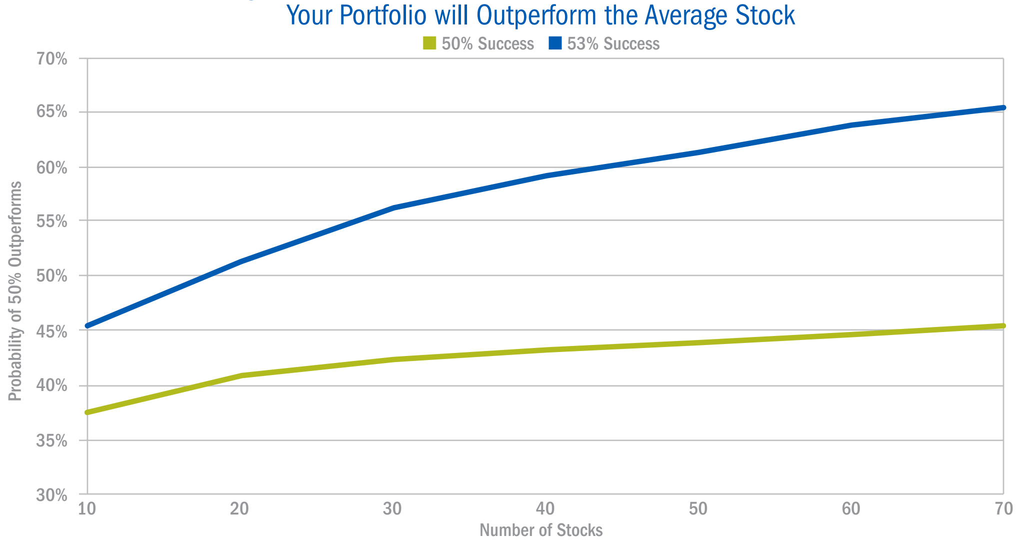
STEP 3 Tilt the Risk-Return Equation in Your Favor

By holding 40 or more stocks in your portfolio, you improve the probability that your portfolio will outperform its benchmark.

The probability that your **portfolio** will outperform the average rated stock in an equity market depends on two things: the success of your stock selection approach, and the number of stocks you hold, which represents the number of opportunities to apply your approach.

The success of a stock selection strategy can be measured by the average return of the stocks evaluated by the strategy. Historically, based on simulated back test results using 12-month holding period returns, 53% of stocks rated A by Schwab Equity Ratings International™ have outperformed the average return of rated stocks.

Figure 3: The Probability that At Least 50% of the Stocks in Your Portfolio will Outperform the Average Stock



Source: Schwab Center for Financial Research. Hypothetical results reflected in the chart are displayed for illustrative purposes only.

A 53% success rate may seem barely better than random chance, but in reality it's relatively high. Since stock returns aren't "normally distributed"—they don't look like a bell-shaped curve—the average return is actually **above** the median return, which is the return where 50% of stocks have higher returns and 50% have lower returns. A strategy in which 53% of its stocks outperform the average stock will boost portfolio performance more than a strategy in which 50% outperform. The two curves in Figure 2 illustrate this point: the better the success rate, the higher the probability that your portfolio will contain at least 50% outperformers.

The effect of increasing the number of stocks you hold is similar to attempting to estimate the proportion of randomly placed red and blue marbles in a jar containing both colors by "sampling"—taking a handful of marbles. The probability that your handful matches the jar's proportions depends on the actual red/blue proportion in the jar **and** the size of your handful. A giant's handful is more likely to successfully mimic the jar's proportion than a toddler's handful. Figure 3 illustrates this point as well: For any success rate—that is, moving along either line on the graph—the probability that your portfolio has 50% or more stocks that outperform the average stock depends on how many stocks you hold. Richard Grinold and Ronald Kahn, in their text on portfolio management, stated it this way:

> You must play often and play well to win at the investment management game. It takes only a modest amount of skill to win, as long as that skill is deployed frequently and across a large number of stocks.[5]

We believe the best way to harness the predictive power of the Ratings is to hold a portfolio of 40 or more stocks.

STEP 4 Set Realistic Expectations

It's important to set realistic expectations and measure your performance appropriately. Once your portfolio is in place, make sure you:

- Measure your results over a specified time horizon—at least annually, but ideally over a full market cycle (peak to peak or trough to trough). Don't evaluate performance on a short-term basis, such as daily or weekly.
- Understand that even the best stock selection strategies will not work all the time. In periods when investors exhibit "risk-loving" behavior (e.g., the late 1990s), the Ratings may not perform as expected.
- Focus on relative, not absolute, performance. A 5% gain could represent poor performance if your portfolio's benchmark has risen 10%. And an 8% loss of portfolio value may represent exceptional performance if your benchmark has fallen 20%.
- Don't focus on a small number of winning or losing stocks. The Ratings will not accurately predict every single stock, and in any period, some A- and B-rated stocks can be expected to underperform.

[5] Richard C. Grinold and Ronald N. Kahn. *Active Portfolio Management*, 2nd ed., 2000.

We believe a reasonable goal is for your portfolio to beat its benchmark in roughly two out of three years of an entire market cycle. Over time, that can really help you achieve your goals.

Making money or not losing money is not a reasonable short-term expectation or an appropriate short-term benchmark. Only very conservative investments like money market funds or Treasury bills tend to hold their nominal values in most periods (though both investments can lose value in "real" terms after the effects of taxes and inflation are taken into account).[6] Equity investing should be for long-term capital growth, not short-term money making.

STEP 5 Select a Benchmark

You're probably familiar with the use of stock indexes—averages of the performance of securities in a particular market or market segment—as barometers of that market's behavior. But indexes may also be used as performance benchmarks.

Your portfolio's benchmark should represent the types of stocks you want to hold. Just as we wouldn't hold this year's Little League champions to the same standards as the New York Yankees, the performance of your stock portfolio should be measured against an index that's representative of the types of stocks you hold. Standard & Poor's provides information on market capitalization–weighted indexes for a number of countries. You can view the data for various country indexes on Schwab.com by logging in to your account and clicking on ***Research*** and ***Markets***. Select the ***International*** tab, and on the ***Overview*** page, click on the S&P Index for the country of interest.

[6] Laurence B. Siegel and David Montgomery. "Stocks, Bonds, and Bills after Taxes and Inflation," *Journal of Portfolio Management*, Winter 1995.

PART 2

BUILDING YOUR PORTFOLIO

Schwab research has examined how to construct your portfolio for suitable diversification. Your total allocation to all stocks (or other equities) as a percentage of your portfolio will depend on your risk tolerance, time horizon, and investment objectives. Schwab's guidelines for allocating funds to stocks vary from 20% for conservative investors to 95% for aggressive investors. For each of those suggested allocations, Schwab believes that 25% of your total equity portfolio should be invested in international equities.[7] Within the suggested 25% allocation to international equities, we suggest that you use the guidelines in Table 2 to construct a portfolio of international stocks.

Schwab researchers utilized historical simulations to examine the implications of these guidelines for the risks and returns of hypothetical portfolios. Our testing also examined the consequences of varying each guideline within, and beyond, the tolerances noted. Reducing diversifiable sources of risk can help in positioning your portfolio to potentially achieve its goal of outperforming a broadly based benchmark.

[7] Schwab's recommended allocation guidelines are available on Schwab.com—select the ***Research*** tab, the ***Markets*** tab, the ***International*** tab, and the ***Allocation Guidelines*** tab.

We will refer to the guidelines in Table 2 by their numbers (e.g., **Guideline II.A**) when describing the research process for constructing and maintaining your portfolio. For the benchmark weights noted in Table 2, please see the **International Equity Benchmark Weights** document on the ***Market Insight*** tab (click on Investing, Stocks, and the link to the document under **Schwab Center for Financial Research Reports**).

TABLE 2: PORTFOLIO CONSTRUCTION GUIDELINES

I. Return and Risk Objectives		
Construct a well-diversified portfolio of international stocks that seeks to outperform an international "total market index" benchmark		
II. Stock Selection Rules		
II.A—Buy rules	Consider A-rated stocks for purchase; consider B-rated stocks if necessary to maintain diversification, with a preference for better-ranked B's (that is, those with lower percentile ranks such as 6–15).	
II.B—Sell rules	Consider selling stocks whose ratings fall to D or F; more active investors may elect to sell C-rated stocks with percentile ranks ≥ 51 if a suitable A-rated stock is available.	
III. Portfolio Risk Exposure—Target Levels and Tolerances		
Business Risk Sources	**Target Risk Exposures**	**Risk Exposure Tolerances**
III.A—Company-specific risk	40 stocks, equal weighted positions (2.5% each)	4.0% maximum weight; 1.5% minimum weight
III.B—Company size	75% of portfolio in large-cap stocks (cap > U.S.$7.5 billion); 25% in small-caps	65%–100% in large-caps; 0%–35% small-caps
III.C—Sector/Industry	Market value of stocks in each of the 10 economic sectors should approximately match sector weights in benchmark	Sector weights can deviate up to +/-10% from benchmark weights; holdings should be from at least two industries in each sector (industries are subclassifications of sectors)
Geographic Risk Sources	**Target Risk Exposures**	**Risk Tolerances**
III.D—Developed vs. emerging markets	80% of portfolio stocks from developed market countries; 20% from emerging markets	65%–100% from developed-market countries; 0%–35% from emerging markets
III.E—Geographic region and countries	Stock positions sorted by geographic region approximately match benchmark weights	Region weights can deviate up to +/-10% from benchmark weights; minimum of one holding per region and one holding from any country whose benchmark weight exceeds 5%

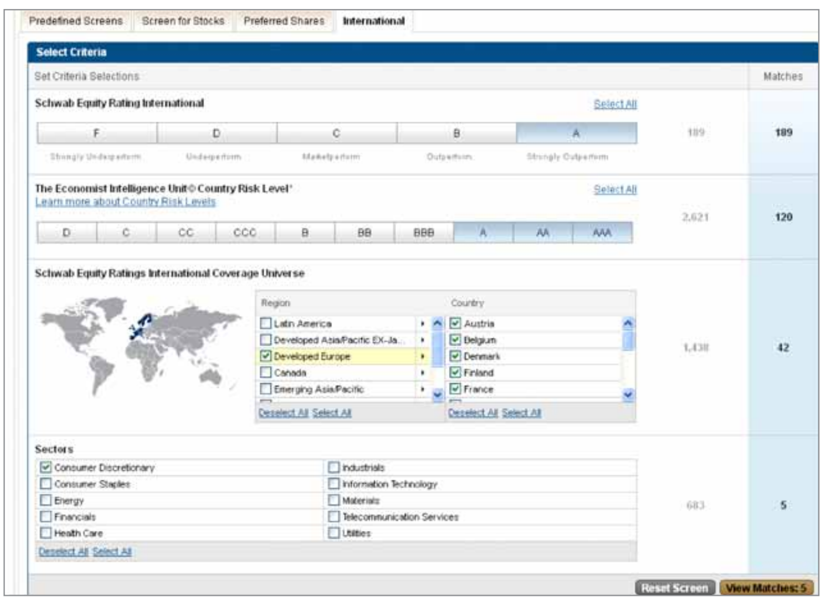
HOW WE PICK STOCKS USING SCHWAB EQUITY RATINGS INTERNATIONAL™

You'll find about 1,200 A- and B-rated stocks within our universe of approximately 4,000 equities. The Ratings are country-neutral, which means that approximately 5% of the stocks in each country where Schwab clients can trade will be rated A and 25% rated B. With that many possibilities, our recommended research process is one of **elimination**, not **selection**.

The Three Stages of Stock Research

Schwab believes that stock selection involves a three-stage research process:

- **Primary Research:** Start by finding stocks rated A or B by the Ratings, with a strong preference for A-rated stocks. Make sure the stock is appropriate for your portfolio, understand the perspectives embodied in its rating, and gain a basic knowledge of the company, its country and equity market, and its sector and industry.
- **Secondary Research:** Check for recent and relevant information that may not be incorporated in the stock's rating. Look at recent news, price trends, earnings history and upcoming earnings announcements, and the opinions of other research providers.
- **Optional Research:** This is a "time permitting" stage, intended to deliver additional insight into the company, its markets and industry, and the political and economic environment of its country.



The country-neutral approach of the Ratings simplifies the process of creating and maintaining a portfolio of stocks diversified across countries and regions. You will generally be able to find A- and high B-rated stocks in every country and region as long as Ratings are available within one or more of the countries in that region.

The Schwab Equity Research team developed an eight-step process to winnow your choices. If you're a Schwab client, simply log in to begin.

Primary Research

1. START WITH As AND HIGH Bs (**GUIDELINE II.A**).

This rule is the core principle of our recommended research process. A-rated stocks, those with percentile ranks of 1 through 5, are preferred to B-rated stocks, and more highly ranked Bs (those with percentile ranks of 6 through 15) are preferred to lower-ranked Bs. Since the Ratings approach is country-neutral, an A-rated stock is rated against other stocks within the same headquarters country, not against other A-rated stocks around the world. Consider the risks associated with individual countries, as well as individual stocks, before deciding to invest. You may wish to check the Country Risk Levels provided by the Economist Intelligence Unit, an unrelated third-party research provider.

To find A- and B-rated stocks on Schwab.com, use Schwab's International Stock Screener. The Screener can help you find buy-rated stocks with Economist Intelligence Unit Country Risk Levels of A or higher in the regions, countries, and sectors that meet your portfolio's objectives. You can access the Stock Screener by starting at the Research tab, selecting Stocks and Find Stocks, and clicking on the International tab as shown below. In this instance, the Stock Screener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Schwab Equity Ratings International® Report

Report generated on 08/24/2011, 03:25 PM

BMW AG

Frankfurt

Strongly Outperform
Within Germany
Data as of 08/19/2011

The Economist Intelligence Unit© Country Risk Level

SCHWAB EQUITY RATING INTERNATIONAL

Strongly Outperform
Percentile Ranking: 1
Data as of 08/19/2011

Within the country of Germany

Last weeks rating:
Strongly Outperform
Percentile Ranking: 1

Data as of 08/12/2011

A	1-5	Strongly Outperform	BUY
B	6-30	Outperform	
C	31-70	Marketperform	
D	71-95	Underperform	
F	96-100	Strongly Underperform	SELL

For details about using managing a global portfolio using Schwab Equity Ratings International, please see the Schwab Center for Financial Research report "Managing a Portfolio Using Schwab Equity Ratings" in the Stocks article library under Market Insight.

See page 4 for further documentation on Schwab Equity Ratings International, Important Disclosures, and Regulation Analyst Certification.

RATIONALE BEHIND OUR A RATING ON BMW:XETR

For details about inputs to Schwab Equity Rating, see "Schwab Equity Ratings Foundations" in the "Stocks" article library under Market Insight.

▲ IMPROVED VS. PREVIOUS WEEK
▼ DECLINED VS. PREVIOUS WEEK

	THIS WEEK	LAST WEEK	IMPORTANCE
A FUNDAMENTAL GRADE			
Operating Profitability	Positive	Positive	Low
Earnings Quality	Positive	Positive	Medium
Balance Sheet Quality	Positive	Positive	High
B VALUATION GRADE			
Income Statement Valuation	Positive	Positive	Medium
Balance Sheet Valuation	Neutral	Neutral	Low
Shareholder Return	Neutral	Neutral	Low
A MOMENTUM GRADE			
Price Momentum	Positive	Positive	Low
Analyst Sentiment Change	Positive	Positive	Low
B RISK GRADE			
Market Share	Positive	Positive	Low
Information Availability	Positive	Positive	Low

PRICE & VOLUME HISTORY

Price data source: Reuters

BMW AG LISTINGS

Source: Reuters

SEDOL	5756029
ADR Symbol	BAMXY
OTC Symbol	BAMXF
Local Market Symbol	BMW:XETR

OVERVIEW

Source: Reuters

1 USD = 0.693 EUR

Price as of 8/18/11	$78.10 /	54.15
Market Capitalization	$47.0B /	32.6B
Float (Shares)		374
Asset Class		–
Beta		1.08

SECTOR/INDUSTRY

Source: Reuters

Sector	Consumer Discretionary
Industry	Automobiles
Sub-Industry	Automobile Manufacturers

METRICS

Source: Reuters

Value Metrics	BMW:XETR	*INDUSTRY AVERAGE
P/E last 4Q	7.0	16.3
P/E forecast EPS	5.2	–
P/Free Cash Flow last 4Q	2.6	22.8
P/Sales last 4Q	.52	2.17
Price/Book	1.4	3.4
Dividend Yield(%)	2.4	2.8
Growth Metrics (%)		
1 year sales growth	23.4	15.1
3 year sales growth	2.6	5.7
1 year EPS growth	264.1	25.6
3 year EPS growth	.9	7.3
1-year forecast EPS growth	58.7	–
3-5 year EPS growth forecast	20.0	–
1 year dividend growth	333.3	3.5
3 year dividend growth	7.0	3.5
Momentum Metrics (%)		
4 week stock price change	–	-11.2
26 week stock price change	–	-11.1
Financial Metrics (%)		
Gross margin	20.5	45.2
Net margin	7.7	14.2
Return on assets	4.7	9.1
Return on equity	22.1	29.4
Return on invested capital	7.1	9.1
Long-term debt/capital	.69	.33

*Industry average is for all companies within this country and industry.

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This and other depictions of the Ratings Report appear for illustrative purposes only and are not intended to be representative of a current Report. Ratings are updated weekly and you should produce a current version of the Report.

found five A-rated Consumer Discretionary stocks in countries within the Developed Europe region that have Country Risk Levels of AAA, AA, or A.

2. PRINT A RATINGS REPORT. Once you've identified an A- or B-rated stock, you need to understand its appropriateness for your portfolio and the rationale behind its rating. Enter a stock's name or its U.S. ADR or OTC ticker symbol[8] in the Research field, select the appropriate security (foreign ordinary share, U.S. ADR, or OTC share), and click on the link to the ***Ratings Report*** ("Report") in the Ratings Summary area of the window.[9] Print the Report and use it in the following steps. A link to a User's Guide to the Report is available in the ***Ratings Summary*** area of the window.

3. DETERMINE WHETHER THE STOCK IS APPROPRIATE FOR YOUR PORTFOLIO. Does the stock fit the strategy, objectives, and needs of your portfolio? The *Overview, Sector/Industry*, and *Metrics* sections of the Ratings Report can help answer this question.

- Check the stock's asset class in the Overview section for its market capitalization category (**Guideline III.B**). A small-capitalization stock would not be suitable if your investment strategy requires a large-cap stock.
- Check the sector and industry of the stock (**Guideline III.C**). If you wish to add the stock, make sure it will not overexpose your portfolio to a particular sector or industry.
- Check the stock's beta to get an indication of the stock's risk. Beta is a

[8] If the stock trades in the U.S. in American Depositary Receipt (ADR) form, it will have a U.S.-compliant three-, four-, or five-letter ticker symbol. If it trades in the U.S. as an over-the-counter ("OTC" or "bulletin board") stock, it will have a five-letter ticker symbol ending with the letter F.

[9] If you found the stock by using the International Stock Screener, simply click on the stock's letter grade and then click on the link to the Report.

measure of a stock's tendency to move with the overall stock market. Values greater than 1 represent stocks that move upward or downward to a relatively greater extent than the overall market.

- Check the dividend yield if you're seeking income from your equity investments.

The Metrics section displays common valuation, momentum, and growth measures. The expanded description of the company's business in the Report can provide a fuller understanding of the company's industry and areas of geographic operations.

4. GET INSIDE THE RATING. The Report shows the stock's current rating and percentile rank, last week's rating and rank, and a visual display of the rating on a scale from 1 to 100. The Ratings and percentile ranks are relative to other stocks in the same headquarters country. An asterisk next to the letter grade indicates that a potentially significant event affecting the company has occurred. You can also see the name and abbreviation of the foreign stock exchange where the stock trades and the U.S. American Depositary Receipt or over-the-counter symbols if those securities are available.[10]

Look for the ***"Rationale Behind Our ___ Rating."*** This provides details on the Component grades—Fundamentals, Valuation, Momentum, and Risk—of the rating, as well as the Research Concepts.

The Component Grades

These are less powerful and less diverse than the overall Ratings grade and should not be used to make decisions about buying or selling a stock. They represent different perspectives on a stock's characteristics, and may be thought of as representing the stock's positive, neutral, or negative prospects.

- **Fundamentals:** Fundamentals grades are based on a number of operating performance measures derived from recent financial statement data. Stocks with attributes such as high profitability, quality earnings, and well-managed balance sheets tend to have better Fundamentals grades.
- **Valuation:** Valuation grades are based on several value-oriented investment criteria. Stocks with attributes such as high levels of sales, income, and cash returned to shareholders relative to stock price tend to have better Valuation grades.
- **Momentum:** Momentum grades are based on several measures of short-term (6–12 months) change in investor expectations. Stocks with attributes such as improving analysts' earnings forecasts and strong price performance tend to have better Momentum grades.
- **Risk:** Risk grades are based on diverse measures of investment risk. Stocks with strong positions in their product markets and those more widely followed by brokerage firm analysts are believed to represent better risk-return trade-offs (but are not riskless or low-risk) and therefore tend to have better Risk grades.

It is important to note that the model does not actually predict future performance and that past performance is not a guarantee or indication of future returns.

[10] For more information on U.S.-traded versions of foreign securities, see "Going Global: Selecting ADRs or Foreign Stocks" and "Going Global: Trading Foreign Stocks OTC" on the Market Insight page of Schwab.com.

The Research Concepts
Research Concepts represent the measures that underlie each of the Component grades. You can see each Research Concept's current assessment, its relative importance, and any change from the previous week. A downward-pointing arrow indicates a decline from the past week. An upward-pointing arrow indicates improvement. You can also see a detailed explanation of the Research Concepts by entering a ticker symbol, clicking on the ***Ratings*** tab, and looking at the ***Schwab's Viewpoint*** tab. Simply click on the "expand all" link for a fuller description of the Research Concepts.

If the stock's Ratings grade has changed in the past week, try to find out what drove the change. For example, within the Fundamentals component, you might see that the company's profitability has changed. Such a change will generally occur when the company files its financial statements. Or, in the Momentum component, recent changes in brokerage analysts' forecasts can be interpreted as an early sign of changing market sentiment.

5. CHECK THE COUNTRY RISK LEVEL (THE "LEVEL"). The Economist Intelligence Unit, an Economist Group business, provides Country Risk Levels. The Economist Intelligence Unit is a third-party research service unaffiliated with Charles Schwab & Co., Inc. The Levels and the explanation underlying each Level are as shown in Table 3.

TABLE 3: ECONOMIST INTELLIGENCE UNIT COUNTRY RISK LEVELS AND EXPLANATIONS

Country Risk Level	Explanation
AAA	Capacity and commitment to honor obligations not in question under any foreseeable circumstances.
AA	Capacity and commitment to honor obligations not in question.
A	Capacity and commitment to honor obligations strong.
BBB	Current capacity and commitment to honor obligations, but it's somewhat susceptible to changes in economic climate.
BB	Current capacity and commitment to honor obligations, but it's susceptible to changes in economic climate.
B	Current capacity and commitment to honor obligations, but it's very susceptible to changes in economic climate.
CCC	Questionable capacity and commitment to honor obligations. Patchy payment record.
CC	Somewhat weak capacity and commitment to honor obligations. Patchy payment record. Likely to be in default on some obligations.
C	Weak capacity and commitment to honor obligations. Patchy payment record. Likely to be in default on significant amount of obligations.
D	Very weak capacity and commitment to honor obligations. Poor payment record. Currently in default on significant amount of obligations.

Country Risk Levels provide a quantitative assessment of the risk of doing business in a specific country. This assessment is oriented toward commercial bankers, institutional investors, and corporate executives who have or are considering direct[11] foreign investment(s) in a particular country. Schwab recommends that you limit your international equity investments to those countries with Country Risk Levels of AAA, AA, or A. Because prospects for direct foreign investors and portfolio investors are closely related, Schwab believes that Country Risk Levels below A represent a relatively unfavorable environment for foreign equity investments of either type.

The Country Risk Levels should **not** be used to create return expectations for a particular country, equity market, or company headquartered, incorporated, or traded within a country. Additional research should **always** be performed to help determine the investment merits of a country. Consider the Country Risk Levels as a risk management tool and use them to instill a higher level of awareness of the riskiness of investing in a particular country.

SECONDARY RESEARCH: Check for New Information

The Ratings are recomputed each weekend and published on Sunday evenings (U.S. Eastern time). Information arriving during the week won't be captured in a rating until the next weekend's update. Secondary research is intended to check for significant, very recent information that may not yet be reflected in a stock's rating.

If something in the Secondary Research makes you unwilling to buy a particular stock, eliminate it and move on. There will generally be other A- and B- rated stocks available within a particular country, so an acceptable alternative should be easy to find.

6. DO A MARKET SENTIMENT CHECK: A "sentiment check" looks for evidence of recent changes in investor perception, as reflected in the stock's price history. The first page of the Ratings Report displays two charts that may provide insight into the market's sentiment.

The upper price chart displays the stock's weekly closing price for the last year, along with a 200-day moving average of its prices, its weekly trading volume, the most recently reported earnings-per-share (EPS) values, and its high and low prices during the year. If the company's reported earnings were higher than the consensus estimate of brokerage analysts (a "positive surprise"), the earnings value will include an upward-pointing green arrow (negative surprises are represented by downward-pointing red arrows). The prices and earnings data are displayed in the currency used in the stock's headquarters country market and its financial statements.

The lower chart displays the stock's price performance over the past year in comparison to the Standard & Poor's

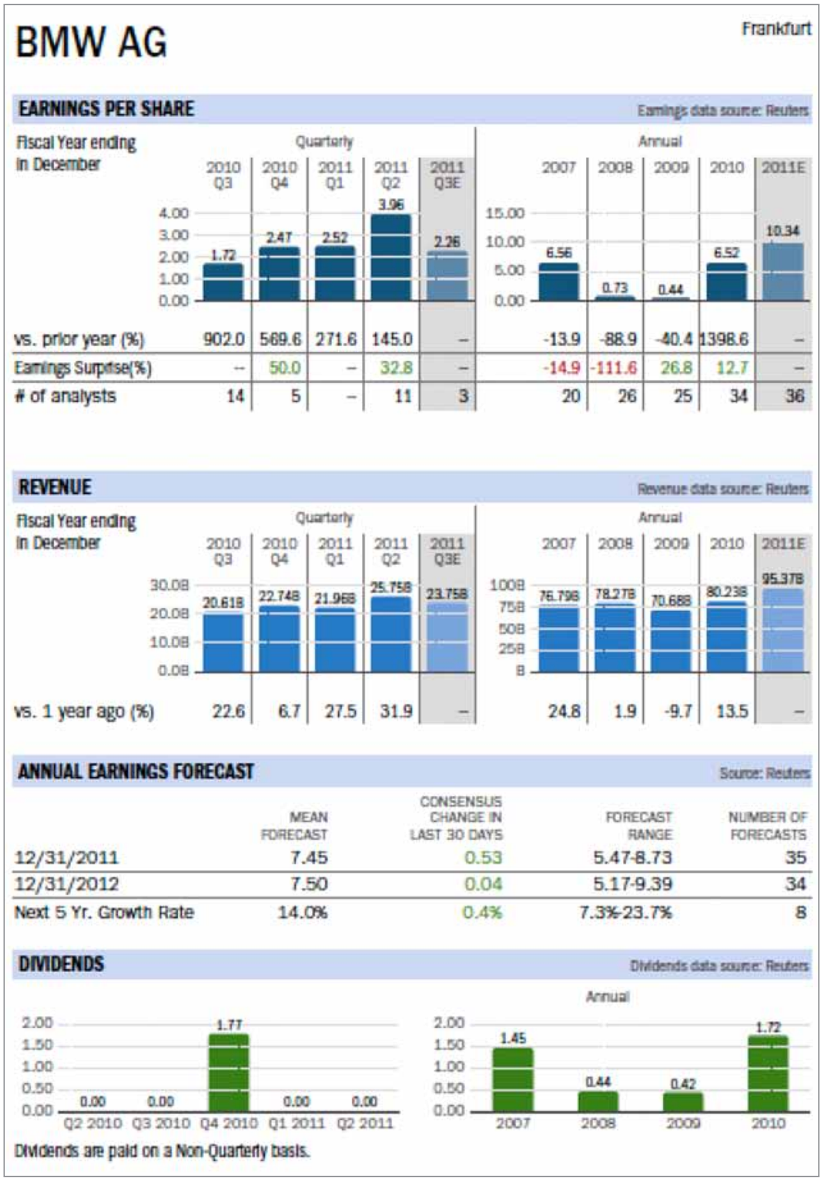
[11] "Direct investment" generally means the ownership of actual physical assets within a country. "Portfolio investment", in contrast, generally means the ownership of securities issued by units of government or companies within a country.

Broad Market Index (S&P BMI) for the headquarters country's stock market. Check to see how the stock's price has moved, particularly over the prior three months, relative to the S&P BMI, and particularly how the price has moved in response to the last EPS report. If a stock is in the midst of a major (for example, 20% from peak) downswing, eliminate it and move on. If you observe price or volume spikes (up or down) in the last eight weeks, check the news and the company's earnings. At the individual-company level, a notable market reaction usually occurs for a reason, so try to determine the reason for any unusual price or volume behavior.

7. CHECK THE COMPANY'S EARNINGS, REVENUES, AND EARNINGS FORECASTS. The second page of the Report contains important information about the company's reported and expected earnings and revenues, when available.

Investors used to the concept of quarterly financial statements and earnings reports may be surprised to discover that many foreign companies report less frequently, usually on an "interim" basis—approximately every six months—or, in some cases, only annually. In the following paragraphs, we'll assume that financial reports are available on both a quarterly and an annual basis. If financial results are reported on an interim or annual-only basis, the displays in the Ratings Report will change accordingly (BMW, shown on the next page, reports financial results on a quarterly basis).

The Report displays quarterly or interim and annual earnings and revenues, current information about earnings forecasts, and quarterly or interim and annual dividends, in the currency used within the company's headquarters country. Here are some things to consider in viewing this portion of the Report:



Earnings per Share

The Earnings per Share section displays quarterly or interim (if available) and annual earnings data, including the current consensus forecast for the next quarter, interim period, or year; the percentage change over year-ago periods; and the expected date of the next earnings announcement. Look for the following:

- Check the expected date of the next EPS announcement, if available. If the date is within the next one to two weeks, you may want to wait until shortly after earnings are reported to see the new financial results and how the market reacts to the announcement.
- Check the row in the table that displays the percentage changes in EPS versus the year-ago quarter, interim period, or prior year. Period-over-year-ago-period increases are generally preferable. If the period-over-year-ago percentage changes are generally negative, it might be desirable to eliminate the stock and consider another.
- Check the “Earnings Surprise” row. A positive earnings surprise is defined as reported earnings exceeding the average earnings estimate as provided by brokerage analysts. If the most recent earnings report produced a negative surprise of 5% or more, consider eliminating the stock and looking for another.
- If a company has failed to report its earnings by the expected EPS report date, you may wish to eliminate it and move on. Late reporting of financial results often signals looming financial or other problems.

Revenue

The Revenue section displays quarterly or interim (if available) and annual revenue data and the percentage change over year-ago periods.

- Check the row that displays the percentage changes in revenues versus the year-ago period. If the year-over-prior-year percentage changes are generally negative, it might be desirable to eliminate the stock and look for another candidate.

Annual Earnings Forecast

This section displays the consensus forecast of fiscal year earnings for the current and next fiscal years and for long-term EPS growth.

- The forecast for the next fiscal year should generally be higher than the forecast for the current fiscal year, and the long-term growth forecast should generally be positive.
- A negative change in earnings forecasts for the current and upcoming fiscal years and/or in the long-term growth rate of earnings implies that analysts' expectations are worsening. You may wish to consider another stock, though negative forecasts are not conclusive in and of themselves.

8. CHECK THE NEWS: You should consider two categories of news in the course of your research: recent news stories and Pertinent News information, which will be present when a rating is accompanied by an asterisk. News stories can be found on the third page of the Ratings Report and on the International Stock Summary page on Schwab.com. Be aware that news coverage for international stocks varies widely in terms of quality, quantity, and timeliness.

News Stories

Many news stories are simply not relevant in terms of having an impact on stock prices. So read news selectively, focusing on **recent**, **non-quantitative**, and **significant news** items. Examples of the things a news check should search for include, but are not limited to:

- Product news (recalls, new product releases, patents granted or ending)
- Company news (management changes, changes of auditors)
- Competitive developments
- Significant litigation (e.g., product liability or environmental issues)
- An investigation by a tax, regulatory, or investigative body
- An announced offering of new shares that may dilute earnings per share
- Announced merger or acquisition activity
- Significant volume of insider sales
- Delayed filing of financial statements or restatements of prior filings

If a news story contains negative information that you believe constitutes a reason not to consider the stock, eliminate it from consideration and move on.

Pertinent News

Pertinent News about a company, denoted by an asterisk ("*") next to a stock's rating, means that a potentially significant business event involving the company has occurred. Click on the rating letter to view more details about the nature and date of this news.

Schwab assigns Pertinent News asterisks based on analysis of company press releases, corporate filings of financial statements and other required documents, and other information sources. Whether Schwab will assign a Pertinent News asterisk or remove a stock's rating entirely (changing the rating to "NR" or Not Rated) depends on the nature and materiality of the business event. If analysis suggests that the event may impact Schwab's ability to reliably determine a rating, the stock won't be rated. Note that Schwab does not review all rated stocks, focusing its efforts of A- and B-rated stocks. For more information about NR ratings, please see our article *"What to Do When the Schwab Equity Rating Disappears,"* available on the Market Insight page of Schwab.com.

The existence of news stories or Pertinent News events does not necessarily eliminate a company from consideration, but you should familiarize yourself with the nature of the news event and evaluate its potential impact on the stock before proceeding. If a news event makes you unwilling to invest in a stock, eliminate it and move on.

OPTIONAL RESEARCH: If You Have Time

The goal of optional research is to check for more detailed information, principally for informational purposes. If you have time, consider the following tools from third-party research providers. Be aware that third-party research coverage of international stocks is limited.

- **Independent Third-Party Research—Ratings:** Schwab provides research from unrelated third-party research firms that may provide additional information about companies. You can find the recommendations of third-party research providers on the Stock Summary page and on the second page of the Ratings Report, in the Other Opinions section. Don't expect total agreement between the Ratings grades and third-party ratings, but note any major difference. If a stock's Schwab Equity Ratings International™ grade is A or B, but a third-party recommendation is "sell" or "underperform" or the equivalent, try to determine the rationale for the research firm's rating by checking its report, as described below. While Schwab Equity Ratings International provides an equal number of buy- and sell-rated stocks in every country, negative ratings from third-party sources are relatively rare.
- **Independent Third-Party Research—Reports:** Schwab also provides research reports from the research firms mentioned earlier. You can find these reports, if available, on the Reports page of Schwab.com. These research reports can sometimes provide additional information about companies, their industries, or their national economies. A more in-depth understanding of a company's business and industry may help you interpret recent news events.

SOME GUIDANCE: Trading Foreign Stocks

A U.S. investor can buy foreign stocks in one or more of three possible ways:

- Purchasing the company's shares through the NASDAQ-managed over-the-counter (OTC) market

- Purchasing American Depositary Receipts (ADRs), which may trade on U.S. exchanges like the NYSE or the NASDAQ National Market System or on the OTC market
- Purchasing foreign ordinary shares directly on the foreign equity market where the stock normally trades

In some cases, a stock may trade in all three venues. Toyota, the Japanese automaker, is listed and trades on the Tokyo stock exchange, as well as being available in the U.S. on the OTC market and as an ADR. All three methods have advantages and disadvantages in terms of liquidity, fees, minimum position amounts, trading hours, whether positions are marginable, and others. Whichever you select, you can find the appropriate ticker symbol for the foreign ordinary, ADR, or OTC BB security on the right-hand side of the first page of the Schwab Equity Ratings International™ Report. For more information on these trading venues, please see Schwab's articles ***"Going Global: Selecting ADRs or Foreign Stocks"***[12] and ***"Going Global: Trading Foreign Stocks OTC"***[13] on the Market Insight page of Schwab.com (select Research, Markets, Market Insight, Investing, and International).

IN CONCLUSION: BUILDING YOUR PORTFOLIO

Use the steps outlined above for each of the stocks you select for your portfolio. Remember, your objective is to build a portfolio of 40 or more stocks (**Guideline III.A**), allocated across developed and emerging markets (**Guideline III.D**) and different countries and geographic regions (**Guideline III.E**). And your portfolio should be diversified in terms of those sources of risk (sector/industry and market capitalization category) that can be reduced by diversification. Next, we'll discuss the steps you should take to monitor and manage your international stock portfolio.

[12] https://investing.schwab.com/secure/cc/research/markets/market_insight/investing_strategies/international/going_global_selecting_adrs_or_foreign_stocks.html?cmsid=P-4014908&lvl1=research&lvl2=markets

[13] https://investing.schwab.com/secure/cc/research/markets/market_insight/investing_strategies/international/going_global_trading_foreign_stocks_otc.html?cmsid=P-3881661&lvl1=research&lvl2=markets

PART 3

MANAGING YOUR PORTFOLIO

Once you've built your portfolio—a diversified portfolio of at least 40 highly rated large- and small-cap stocks drawn from all 10 economic sectors and representing the major developed and emerging market regions of the world—you're in the "monitor and manage" stage of the portfolio management process. In this stage, you'll learn how to monitor your portfolio to determine when you should sell stocks, rebalance your portfolio, and react to changes in your stocks' ratings.

Keep the following points in mind:

- **Know why you bought the stock—and why you would sell:** In Part II of this Guide, we suggested a fairly simple strategy for stock purchases (A- or B-rated, matching Schwab's guidelines for market capitalization, developed/emerging markets and regions, drawn from all 10 economic sectors, and passing the criteria described in our eight-step research process). You should have an equally clear set of reasons for why you would sell.
- **Develop sell rules and stick to them:** Sell rules are as important as buy rules—don't neglect them! Schwab Equity Ratings International™ provides a straightforward sell strategy: Consider selling a stock if its rating falls to D or below. This recommendation is as important as our suggestion to consider purchasing A- and B-rated stocks. Other sell rules, such as sales of overly concentrated positions or of stocks that no longer meet your portfolio's objectives, may also be applicable.

The Schwab Center for Financial Research has conducted simulations of various trading strategies in an effort to assess the potential returns and potential portfolio turnover associated with alternative buy and sell rules and risk exposure tolerances.[14] Our simulations showed that, in general, a strategy of buying stocks rated A (percentile ranks 1–5) and high B (percentile ranks 6–15) and selling when a stock's rating falls to D or F, resulted in simulated portfolio returns that outperformed well-known equity benchmarks with relatively low turnover.

More active strategies such as selling stocks whose percentile ranks fall below 50 (the middle of the C ratings range) increased simulated portfolio turnover by more than 70% above the level associated with the less restrictive rule of selling D- and F-rated stocks (**Guidelines II.A** and **II.B**). The increase in turnover also resulted in higher transaction costs.

Finally, an important part of your sell strategy is putting your emotions on hold. Academic researchers have found that selling is much more difficult for the average investor than buying. Investors may become emotionally attached to a stock, fixate erroneously on the price they paid for it, or believe that selling (particularly at a loss) is equivalent to admitting a mistake. None of these reasons has any basis in fact. And facts—not emotions—should drive your investment decisions.

MONITORING YOUR PORTFOLIO

Monitor your portfolio each week, preferably early in the week, by using the Accounts page and selecting the Market Value page within the Positions tab to see the current rating of each stock—domestic or foreign—in your portfolio. Your goal in monitoring your portfolio is simple: to determine if any action, principally checking for news about a stock or considering its sale, is necessary.

What should you look for in monitoring your portfolio? Three things: the current rating, the presence of Pertinent News asterisks, and the relative weight of each region, country, sector, industry, market capitalization category, and individual

[14] See **Important Disclosures about Portfolio Simulations** at the end of this document.

stock within your overall stock portfolio. We'll discuss the importance of the last point later in this Guide (under "Rebalancing to Maintain Diversification").

What if the rating has changed? Our guidance for the appropriate response to a change in rating depends on the nature of the change. If a stock's rating has changed, click on the letter grade of the rating to see the percentile rank of the rating.

- **Ratings change from A, B, or C (Buy or Hold) to D or F (Sell):** A change from buy or hold to sell suggests that you should carefully consider selling the stock. Check the Schwab's Viewpoint tab to see which Research Concepts are driving the change from the prior week by looking for the colored directional arrows, as described in Step 4 of our stock selection process.
- **Ratings changes from A to B, A to C, or B to C:** Generally, no action is required in these cases. Since all stocks are rated relative to one another, a stock's rating change may be caused by changes in the ratings of other stocks, not by any change in the characteristics of the stock itself.
- **Percentile rank falls to a value greater than 50:** Selling C-rated stocks or selling those stocks whose percentile ranks have fallen into the 50s or 60s can be done. But as noted above, when tested in portfolio management simulations, this approach led to higher turnover and higher transaction costs. Although we did not test the tax implications of such a strategy, you should be aware that more active approaches like selling Cs or selling stocks whose percentile ranks fall below 50 may—at least potentially—lead to higher taxes, since a larger fraction of any gains will generally be short-term in nature.
- **Small changes in percentile ranks:** A small change in percentile rank that leads to a change in the rating (e.g., an A-rated stock with a percentile rank 5 changing to a B rating with a rank of 6) are generally not significant. This phenomenon is known as "ratings flutter" and can occur whenever a specific numerical boundary exists between ratings categories.

PERTINENT NEWS AND HEADLINE RISK:

Pertinent News asterisks were discussed in Part II of this Guide. In some cases, a recent news story may create "headline risk"—that is, the news comes as a surprise to the market and has a significant negative effect on the stock's price. Headline risk is, by its nature, unpredictable by the Ratings or any other stock selection system. And since these events can't be predicted, there's no way to avoid them by careful stock selection or good research. When negative news appears, we suggest that you:

- Determine the reason for the asterisk. By clicking on the rating letter, you can see the explanation for the asterisk and the date when it was attached to the rating.
- Check the news. It may take some time before securities analysts at third-party research sources can react to recent news events, but news stories regarding the event may be available more quickly. Be aware that news coverage of international stocks may be limited. In addition, many news stories lack any perspective regarding the investment implications of the story.

- Check the stock's price chart to see if the market's reaction to the news was significant. In general, markets react to meaningful news, but news reactions may be contrary to expectations (as, for example, when a company acknowledges the existence of a loss that investors had already anticipated, but also announces that the loss was smaller than expected). Market reaction may also be muted if the news was previously anticipated and reflected in the stock's prices over earlier periods.
- Check Schwab's Viewpoint by entering the ticker symbol and clicking on the Ratings tab. The Components and Research Concepts shown in the Schwab's Viewpoint section react at different rates to news stories, with Momentum- and Sentiment-related Concepts—particularly analyst sentiment—reacting first, and Fundamental and Risk-related Concepts reacting more slowly. Valuation-related Concepts may react in what seem to be an unusual way: As a stock's price falls, Valuation-related Concepts may actually improve because the stock looks cheaper.
- Check third-party research sources. If a significant business event has occurred and the company is covered by one or more of the available third-party research sources, you may be able to discover details about the event as well as its investment implications.

REBALANCING TO MAINTAIN DIVERSIFICATION: Each week you should review the relative weights of the stocks in your portfolio. In addition, review Guideline I as the weights of each region, country, sector, industry, and market capitalization category. Your portfolio's diversification can be undercut if one or more of the stocks in your portfolio experiences a significant increase in value, exposing you to excess concentration in the stock or its various risk categories (sector, country, and so on). This may sound like a problem you'd love to have, but a lack of diversification may expose you to additional risk without an associated reward.

Consider selling part of a position or part of your holdings based on the following guidelines.

- If the market value of any individual stock in your portfolio rises above 4% of your stock portfolio's value, consider selling part of the position (**Guideline III.A**). While this may lead you to sell your winners, remember that maintaining a diversified portfolio—and, therefore, not allowing any individual stock to distort your diversification—is a critical element of your strategy.
- If small-cap stocks as a group increase to more than 35% of your international stock portfolio's market value, consider selling a portion of your holdings in that capitalization category (**Guideline III.B**), starting with the stocks with the lowest Ratings percentile ranks.
- If the market value of any sector in your portfolio exceeds more than twice the weight of that sector in your benchmark index, consider selling a portion of your holdings in that sector (**Guideline III.C**). For example, if the benchmark weight of the Consumer Discretionary sector was 12%, consider selling a portion of your holdings in that sector if its market value rises above 24% of your portfolio, again starting with the stocks with the lowest Ratings percentile ranks.

- If the market value of your portfolio's stocks from emerging markets rises above 35% of your portfolio's market value, consider selling a portion of your holdings in emerging markets (**Guideline III.D**), again starting with the stocks with the lowest Ratings percentile ranks.
- If the market value of your portfolio's holdings in a specific region or country exceeds the weight of that region or country by more than 10% above its weight in your benchmark index, consider selling a portion of your holdings in that region or country (**Guideline III.E**). For example, if the benchmark weight of the Emerging Asia region was 8%, consider selling a portion of your holdings in that region if the region's market value rises above 18% of your portfolio, again starting with the stocks with the lowest Ratings percentile ranks.

THE TAX MAN COMETH

When it comes to selling a stock, keep your portfolio goals in mind. We believe you shouldn't obsess about taxes. The fact that capital gains taxes may result is inevitable (and would ideally be the result of a successful investment strategy!). Those taxes, should you have to pay them, should not prevent you from selling when you need to.

Basics

The capital gain or loss on a stock held in a taxable account is the difference between the proceeds from a sale of the stock, after commissions, and the stock's original cost including commissions (your "tax basis"). Capital gains taxes are levied only on net gains—that is, gains minus losses—and depend on how long you hold the stock. Losses can offset gains without limit, and can also offset $3,000 of ordinary income in a single year. Losses after that carry over without expiring.

Long-term gains—gains on stocks that you've held for more than one year—are taxed at a lower rate (currently 15%). Gains on stocks held for one year or less are considered short-term gains and are taxed at your marginal income tax rate.

Harvest Your Losses

If you have realized capital gains as the end of the year draws near, consider selling losers to create realized losses that offset your tax liability on realized gains (particularly if any are short-term). You may also want to realize losses when a stock with a meaningful loss (for example, 15% or more) can be replaced by one with a higher rating, creating a "loss storehouse" to offset future realized gains.

Low Basis vs. Low Rates

Investors with large gains in low-cost-basis stocks often become paralyzed by the tax consequences of selling those stocks, even if the gains are long-term in nature. But holding large positions in big winners may actually increase risk if your portfolio lacks diversification as a result. Avoiding a 15% tax doesn't make sense if the underlying stock experiences a large downward move, as many tech-stock investors with large positions in low-cost-basis stocks discovered the hard way during the tech stock collapse of 2000–2002.

If you want to know what you're actually earning on your investments, it's important to factor in all costs, including taxes. Just remember not to get so wrapped up in tax calculations that you don't make good investment decisions. As always, check with your financial advisor or tax advisor before you conduct any transactions that could have significant tax implications.

PORTFOLIO PERFORMANCE

The final step in managing and monitoring your portfolio is to periodically evaluate your performance relative to your selected benchmark. Use the Performance feature of Schwab.com to evaluate your performance, at least annually. But remember that short-term performance can vary considerably. Using the Ratings means that you are investing via a strategy—a strategy that emphasizes holding quality stocks, investing without emotion and for the long term.

The most appropriate period for evaluating such a strategy may be a full market cycle (from one market peak to the next or one trough to the next). A focus on short-term performance can lead investors to abandon a winning strategy just at the very point when it should be maintained. Stick with your strategy until it has had time to work!

International investing involves special risks such as currency fluctuations and political instability that should be considered prior to making an investment decision. Companies whose stocks trade on foreign exchanges and markets are not subject to the same accounting, regulatory, and reporting requirements as stocks traded on U.S. exchanges. Investing in emerging markets may accentuate these risks. Most of the securities rated by Schwab Equity Ratings International™ (the "Ratings") are not registered for purchase or sale in the United States. As a result, although you may use the Ratings to make your own self-directed investment decisions and place your order through Schwab, neither Schwab nor any of its representatives are able to recommend specific foreign equities for purchase other than certain American Depositary Receipts listed on U.S. exchanges, which must meet additional criteria to be recommended. Schwab and its representatives may recommend the sale or continued holding of any foreign equity, including U.S. ADRs, foreign equities traded in the U.S. Over-the-Counter market, and foreign equities traded on foreign securities exchanges.

This report is for informational purposes only and is not an offer, solicitation or recommendation that any particular investor in any particular location should purchase or sell any particular security or pursue a particular investment strategy. All expressions of opinion are subject to change without notice in reaction to shifting market conditions. Examples are provided for illustrative purposes only and not intended to be reflective of results you should expect to achieve. Past performance of stocks, markets or indexes is not a guarantee of future results.

Diversification strategies do not ensure a profit and do not protect against losses in declining markets.

This information is not intended to be a substitute for specific individualized tax, legal or investment planning advice. Where specific advice is necessary or appropriate, Schwab recommends consultation with a qualified tax advisor, CPA, Financial Planner or Investment Manager.

Quotes on Canadian securities are provided by the Toronto Stock Exchange. Trade executions are through third parties who may execute trades on a principal basis and may include additional fees, a mark-up or mark-down as appropriate. Investing in these securities involves additional risks related to currency exchange calculations and fluctuations, economic and political differences and differences in accounting standards.

As your agreement for the receipt and use of market data provides, the securities markets (1) reserve all rights to the market data that they make available; (2) do not guarantee that data; and (3) shall not be liable for any loss due either to their negligence or to any cause beyond their reasonable control.

Schwab investment advisory affiliates may also receive research information from the Schwab Center for Financial Research that is not included in the SERI universe or is furnished on a basis to allow such investment advisory affiliates to manage their investment funds as required under their investment objectives and strategies as set forth in their offering documents.

Important Disclosures About Schwab Equity Ratings International

Schwab Equity Ratings International grades are assigned to approximately 4,000 stocks issued by companies headquartered, incorporated, and traded in certain foreign nations. In a limited number of cases, a company may be headquartered and conduct its business operations in one country and trade on a stock market in another country. In such cases, Schwab will generally rate the stock within the country where the company maintains its headquarters and conducts its primary business operations (see "Percentile Ranking Explanation" below). Not every foreign equity market will be represented.

Schwab Equity Ratings International are based on a quantitative model that is designed to evaluate international equities. The model assigns a rating to each eligible stock on the basis of a wide variety of investment criteria from a number of broad categories, or components. Ratings are based on a scale of A, B, C, D, and F. Schwab's research outlook is that A-rated stocks are likely to strongly outperform, and F- rated stocks are likely to strongly underperform, the average rated stock within the country in which the stock is rated.

If a stock is not included in the universe of rated stocks, or no longer qualifies for inclusion due to one or more factors (including, without limitation, failure to meet minimum market capitalization, recent change of symbol, or is prohibited from coverage for regulatory or other reasons), it will be classified as NC ("Not Covered"). If a rating is not assigned to a stock because one or more critical data elements are missing, the stock will be classified as NA ("Not Available"). If Schwab does not publish a rating on a stock due to unusual or extraordinary business circumstances related to the issuing company, the stock will be classified as NR ("Not Rated"). If an asterisk ("*") is assigned to the rating of a stock, it indicates that you should check current news because a potentially significant business event has been announced for an A- or B-rated stock. Clients can view a short description of the event by clicking on the rating. Although Schwab generally does not monitor C-, D-, and F-rated stocks for current news, from time to time, asterisks may appear on a particular stock due to certain circumstances (e.g., the downgrade of a stock from a B to a C rating). Schwab Equity Ratings International are generally updated weekly, so you should always review and consider any recent market or company news before placing a trade.

The Schwab Equity Ratings International model utilizes third-party data in the forming of a rating. While Schwab believes such third-party information is reliable, we do not guarantee its accuracy, timeliness, or completeness. Third-party information is subject to change without notice. The news sources used on Schwab.com come from independent third parties. Schwab is not affiliated with any of the news content providers. Schwab is not responsible for the content, and does not write or control which particular article appears on its website. Consensus data about forecasted earnings per share, revenues, dividends, and growth rates are provided by Reuters Research, and may exclude certain items or discontinued operations.

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The Standard & Poor's (S&P) Broad Market Indexes are indexes of stocks traded in a national market. Indexes are unmanaged, do not incur fees or expenses and cannot be invested in directly. The S&P Broad Market Indexes are capitalization-weighted, meaning that price changes for companies with larger market capitalizations will influence the index more than price changes for small-capitalization stocks. Small-capitalization stocks have historically been more volatile than the stocks of larger, more established companies.

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