

# Schwab Bond Funds

## **Semiannual Report**

February 28, 2005

Schwab YieldPlus Fund®

Schwab Short-Term  
Bond Market Fund™

Schwab Total  
Bond Market Fund™

Schwab GNMA Fund™

*charles* SCHWAB

*Four smart, cost-effective ways investors can use  
bonds in an asset allocation strategy.*

## In this report

### Management's Discussion . . . . . 2

The president of Schwab Funds® and the funds' managers take a look at the factors that shaped fund performance during the report period.

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### Schwab YieldPlus Fund®

Investor Shares: **SWYPX** Select Shares®: **SWYSX**

The fund seeks high current income with minimal changes in share price.

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### Schwab Short-Term Bond Market Fund™

Ticker Symbol: **SWBDX**

The fund seeks current income by tracking the performance of the Lehman Brothers Mutual Fund Short (1-5 Year) U.S. Government/Credit Index.

Performance and Fund Facts . . . . . 10

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### Schwab Total Bond Market Fund™

Ticker symbol: **SWLBX**

The fund seeks current income by tracking the performance of the Lehman Brothers U.S. Aggregate Bond Index.

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### Schwab GNMA Fund™

Investor Shares: **SWGIX** Select Shares: **SWG SX**

The fund seeks high current income consistent with preservation of capital.

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Fund investment adviser: Charles Schwab Investment Management, Inc. (CSIM).  
Distributor and transfer agent: Charles Schwab & Co., Inc. (Schwab).

# From the Chairman



Charles Schwab  
Chairman

Dear Shareholder,

I am a big fan of mutual funds and have been throughout my 40-year career. During this time, I've watched the mutual fund market grow, with investors today having nearly 17,000 funds from which to choose.

I also have advocated the need to take a long-term view of investing, as well as the importance of developing and maintaining an asset allocation plan. I continue to believe that mutual funds are excellent vehicles to help you build a diversified portfolio in keeping with your goals. More specifically, bond funds can fill the fixed income portion of your asset allocation plan while helping to cushion the impact of more volatile asset classes.

We have developed Schwab bond funds that are designed to deliver both performance and value. We are especially pleased with the top ten percent performance of our Schwab YieldPlus Fund® for the year ended February 28, 2005 (Source: Lipper Ultra Short Funds, Select Shares #4 and Investor Shares #7 out of 70 funds; rankings for the 3-year period were, respectively, #1 and #3 out of 45 funds; rankings for the 5-year period were, respectively, #7 and #9 out of 31 funds).<sup>1</sup> With a target duration of just under a year, this fund is designed for your longer-term cash holdings.

As to value, I'd like to remind you that many of the Schwab Funds®, including the Schwab YieldPlus Fund, offer Select Shares®, a share class that carries lower expenses in exchange for higher investment minimums.

In closing, I want to remind you that our commitment to our shareholders will not change. Thank you for investing with us.

Sincerely,

A handwritten signature in cursive script that reads "Charles Schwab".

<sup>1</sup> Additional performance information is provided on page 7.

# Management's Discussion

for the six months ended February 28, 2005



**Evelyn Dilsaver** is President and CEO of Charles Schwab Investment Management, Inc. and is president of each of the funds covered in this report. She joined the firm in 1992 and has held a variety of executive positions at Schwab.

Dear Shareholder,

When I assumed my new role as President and CEO of Schwab Funds® last year, I pledged that I would be committed to offering you more relevant choices and better value. I am pleased to report that we already have done both.

In terms of new products, we recently introduced two new tax-free bond funds: Schwab Tax-Free YieldPlus Fund™ and Schwab California Tax-Free YieldPlus Fund™. These funds are designed to help you get more from your long-term cash investments. In response to growing investor concern over the federal alternative minimum tax (AMT), neither of these two funds has invested in securities that generate income subject to AMT.

I'm also happy to announce that Schwab Funds has launched another equity fund. The Schwab Premier Equity Fund™ is the newest addition to the actively managed Schwab Funds that use Schwab Equity Ratings®.

To reiterate what Chuck Schwab said about providing great value to our shareholders, our two new funds—the Schwab Tax-Free YieldPlus Fund and the Schwab California Tax-Free YieldPlus Fund—as well as the Schwab YieldPlus Fund® and the Schwab GNMA Fund™ offer Select Shares®.

I speak for all of Schwab Funds, when I say we want Schwab to be a place where investors can find useful, quality financial products and services to help them succeed. Regardless of the size of their portfolios, Schwab should be the place investors can always trust to watch out for their best interests.

I continue to look for more ways to offer you relevant choices and value. Your trust is very important to us, and I will do all I can to maintain that trust. Thank you for investing in Schwab Funds.

Sincerely,

A handwritten signature in dark ink that reads "Evelyn Dilsaver". The signature is fluid and cursive, with the first name being more prominent.

*Investors should consider carefully information contained in the prospectus, including investment objectives, risks, charges and expenses. You can request a prospectus by calling Schwab at 1-800-435-4000. Please read the prospectus carefully before investing.*



**Kim Daifotis, CFA**, at right, a senior vice president and chief investment officer, fixed-income, of the investment adviser, has overall responsibility for management of the funds. He joined the firm in 1997, and has worked in fixed-income asset management and research since 1982.

**Michael Shearer, PhD**, at left, a vice-president and senior portfolio manager, has day-to-day responsibility for management of the funds. Prior to joining the firm in 2003, he worked for more than 10 years in the financial industry as a portfolio manager and quantitative analyst/strategist.

**Matthew Hastings, CFA**, in center, a director and portfolio manager, has day-to-day co-management responsibility for the funds. He joined the firm in 1999 and has worked in fixed-income and asset management since 1996.

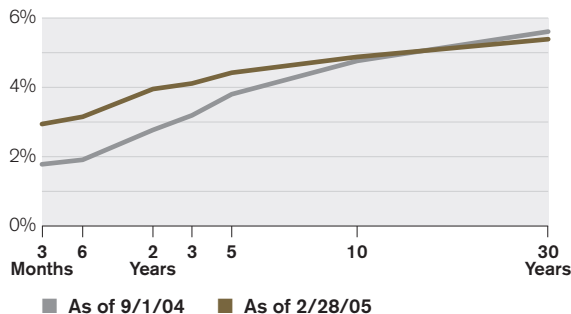
## The Investment Environment and the Funds

Oil prices hit highs never seen before, the Federal Reserve raised short-term interest rates to curb inflationary pressures, and GDP showed impressive growth. As expected in this type of economic environment, short/intermediate bonds went up in yield and down in price. What wasn't expected was how little these events affected long-term bonds, which traded in a narrow range throughout the six-month report period.

Early in the period, investors were heartened when oil prices dipped and major summer events—both political conventions and the Olympics in Greece—went off without any terrorism. Unfortunately, the brief respite in oil prices was short-lived. Strengthening global demand for oil, particularly in the Pacific Rim, and supply constraints in the wake of the Florida hurricanes, drove crude prices to record highs, above \$50 per barrel in late October. After that crude prices backed off to the mid-\$40 range, as supply concerns dissipated, but then spiked upwards again in mid-February.

The firming labor market, as well as steady gains in capital spending, kept the economic expansion on a self-sustaining path. The caution surrounding the economic outlook and geopolitical environment began to dissipate just prior to the beginning of the report period and firms, unable to continue boosting productivity by restraining hiring, added more than two million new jobs during 2004. Moreover, many leading

**Yield Curve: Average Yields of AAA Securities of Seven Maturities**



**The yield curve flattened during the period. Short and intermediate rates increased, as the Fed continued to tighten.**

This chart shows where yields stood at the beginning of the report period and at the end of the period. For debt securities of comparable quality, those with longer maturities typically pay higher interest rates, in part because they are presumed to carry higher risk.

Data source: Bloomberg L.P.

*Amid signs of solidly expanding output and improved hiring, the Fed began to take the Fed funds rate higher.*

indicators, such as the Institute for Supply Management's business activity surveys suggested further improvement, while continuing claims for unemployment benefits remained near cyclical lows.

Consumer sentiment rebounded, the labor market continued to sustain consumer spending, and corporate liquidity remained positive. Though some adverse effects of high oil and commodity prices earlier in the year may have hampered growth and stirred inflationary pressures, strong productivity growth and slack in the economy have thus far kept a lid on inflation.

Amid signs of solidly expanding output and improved hiring, the Fed began to take the Fed funds rate higher. The rate was raised in June and August, as well as another four times since then, ending the report period at a still-moderate 2.50%. The moves have had a limited impact on overall economic growth, due primarily to the record-low level of rates from which the increases began.

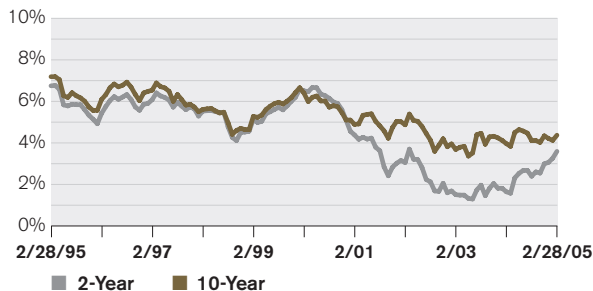
The Fed's action led investors to expect that rates would continue to rise, causing the yield curve to flatten considerably at the front end: the 2-year Treasury Note increased about 1.20% during the period, while the 10-year Treasury Note declined about 0.26%. Fed chief Alan Greenspan called it a conundrum as to why in this type of economy longer rates on bond yields haven't gone up more. Other experts suggested that the slight inflation we're seeing remains contained, and the Fed won't let it get out of control.

#### Yields of U.S. Treasury Securities: Effective Yields of Two- and Ten-Year Treasuries

**Yields rose over the report period for both the 2- and 10-year Treasury Notes. During the period the spread between the 2- and 10-year Treasury Notes narrowed, as the 2-year increased more than the 10-year.**

Yields, or interest rates, represent the cost of borrowing money. Rapid economic growth, waning investor interest in bonds, an increase in the issuance of bonds, or the expectation of higher inflation can drive rates up, while the opposite conditions can push rates down.

Data source: Bloomberg L.P.



## Performance at a Glance

Total return for the six months ended 2/28/05

**The performance data quoted represents past performance. Past performance does not guarantee future results. Investment returns and principal value will fluctuate so that an investor's shares may be worth more or less than their original cost. Current performance may be lower or higher than performance data quoted. To obtain performance information current to the most recent month end, please visit [www.schwab.com/schwabfunds](http://www.schwab.com/schwabfunds).**

### Schwab YieldPlus Fund®

|                           |       |
|---------------------------|-------|
| Investor Shares . . . . . | 1.15% |
| Select Shares® . . . . .  | 1.33% |
| Benchmark . . . . .       | 0.37% |
| Fund Category¹ . . . . .  | 0.84% |

*Performance Details . . . . . pages 7-8*

### Schwab Short-Term

|                                    |        |
|------------------------------------|--------|
| <b>Bond Market Fund™</b> . . . . . | -0.02% |
| Benchmark . . . . .                | -0.25% |
| Fund Category¹ . . . . .           | 0.25%  |

*Performance Details . . . . . page 10*

### Schwab Total Bond

|                               |       |
|-------------------------------|-------|
| <b>Market Fund™</b> . . . . . | 1.40% |
| Benchmark . . . . .           | 1.26% |
| Fund Category¹ . . . . .      | 1.34% |

*Performance Details . . . . . page 12*

### Schwab GNMA Fund™

|                           |       |
|---------------------------|-------|
| Investor Shares . . . . . | 1.34% |
| Select Shares . . . . .   | 1.44% |
| Benchmark . . . . .       | 1.67% |
| Fund Category¹ . . . . .  | 0.83% |

*Performance Details . . . . . pages 14-15*

**In the taxable portion of the bond market, spreads on investment grade corporate bonds remained narrow**, suggesting that investors continued to be confident as corporate balance sheets remained flush with cash. Also of note is that the yield curve continued its flattening trend, with rates rising at the short end on prospects for more rate hikes. Generally speaking, a flattening trend in the yield curve suggests that the Fed will continue to raise rates to contain inflation.

Within this economic scenario, there were several unknowns, including the escalating price of oil, variable monthly employment numbers, and the direction that interest rates would take. We were of the opinion that interest rates would move higher and we managed our portfolios accordingly.

This strategy worked, with the best performing sectors commodity-based, including basic materials, metals and mining. Fortunately, we avoided the worst performing sectors, such as automotive and insurance, the latter of which continued to suffer from regulatory inquiries. Also, credit-quality spreads remained extremely narrow, with lower-quality paper outperforming their higher-quality cohorts on a total-return basis.

**The Schwab YieldPlus Fund** was positioned for a continued economic expansion and performed very well, beating both its benchmark and category-average. The fund was heavily invested in medium-to-higher-quality corporate bonds issued by companies expected to outperform during this type of economy. The portfolio also carried a sizable investment in floating-rate securities and asset-backed securities, particularly home equity loans. The portfolio held a smaller weighting in both mortgage-backed and government securities. During the report period, the fund continued to add mortgage-backed securities and reduced exposure in selected lower-quality corporate and asset-backed sectors.

The fund was generally positioned to defend against interest rate increases during the period by staying close to the short end of its duration range. This caused the fund's NAV to remain relatively stable during the period.

All fund and index figures on this page assume dividends and distributions were reinvested. Index figures do not include trading and management costs, which would lower performance. Indices are unmanaged, and you cannot invest in them directly. Performance results less than one year are not annualized.

Expenses may be partially absorbed by fund management. Without these reductions, the fund's total return would have been lower. Performance does not reflect the deduction of taxes that a shareholder would pay on fund distributions or on the redemption of fund shares.

¹ Source for category information: Morningstar, Inc.

*Spreads on investment grade corporate bonds remained narrow, suggesting that investors continued to be confident as corporate balance sheets remained flush with cash.*

**The Schwab Short-Term Bond Market Fund and the Schwab Total Bond Market Fund** were positioned to take advantage of an expanding economy. Both funds outperformed their respective benchmarks, the Lehman Brothers Mutual Fund Short U.S. Government/Credit Index and the Lehman Brothers Aggregate Bond Index, for the six-month period. The Total Bond Fund also beat its category average. The funds had a significant holding in floating-rate securities, which benefit from rising interest rates as they allow us the opportunity to capture a rise in market rates. The funds also benefited from our focus on shorter, lower-quality corporate bonds, and in the mortgage- and asset-backed sectors.

**The Schwab GNMA Fund** also reported positive returns for the period. Although the fund slightly lagged its benchmark, the Lehman Brothers GNMA Index, it beat the category average. The fund was managed conservatively because we were uncomfortable with the leverage in the U.S. housing market for several reasons. First, some new (primarily adjustable-rate) mortgage products, have lowered monthly payments, which ultimately could push up home prices. In addition, many borrowers have increased the size of their loans by paying off other debt. The combination of these two factors working together introduced the potential for weakness to appear in the housing market. In this type of market, we shortened the portfolio's duration and the spread duration, effectively reducing our exposure to the GNMA market.

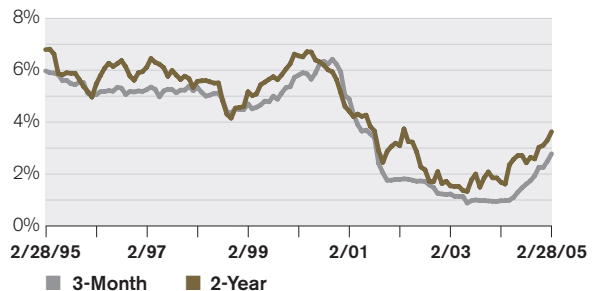
Nothing in this report represents a recommendation of a security by the investment adviser. Manager views and portfolio holdings may have changed since the report date.

#### Yields of U.S. Treasury Securities: Effective Yields of Three-Month and Two-Year Treasuries

**Yields on both the 3-month and the 2-year increased as the Fed continued to raise rates.**

Yields, or interest rates, represent the cost of borrowing money. Rapid economic growth, waning investor interest in bonds, an increase in the issuance of bonds, or the expectation of higher inflation can drive rates up, while the opposite conditions can push rates down.

Data source: Bloomberg L.P.



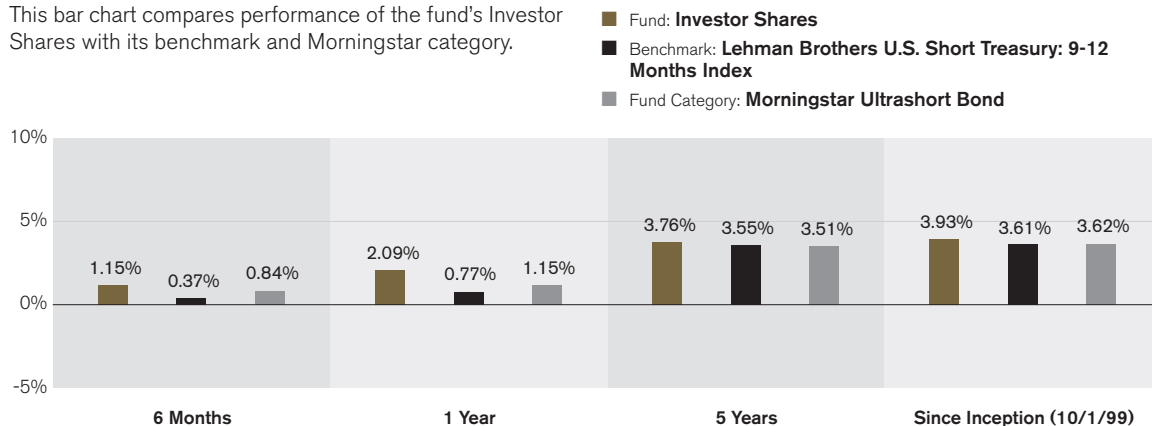


# Schwab YieldPlus Fund®

## Investor Shares Performance as of 2/28/05

### Average Annual Total Returns<sup>1,2</sup>

This bar chart compares performance of the fund's Investor Shares with its benchmark and Morningstar category.

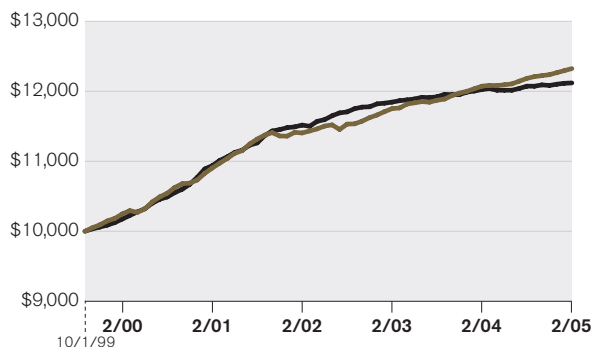


The performance data quoted represents past performance. Past performance does not guarantee future results. Investment returns and principal value will fluctuate so that an investor's shares may be worth more or less than their original cost. Current performance may be lower or higher than performance data quoted. To obtain performance information current to the most recent month end, please visit [www.schwab.com/schwabfunds](http://www.schwab.com/schwabfunds).

### Performance of a Hypothetical \$10,000 Investment<sup>1</sup>

This graph shows performance since inception of a hypothetical \$10,000 investment in the fund's Investor Shares compared with a similar investment in its benchmark.

\$12,324 **Investor Shares**  
 \$12,119 **Lehman Brothers U.S. Short Treasury: 9-12 Months Index**

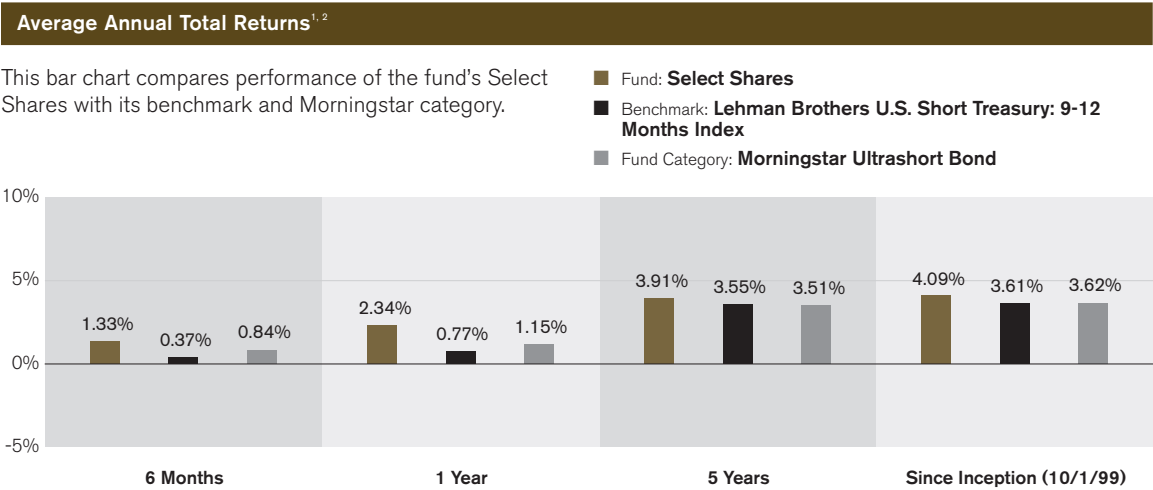


All figures on this page assume dividends and distributions were reinvested. Index figures do not include trading and management costs, which would lower performance. Indices are unmanaged, and you cannot invest in them directly. Performance results less than one year are not annualized.

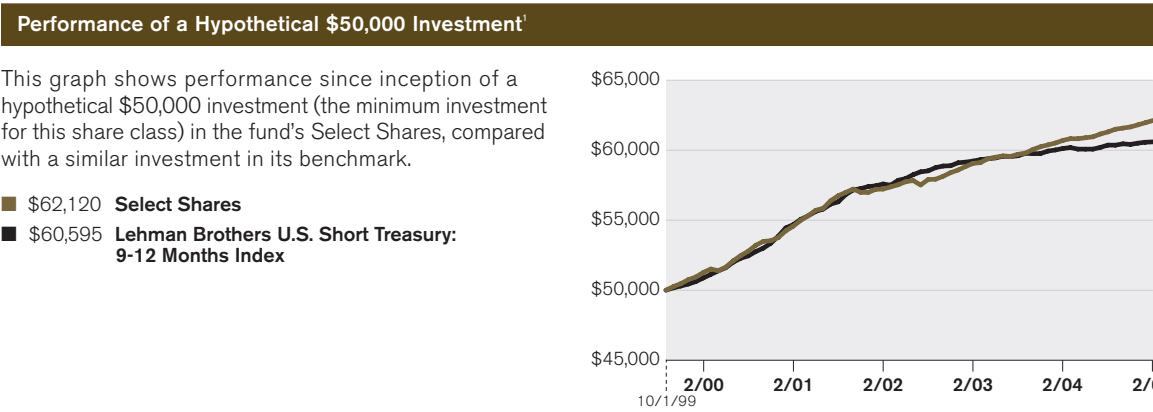
<sup>1</sup> Performance does not reflect the deduction of taxes that a shareholder would pay on fund distributions or on the redemption of fund shares.

<sup>2</sup> Source for category information: Morningstar, Inc.

Select Shares® Performance as of 2/28/05



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All figures on this page assume dividends and distributions were reinvested. Index figures do not include trading and management costs, which would lower performance. Indices are unmanaged, and you cannot invest in them directly. Performance results less than one year are not annualized.

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<sup>2</sup> Source for category information: Morningstar, Inc.

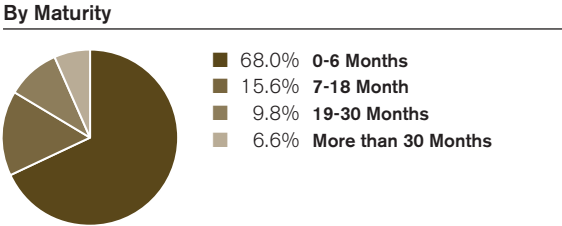
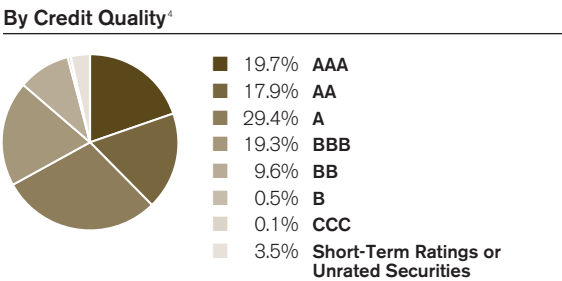
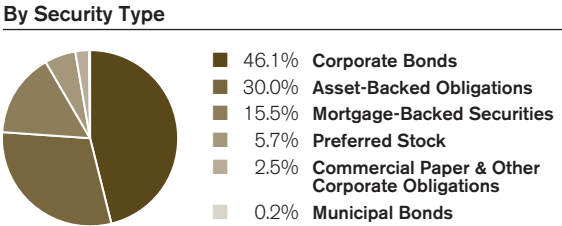
Fund Facts as of 2/28/05

| Statistics  |          |
|---|----------|
| Number of Holdings  | 598      |
| Style Assessment <sup>1</sup>                                   |          |
| Interest Rate Sensitivity                                       | Short    |
| Credit Quality  | Medium   |
| 30-Day SEC Yield <sup>2</sup>                                   |          |
| Investor Shares   | 3.28%    |
| Select Shares   | 3.43%    |
| 12-Month Distribution Yield <sup>2</sup>                        |          |
| Investor Shares   | 2.58%    |
| Select Shares   | 2.73%    |
| Weighted Average Maturity                                       | 0.5 yrs  |
| Weighted Average Duration                                       | 0.5 yrs  |
| Weighted Average Credit Quality                                 | A        |
| Portfolio Turnover Rate <sup>3</sup>                            | 40%      |
| Minimum Initial Investment                                      |          |
| Investor Shares (\$1,000 for retirement and custodial accounts) | \$2,500  |
| Select Shares   | \$50,000 |

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Portfolio Composition % of Investments

These charts show three different views of the fund's portfolio: by type of security, credit quality of the security and remaining maturity.



Portfolio holdings may have changed since the report date.

<sup>1</sup> Source: Morningstar, Inc. Interest rate sensitivity and credit quality are two main components of bond performance. The assessment reflects the fund's portfolio as of 2/28/05, and is not a precise indication of risk or performance—past, present or future. Definitions of style assessments: Sensitivity (measured as duration): Short, up to 3.5 years; Medium, more than 3.5 years to less than six years; Long, six years or greater. Credit quality: High, AA or better; Medium, A or BBB; Low, BB or lower.

<sup>2</sup> The yields do not reflect the deduction of taxes that a shareholder would pay on fund distributions or on the redemption of fund shares.

<sup>3</sup> Not annualized.

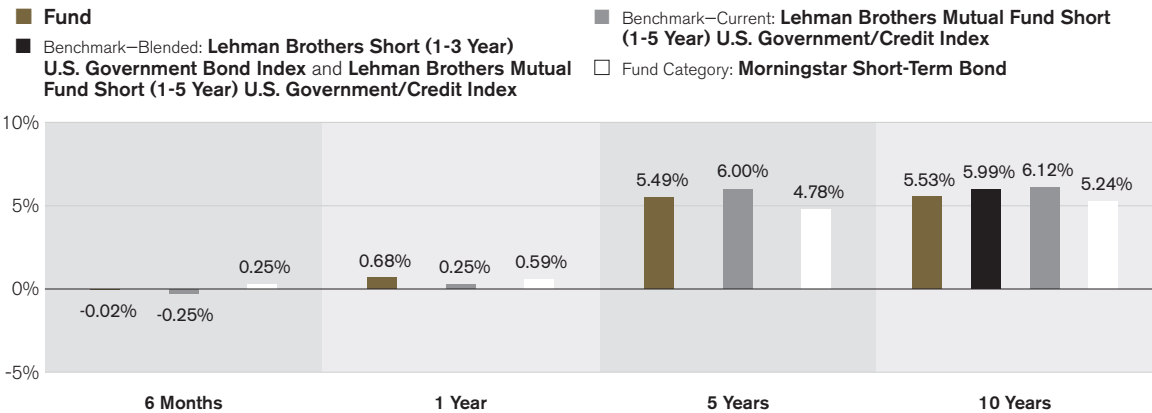
<sup>4</sup> Based on ratings from Moody's. Where Moody's ratings are not available, Standard & Poor's ratings are used. The fund may use different ratings provided by other ratings agencies for purposes of determining compliance with the fund's investment policies.

# Schwab Short-Term Bond Market Fund<sup>TM</sup>

Performance as of 2/28/05

## Average Annual Total Returns<sup>1,2</sup>

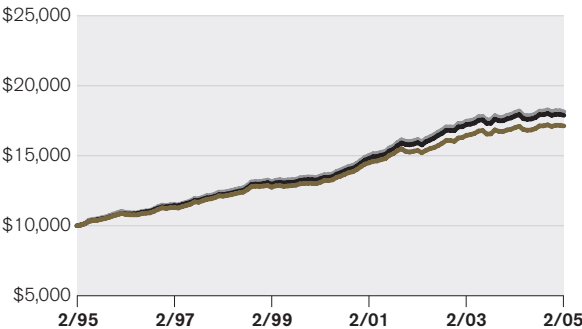
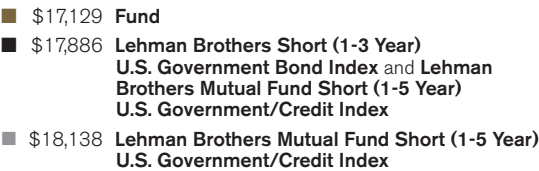
This bar chart compares performance of the fund with its benchmark indices and Morningstar category.



The performance data quoted represents past performance. Past performance does not guarantee future results. Investment returns and principal value will fluctuate so that an investor's shares may be worth more or less than their original cost. Current performance may be lower or higher than performance data quoted. To obtain performance information current to the most recent month end, please visit [www.schwab.com/schwabfunds](http://www.schwab.com/schwabfunds).

## Performance of a Hypothetical \$10,000 Investment<sup>1</sup>

This graph shows performance over ten years of a hypothetical \$10,000 investment in the fund, compared with a similar investment in its benchmark indices.



All figures on this page assume dividends and distributions were reinvested. Index figures do not include trading and management costs, which would lower performance. Indices are unmanaged, and you cannot invest in them directly. Performance results less than one year are not annualized.

<sup>1</sup> The fund changed its benchmark on 2/28/98, when it changed from being a government bond fund to its current strategy. Benchmark performance shown here is the Lehman Brothers Short (1-3 Year) U.S. Government Bond Index from fund inception through 2/28/98 and the Lehman Brothers Mutual Fund Short (1-5 Year) U.S. Government/Credit Index from 3/1/98 through the end of the report period. Benchmark performance for the one- and five-year periods is the Lehman Brothers Mutual Fund Short (1-5 Year) U.S. Government/Credit Index. Fund expenses have been partially absorbed by CSIM and Schwab. Without these reductions, the fund's total return would have been lower. Performance does not reflect the deduction of taxes that a shareholder would pay on fund distributions or on the redemption of fund shares.

<sup>2</sup> Source for category information: Morningstar, Inc.

## Fund Facts as of 2/28/05

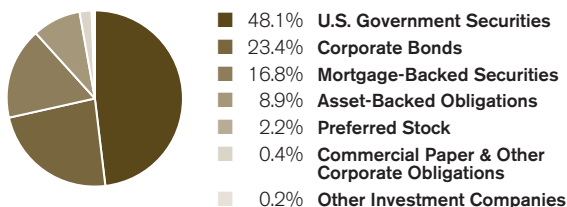
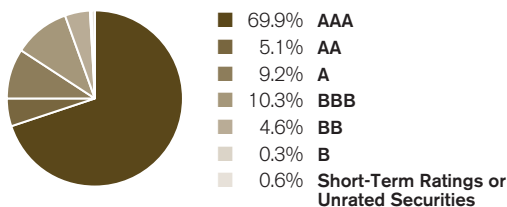
| Statistics                                      |         |
|---|---------|
| <b>Number of Holdings</b>                       | 139     |
| <b>Style Assessment<sup>1</sup></b>             |         |
| Interest Rate Sensitivity                       | Short   |
| Credit Quality                                  | High    |
| <b>30-Day SEC Yield<sup>2</sup></b>             | 3.47%   |
| <b>30-Day SEC Yield—No Waiver<sup>3</sup></b>   | 3.46%   |
| <b>12-Month Distribution Yield<sup>2</sup></b>  | 2.71%   |
| <b>Weighted Average Maturity</b>                | 2.5 yrs |
| <b>Weighted Average Duration</b>                | 2.4 yrs |
| <b>Weighted Average Credit Quality</b>          | AA      |
| <b>Portfolio Turnover Rate<sup>4</sup></b>      | 56%     |
| <b>Minimum Initial Investment</b>               | \$2,500 |
| (\$1,000 for retirement and custodial accounts) |         |

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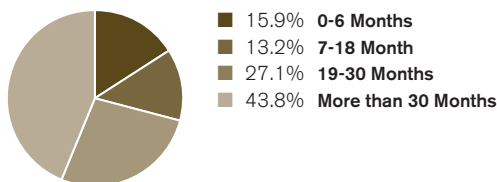
## Portfolio Composition % of Investments

These charts show three different views of the fund's portfolio: by type of security, credit quality of the security and remaining maturity.

## By Security Type

By Credit Quality<sup>5</sup>

## By Maturity



Portfolio holdings may have changed since the report date.

<sup>1</sup> Source: Morningstar, Inc. Interest rate sensitivity and credit quality are two main components of bond performance. The assessment reflects the fund's portfolio as of 2/28/05 and is not a precise indication of risk or performance—past, present or future. Definitions of style assessments: Sensitivity (measured as duration): Short, up to 3.5 years; Medium, more than 3.5 years to less than six years; Long, six years or greater. Credit quality: High, AA or better; Medium, A or BBB; Low, BB or lower.

<sup>2</sup> Fund expenses have been partially absorbed by CSIM and Schwab. The yield does not reflect the deduction of taxes that a shareholder would pay on fund distributions or on the redemption of fund shares.

<sup>3</sup> Yield if fund expenses had not been partially absorbed by CSIM and Schwab.

<sup>4</sup> Not annualized.

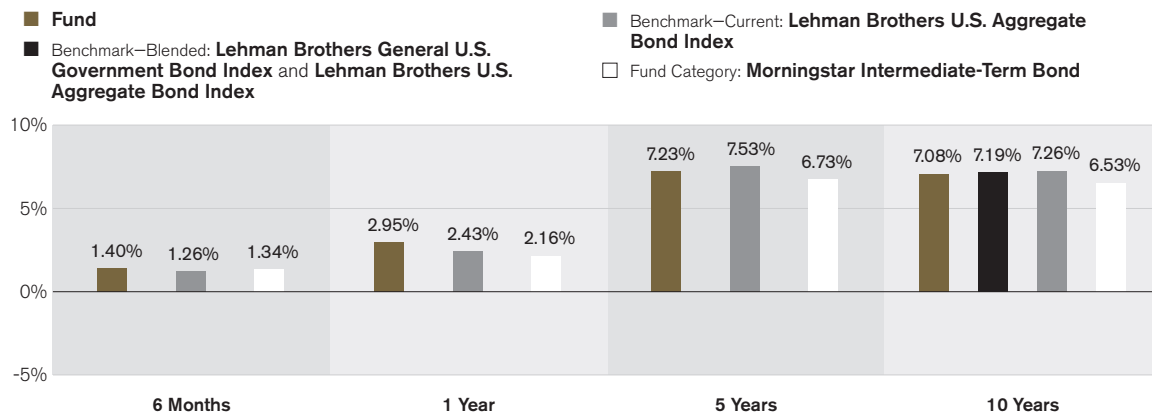
<sup>5</sup> Based on ratings from Moody's. Where Moody's ratings are not available, Standard & Poor's ratings are used. The fund may use different ratings provided by other ratings agencies for purposes of determining compliance with the fund's investment policies.

# Schwab Total Bond Market Fund™

Performance as of 2/28/05

## Average Annual Total Returns<sup>1,2</sup>

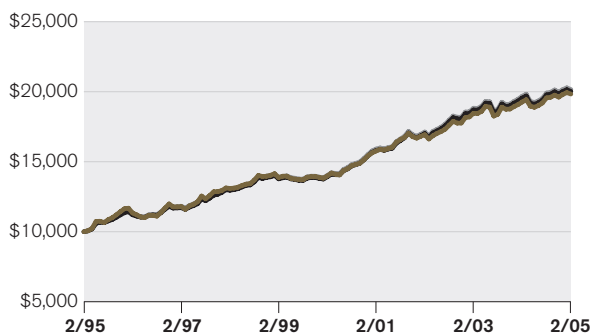
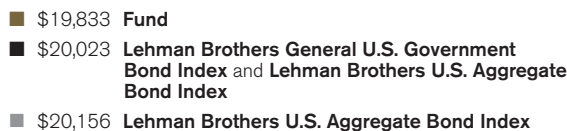
This bar chart compares performance of the fund with its benchmark indices and Morningstar category.



The performance data quoted represents past performance. Past performance does not guarantee future results. Investment returns and principal value will fluctuate so that an investor's shares may be worth more or less than their original cost. Current performance may be lower or higher than performance data quoted. To obtain performance information current to the most recent month end, please visit [www.schwab.com/schwabfunds](http://www.schwab.com/schwabfunds).

## Performance of a Hypothetical \$10,000 Investment<sup>1</sup>

This graph shows performance over ten years of a hypothetical \$10,000 investment in the fund, compared with a similar investment in its benchmark indices.



All figures on this page assume dividends and distributions were reinvested. Index figures do not include trading and management costs, which would lower performance. Indices are unmanaged, and you cannot invest in them directly. Performance results less than one year are not annualized.

<sup>1</sup> The fund changed its benchmark on 2/28/98, when it changed from being a government bond fund to its current strategy. Benchmark performance shown here is the Lehman Brothers General U.S. Government Bond Index from fund inception through 2/28/98 and the Lehman Brothers U.S. Aggregate Bond Index from 3/1/98 through the end of the report period. Benchmark performance for the one- and five-year periods is the Lehman U.S. Aggregate Bond Index. Performance does not reflect the deduction of taxes that a shareholder would pay on fund distributions or on the redemption of fund shares.

<sup>2</sup> Source for category information: Morningstar, Inc.

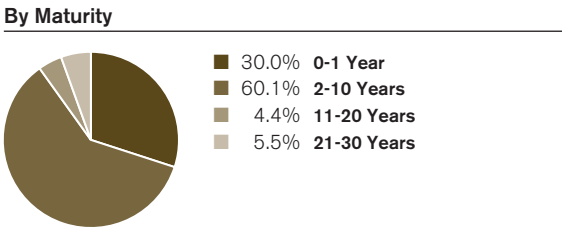
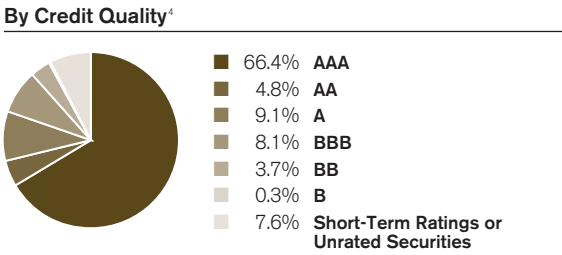
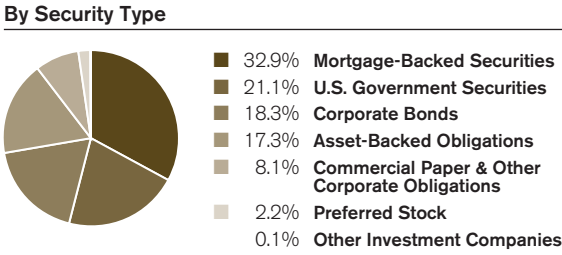
Fund Facts as of 2/28/05

| Statistics                                      |         |
|---|---------|
| Number of Holdings                              | 292     |
| Style Assessment <sup>1</sup>                   |         |
| Interest Rate Sensitivity                       | Medium  |
| Credit Quality                                  | High    |
| 30-Day SEC Yield <sup>2</sup>                   | 3.62%   |
| 12-Month Distribution Yield <sup>2</sup>        | 3.24%   |
| Weighted Average Maturity                       | 4.9 yrs |
| Weighted Average Duration                       | 4.2 yrs |
| Weighted Average Credit Quality                 | AA      |
| Portfolio Turnover Rate <sup>3</sup>            | 111%    |
| Minimum Initial Investment                      | \$2,500 |
| (\$1,000 for retirement and custodial accounts) |         |

The performance data quoted represents past performance. Past performance does not guarantee future results. Investment returns and principal value will fluctuate so that an investor's shares may be worth more or less than their original cost. Current performance may be lower or higher than performance data quoted. To obtain performance information current to the most recent month end, please visit [www.schwab.com/schwabfunds](http://www.schwab.com/schwabfunds).

Portfolio Composition % of Investments

These charts show three different views of the fund's portfolio: by type of security, credit quality of the security and remaining maturity.



Portfolio holdings may have changed since the report date.

<sup>1</sup> Source: Morningstar, Inc. Interest rate sensitivity and credit quality are two main components of bond performance. The assessment reflects the fund's portfolio as of 2/28/05 and is not a precise indication of risk or performance—past, present or future. Definitions of style assessments: Sensitivity (measured as duration): Short, up to 3.5 years; Medium, more than 3.5 years to less than six years; Long, six years or greater. Credit quality: High, AA or better; Medium, A or BBB; Low, BB or lower.

<sup>2</sup> The yield does not reflect the deduction of taxes that a shareholder would pay on fund distributions or on the redemption of fund shares.

<sup>3</sup> Not annualized.

<sup>4</sup> Based on ratings from Moody's. Where Moody's ratings are not available, Standard & Poor's ratings are used. The fund may use different ratings provided by other ratings agencies for purposes of determining compliance with the fund's investment policies.

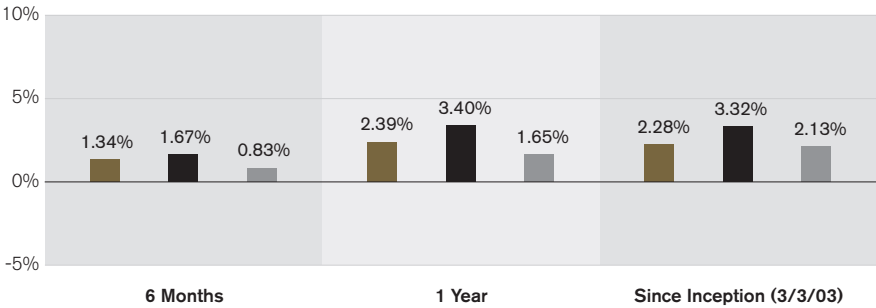
# Schwab GNMA Fund™

## Investor Shares Performance as of 2/28/05

### Average Annual Total Returns<sup>1, 2</sup>

This bar chart compares performance of the fund's Investor Shares with its benchmark and Morningstar category.

- Fund: **Investor Shares**
- Benchmark: **Lehman Brothers GNMA Index**
- Fund Category: **Morningstar Intermediate Government**

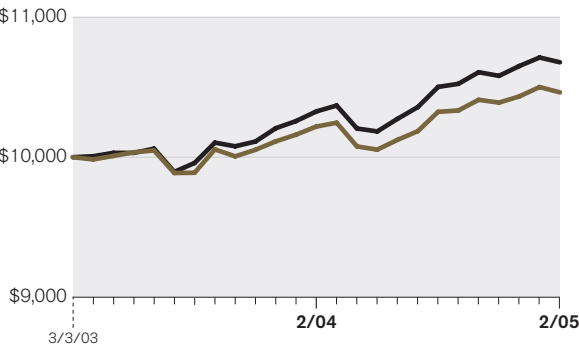


The performance data quoted represents past performance. Past performance does not guarantee future results. Investment returns and principal value will fluctuate so that an investor's shares may be worth more or less than their original cost. Current performance may be lower or higher than performance data quoted. To obtain performance information current to the most recent month end, please visit [www.schwab.com/schwabfunds](http://www.schwab.com/schwabfunds).

### Performance of a Hypothetical \$10,000 Investment<sup>1</sup>

This graph shows performance since inception of a hypothetical \$10,000 investment in the fund's Investor Shares compared with a similar investment in its benchmark.

- \$10,463 **Investor Shares**
- \$10,678 **Lehman Brothers GNMA Index**



All figures on this page assume dividends and distributions were reinvested. Index figures do not include trading and management costs, which would lower performance. Indices are unmanaged, and you cannot invest in them directly. Performance results less than one year are not annualized.

<sup>1</sup> Fund expenses have been partially absorbed by CSIM and Schwab. Without these reductions, the fund's total return would have been lower. Performance does not reflect the deduction of taxes that a shareholder would pay on fund distributions or on the redemption of fund shares.

<sup>2</sup> Source for category information: Morningstar, Inc.

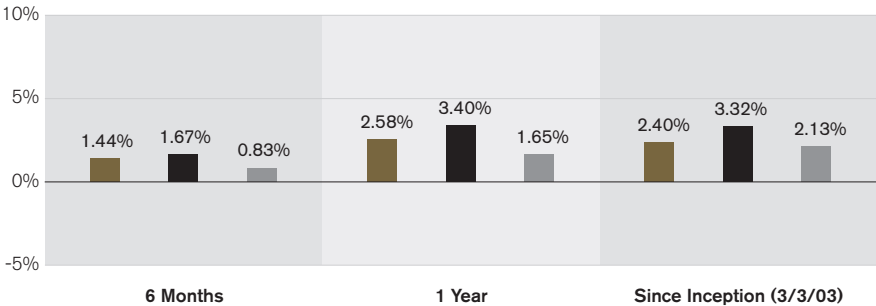


Select Shares® Performance as of 2/28/05

Average Annual Total Returns<sup>1, 2</sup>

This bar chart compares performance of the fund's Select Shares with its benchmark and Morningstar category.

- Fund: **Select Shares**
- Benchmark: **Lehman Brothers GNMA Index**
- Fund Category: **Morningstar Intermediate Government**

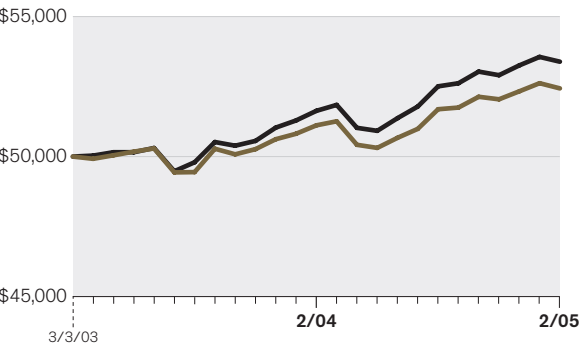


The performance data quoted represents past performance. Past performance does not guarantee future results. Investment returns and principal value will fluctuate so that an investor's shares may be worth more or less than their original cost. Current performance may be lower or higher than performance data quoted. To obtain performance information current to the most recent month end, please visit [www.schwab.com/schwabfunds](http://www.schwab.com/schwabfunds).

Performance of a Hypothetical \$50,000 Investment<sup>1</sup>

This graph shows performance since inception of a hypothetical \$50,000 investment (the minimum investment for this share class) in the fund's Select Shares, compared with a similar investment in its benchmark.

- \$52,435 **Select Shares**
- \$53,388 **Lehman Brothers GNMA Index**



All figures on this page assume dividends and distributions were reinvested. Index figures do not include trading and management costs, which would lower performance. Indices are unmanaged, and you cannot invest in them directly. Performance results less than one year are not annualized.

<sup>1</sup> Fund expenses have been partially absorbed by CSIM and Schwab. Without these reductions, the fund's total return would have been lower. Performance does not reflect the deduction of taxes that a shareholder would pay on fund distributions or on the redemption of fund shares.

<sup>2</sup> Source for category information: Morningstar, Inc.

Fund Facts as of 2/28/05

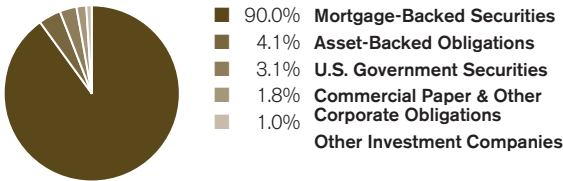
| Statistics  |          |
|---|----------|
| Number of Holdings  | 80       |
| Style Assessment <sup>1</sup>                                   |          |
| Interest Rate Sensitivity                                       | Medium   |
| Credit Quality  | High     |
| 30-Day SEC Yield <sup>2</sup>                                   |          |
| Investor Shares   | 4.38%    |
| Select Shares   | 4.57%    |
| 30-Day SEC Yield—No Waiver <sup>3</sup>                         |          |
| Investor Shares   | 4.08%    |
| Select Shares   | 4.23%    |
| 12-Month Distribution Yield <sup>2</sup>                        |          |
| Investor Shares   | 3.70%    |
| Select Shares   | 3.89%    |
| Weighted Average Maturity                                       | 3.4 yrs  |
| Weighted Average Duration                                       | 2.6 yrs  |
| Weighted Average Credit Quality                                 | AAA      |
| Portfolio Turnover Rate <sup>4</sup>                            | 73%      |
| Minimum Initial Investment                                      |          |
| Investor Shares (\$1,000 for retirement and custodial accounts) | \$2,500  |
| Select Shares   | \$50,000 |

The performance data quoted represents past performance. Past performance does not guarantee future results. Investment returns and principal value will fluctuate so that an investor's shares may be worth more or less than their original cost. Current performance may be lower or higher than performance data quoted. To obtain performance information current to the most recent month end, please visit [www.schwab.com/schwabfunds](http://www.schwab.com/schwabfunds).

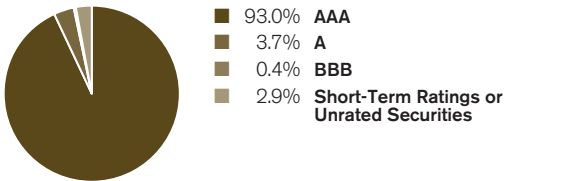
Portfolio Composition % of Investments

These charts show three different views of the fund's portfolio: by type of security, credit quality of the security and remaining maturity.

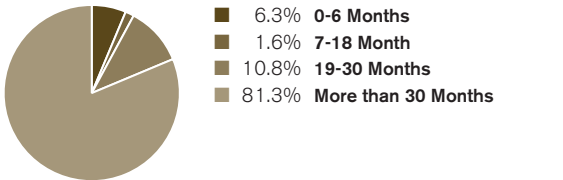
By Security Type



By Credit Quality<sup>5</sup>



By Maturity



Portfolio holdings may have changed since the report date.

<sup>1</sup> Source: Morningstar, Inc. Interest rate sensitivity and credit quality are two main components of bond performance. The assessment reflects the fund's portfolio as of 2/28/05 and is not a precise indication of risk or performance—past, present or future. Definitions of style assessments: Sensitivity (measured as duration): Short, up to 3.5 years; Medium, more than 3.5 years to less than six years; Long, six years or greater. Credit quality: High, AA or better; Medium, A or BBB; Low, BB or lower.

<sup>2</sup> Fund expenses have been partially absorbed by CSIM and Schwab. The yields do not reflect the deduction of taxes that a shareholder would pay on fund distributions or on the redemption of fund shares.

<sup>3</sup> Yield if fund expenses had not been partially absorbed by CSIM and Schwab.

<sup>4</sup> Not annualized.

<sup>5</sup> Based on ratings from Moody's. Where Moody's ratings are not available, Standard & Poor's ratings are used. The fund may use different ratings provided by other ratings agencies for purposes of determining compliance with the fund's investment policies.

# Fund Expenses

## Examples for a \$1,000 Investment

As a fund shareholder, you incur two types of costs: transaction costs, such as redemption fees; and, ongoing costs, such as management fees, transfer agent and shareholder services fees, and other fund expenses.

The expense examples below are intended to help you understand your ongoing cost (in dollars) of investing in a fund and to compare this cost with the ongoing cost of investing in other mutual funds. These examples are based on an investment of \$1,000 invested for six-months beginning September 1, 2004 and held through February 28, 2005.

**Actual Return** lines in the table below provide information about actual account values and actual expenses. You may use this information, together with the amount you invested, to estimate the expenses that you paid over the period. To do so, simply divide your account value by \$1,000 (for example, an \$8,600 account value  $\div$  \$1,000 = 8.6), then multiply the result by the number given for your fund or share class under the heading entitled "Expenses Paid During Period."

**Hypothetical Return** lines in the table below provide information about hypothetical account values and hypothetical expenses based on a fund's or share class' actual expense ratio and an assumed return of 5% per year before expenses. Because the return used is not an actual return, it may not be used to estimate the actual ending account value or expenses you paid for the period.

You may use this information to compare the ongoing costs of investing in the fund and other funds. To do so, compare this 5% hypothetical example with the 5% hypothetical examples that appear in the shareholder reports of the other funds.

Please note that the expenses shown in the table are meant to highlight your ongoing costs only, and do not reflect any transactional costs, such as redemption fees. If these transactional costs were included, your costs would have been higher.

|   | Expense Ratio <sup>1</sup><br>(Annualized) | Beginning<br>Account Value<br>at 9/1/04 | Ending<br>Account Value<br>(Net of Expenses)<br>at 2/28/05 | Expenses<br>Paid During Period <sup>2</sup><br>9/1/04–2/28/05 |
|---|--|---|--|---|
| <b>Schwab YieldPlus Fund<sup>®</sup></b>              |  |   |  |   |
| <i>Investor Shares</i>                                |  |   |  |   |
| Actual Return   | 0.59%                                      | \$1,000                                 | \$1,011.50   | \$2.94  |
| Hypothetical 5% Return                                | 0.59%                                      | \$1,000                                 | \$1,021.87   | \$2.96  |
| <i>Select Shares<sup>®</sup></i>                      |  |   |  |   |
| Actual Return   | 0.44%                                      | \$1,000                                 | \$1,013.30   | \$2.20  |
| Hypothetical 5% Return                                | 0.44%                                      | \$1,000                                 | \$1,022.61   | \$2.21  |
| <b>Schwab Short-Term Bond Market Fund<sup>™</sup></b> |  |   |  |   |
| Actual Return   | 0.55%                                      | \$1,000                                 | \$999.80   | \$2.73  |
| Hypothetical 5% Return                                | 0.55%                                      | \$1,000                                 | \$1,022.07   | \$2.76  |
| <b>Schwab Total Bond Market Fund<sup>™</sup></b>      |  |   |  |   |
| Actual Return   | 0.54%                                      | \$1,000                                 | \$1,014.00   | \$2.70  |
| Hypothetical 5% Return                                | 0.54%                                      | \$1,000                                 | \$1,022.12   | \$2.71  |
| <b>Schwab GNMA Fund<sup>™</sup></b>                   |  |   |  |   |
| <i>Investor Shares</i>                                |  |   |  |   |
| Actual Return   | 0.74%                                      | \$1,000                                 | \$1,013.40   | \$3.69  |
| Hypothetical 5% Return                                | 0.74%                                      | \$1,000                                 | \$1,021.13   | \$3.71  |
| <i>Select Shares</i>                                  |  |   |  |   |
| Actual Return   | 0.55%                                      | \$1,000                                 | \$1,014.40   | \$2.75  |
| Hypothetical 5% Return                                | 0.55%                                      | \$1,000                                 | \$1,022.07   | \$2.76  |

<sup>1</sup> Based on the most recent six-month expense ratio; may differ from the expense ratio provided in Financial Highlights.

<sup>2</sup> Expenses for each fund or share class are equal to its annualized expense ratio, multiplied by the average account value over the period, multiplied by 181 days of the period, and divided by 365 days of the fiscal year.

# Schwab YieldPlus Fund®

## Financial Statements

### Financial Highlights

| Investor Shares                             | 9/1/04–<br>2/28/05* | 9/1/03–<br>8/31/04 | 9/1/02–<br>8/31/03 | 9/1/01–<br>8/31/02 | 9/1/00–<br>8/31/01 | 10/1/99–<br>8/31/00 |
|---|---------------------|--------------------|--------------------|--------------------|--------------------|---------------------|
| <b>Per-Share Data (\$)</b>                  |                     |                    |                    |                    |                    |                     |
| Net asset value at beginning of period      | 9.71                | 9.70               | 9.75               | 10.00              | 9.92               | 10.00               |
| Income from investment operations:          |                     |                    |                    |                    |                    |                     |
| Net investment income                       | 0.13                | 0.24               | 0.30               | 0.42               | 0.62               | 0.61                |
| Net realized and unrealized gains or losses | (0.02)              | 0.01               | (0.02)             | (0.23)             | 0.08               | (0.08)              |
| Total income from investment operations     | 0.11                | 0.25               | 0.28               | 0.19               | 0.70               | 0.53                |
| Less distributions:                         |                     |                    |                    |                    |                    |                     |
| Dividends from net investment income        | (0.13)              | (0.24)             | (0.33)             | (0.44)             | (0.62)             | (0.61)              |
| Net asset value at end of period            | 9.69                | 9.71               | 9.70               | 9.75               | 10.00              | 9.92                |
| Total return (%)                            | 1.15 <sup>2</sup>   | 2.63               | 2.95               | 1.89               | 7.33               | 5.44 <sup>2</sup>   |
| <b>Ratios/Supplemental Data (%)</b>         |                     |                    |                    |                    |                    |                     |
| Ratios to average net assets:               |                     |                    |                    |                    |                    |                     |
| Net operating expenses                      | 0.59 <sup>3</sup>   | 0.59               | 0.59               | 0.55               | 0.55               | 0.56 <sup>3,4</sup> |
| Gross operating expenses                    | 0.59 <sup>3</sup>   | 0.59               | 0.59               | 0.62               | 0.71               | 0.80 <sup>3</sup>   |
| Net investment income                       | 2.62 <sup>3</sup>   | 2.43               | 3.08               | 4.36               | 6.03               | 6.72 <sup>3</sup>   |
| Portfolio turnover rate                     | 40 <sup>2</sup>     | 89                 | 109                | 42                 | 106                | 81 <sup>2</sup>     |
| Net assets, end of period (\$ x 1,000,000)  | 775                 | 639                | 410                | 392                | 185                | 53                  |

\* Unaudited.

<sup>1</sup> Commencement of operations.

<sup>2</sup> Not annualized.

<sup>3</sup> Annualized.

<sup>4</sup> The ratio of net operating expenses would have been 0.55% if certain non-routine expenses (proxy fees) had not been included.

| Select Shares                               | 9/1/04–<br>2/28/05* | 9/1/03–<br>8/31/04 | 9/1/02–<br>8/31/03 | 9/1/01–<br>8/31/02 | 9/1/00–<br>8/31/01 | 10/1/99–<br>8/31/00 |
|---|---------------------|--------------------|--------------------|--------------------|--------------------|---------------------|
| <b>Per-Share Data (\$)</b>                  |                     |                    |                    |                    |                    |                     |
| Net asset value at beginning of period      | 9.70                | 9.70               | 9.75               | 10.00              | 9.92               | 10.00               |
| Income from investment operations:          |                     |                    |                    |                    |                    |                     |
| Net investment income                       | 0.14                | 0.25               | 0.32               | 0.44               | 0.64               | 0.62                |
| Net realized and unrealized gains or losses | (0.01)              | 0.01               | (0.02)             | (0.24)             | 0.08               | (0.08)              |
| Total income from investment operations     | 0.13                | 0.26               | 0.30               | 0.20               | 0.72               | 0.54                |
| Less distributions:                         |                     |                    |                    |                    |                    |                     |
| Dividends from net investment income        | (0.14)              | (0.26)             | (0.35)             | (0.45)             | (0.64)             | (0.62)              |
| Net asset value at end of period            | 9.69                | 9.70               | 9.70               | 9.75               | 10.00              | 9.92                |
| Total return (%)                            | 1.33 <sup>2</sup>   | 2.67               | 3.10               | 2.04               | 7.50               | 5.58 <sup>2</sup>   |
| <b>Ratios/Supplemental Data (%)</b>         |                     |                    |                    |                    |                    |                     |
| Ratios to average net assets:               |                     |                    |                    |                    |                    |                     |
| Net operating expenses                      | 0.44 <sup>3</sup>   | 0.45               | 0.44               | 0.40               | 0.40               | 0.41 <sup>3,4</sup> |
| Gross operating expenses                    | 0.44 <sup>3</sup>   | 0.45               | 0.44               | 0.47               | 0.56               | 0.65 <sup>3</sup>   |
| Net investment income                       | 2.77 <sup>3</sup>   | 2.57               | 3.23               | 4.52               | 6.18               | 6.88 <sup>3</sup>   |
| Portfolio turnover rate                     | 40 <sup>2</sup>     | 89                 | 109                | 42                 | 106                | 81 <sup>2</sup>     |
| Net assets, end of period (\$ x 1,000,000)  | 4,109               | 3,030              | 1,476              | 1,443              | 772                | 219                 |

\* Unaudited.

<sup>1</sup> Commencement of operations.<sup>2</sup> Not annualized.<sup>3</sup> Annualized.<sup>4</sup> The ratio of net operating expenses would have been 0.40% if certain non-routine expenses (proxy fees) had not been included.

**Portfolio Holdings** as of February 28, 2005, unaudited

This section shows all the securities in the fund's portfolio and their value, as of the report date.

The fund files its complete schedule of portfolio holdings with the SEC for the first and third quarters of each fiscal year on Form N-Q. The fund's Forms N-Q is available on the SEC's website at <http://www.sec.gov> and may be reviewed and copied at the SEC's Public Reference Room in Washington, D.C. Call 1-800-SEC-0330 for information on the operation of the Public Reference Room. The schedule of portfolio holdings filed on a fund's most recent Form N-Q is available by visiting Schwab's website at [www.schwab.com/schwabfunds](http://www.schwab.com/schwabfunds).

We use the symbols below to designate certain characteristics of the securities.

- ▲ Delayed-delivery security
- ▷ Variable-rate security
- Callable security
- All or a portion of this security is held as collateral for futures contracts and delayed-delivery security

For fixed-rate obligations, the rate shown is the interest rate (the rate established when the obligation was issued) and the maturity date shown is the stated legal maturity. For variable-rate obligations, the rate shown is the rate as of the report date, and the maturity shown is the later of the next interest rate change date or demand date.

| Holdings by Category |   | Cost<br>(\$x1,000) | Value<br>(\$x1,000) |
|----------------------|---|--------------------|---------------------|
| <b>46.7%</b>         | <b>Corporate Bonds</b>                                    | 2,276,174          | 2,280,393           |
| <b>30.4%</b>         | <b>Asset-Backed Obligations</b>                           | 1,474,917          | 1,481,948           |
| <b>15.6%</b>         | <b>Mortgage-Backed Securities</b>                         | 766,783            | 763,606             |
| <b>0.2%</b>          | <b>Municipal Bonds</b>                                    | 9,523              | 9,510               |
| <b>0.0%</b>          | <b>U.S. Government Securities</b>                         | 1,044              | 1,044               |
| <b>2.6%</b>          | <b>Commercial Paper &amp; Other Corporate Obligations</b> | 125,821            | 125,821             |
| <b>5.8%</b>          | <b>Preferred Stock</b>                                    | 284,583            | 283,614             |
| <b>0.0%</b>          | <b>Other Investment Companies</b>                         | 172                | 172                 |
| <b>101.3%</b>        | <b>Total Investments</b>                                  | <b>4,939,017</b>   | <b>4,946,108</b>    |
| <b>(1.3)%</b>        | <b>Other Assets and Liabilities</b>                       |                    | (62,913)            |
| <b>100.0%</b>        | <b>Net Assets</b>   |                    | <b>4,883,195</b>    |

| Security Series     | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|---------------------|-----------------------------|-----------------------|
| Rate, Maturity Date |                             |                       |

**Corporate Bonds** 46.7% of net assets**Finance** 22.3%**Banking** 13.5%**AB Spintab, 144A**

|                   |       |       |
|-------------------|-------|-------|
| ■ 2.17%, 04/30/05 | 6,500 | 6,499 |
| ■ 7.50%, 08/14/49 | 2,100 | 2,204 |

**■ Artesia Overseas, Ltd.**

|                 |        |        |
|-----------------|--------|--------|
| 3.62%, 05/25/05 | 10,000 | 10,150 |
|-----------------|--------|--------|

**■ BBVA Bancomer Capital Trust I, 144A**

|                  |        |        |
|------------------|--------|--------|
| 10.50%, 02/16/11 | 24,900 | 26,550 |
|------------------|--------|--------|

**■ BNP Paribas**

|                 |        |        |
|-----------------|--------|--------|
| 2.54%, 03/21/05 | 42,700 | 42,649 |
|-----------------|--------|--------|

| Security Series     | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|---------------------|-----------------------------|-----------------------|
| Rate, Maturity Date |                             |                       |

**■ Countrywide Home Loan**

|                 |        |        |
|-----------------|--------|--------|
| 2.98%, 08/26/05 | 17,000 | 17,002 |
|-----------------|--------|--------|

**■ Cullen/ Frost Capital Trust II**

|                 |        |        |
|-----------------|--------|--------|
| 3.95%, 03/01/05 | 13,000 | 13,414 |
|-----------------|--------|--------|

**■ Deutsche Bank Capital Trust, 144A**

## Class B

|                 |        |        |
|-----------------|--------|--------|
| 3.97%, 03/30/05 | 48,400 | 48,645 |
|-----------------|--------|--------|

**■ Doral Financial Corp.**

|                 |        |        |
|-----------------|--------|--------|
| 3.50%, 04/20/05 | 30,035 | 30,035 |
|-----------------|--------|--------|

**■ Emigrant Capital Trust I, 144A**

|                 |        |        |
|-----------------|--------|--------|
| 4.95%, 03/10/05 | 18,920 | 18,857 |
|-----------------|--------|--------|

**■ Fifth Third Bank**

|                 |       |       |
|-----------------|-------|-------|
| 7.75%, 08/15/10 | 5,000 | 5,086 |
|-----------------|-------|-------|

| Security Series<br>Rate, Maturity Date                        | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|---|-----------------------------|-----------------------|
| ■ <b>Fleet Capital Trust V</b><br>3.51%, 03/18/05             | 42,300                      | 42,228                |
| ▶ <b>HSBC USA, Inc.</b><br>2.59%, 03/21/05                    | 35,000                      | 35,045                |
| ▶ <b>Intesa Bank Overseas Ltd.</b><br>3.41%, 04/04/05         | 31,000                      | 31,144                |
| ▶ <b>JP Morgan Chase &amp; Co.</b><br>2.56%, 03/14/05         | 25,000                      | 25,033                |
| ■ <b>Koram Bank</b><br>5.64%, 09/26/12                        | 25,300                      | 26,117                |
| ▶ <b>Nationwide Building Society, 144A</b><br>2.59%, 03/11/05 | 40,000                      | 40,078                |
| ■ <b>RBS Capital Trust IV</b><br>2.77%, 03/30/05              | 39,800                      | 40,554                |
| ■ <b>Republic New York Corp.</b><br>3.19%, 08/01/05           | 44,700                      | 44,219                |
| <b>Santander Financial Issuances</b>                          |                             |                       |
| ■ 3.66%, 03/16/05   | 17,750                      | 17,697                |
| ■ 2.14%, 04/26/05   | 29,000                      | 28,927                |
| ■ <b>Societe Generale</b><br>2.26%, 04/21/05                  | 28,000                      | 28,273                |
| ▶ <b>Sovereign Bancorp.</b><br>3.20%, 05/26/05                | 16,000                      | 16,011                |
| ■ <b>Wachovia Bank N.A.</b><br>7.70%, 08/01/10                | 2,775                       | 2,816                 |
| ▶ <b>Wachovia Corp.</b><br>2.77%, 04/22/05                    | 30,000                      | 30,034                |
| <b>Wells Fargo &amp; Co.</b>                                  |                             |                       |
| ▶ 2.59%, 03/23/05   | 15,950                      | 15,965                |
| ▶ 2.03%, 03/28/05   | 15,000                      | 15,012                |
|   |                             | <b>660,244</b>        |
| <b>Brokerage 4.0%</b>   |                             |                       |
| ■ <b>Credit Suisse Financial Products</b><br>3.19%, 03/07/05  | 20,770                      | 20,810                |
| <b>Goldman Sachs Group, Inc.</b>                              |                             |                       |
| ▶ 2.08%, 03/30/05   | 39,600                      | 39,641                |
| ▶ 2.69%, 04/05/05   | 40,000                      | 40,021                |
| ▶ <b>Lehman Brothers Holdings</b><br>2.79%, 04/20/05          | 25,715                      | 25,749                |
| ▶ <b>Morgan Stanley</b><br>2.90%, 05/09/05                    | 70,000                      | 70,083                |
|   |                             | <b>196,304</b>        |

| Security Series<br>Rate, Maturity Date                                 | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|--|-----------------------------|-----------------------|
| <b>Finance Companies 2.3%</b>  |                             |                       |
| <b>Capital One Financial</b><br>4.74%, 05/17/07                        | 3,950                       | 3,992                 |
| <b>Countrywide Home Loan</b>   |                             |                       |
| ▶ 2.09%, 03/29/05  | 45,000                      | 45,020                |
| ▶ 2.78%, 04/29/05  | 24,500                      | 24,493                |
| ▶ <b>General Electric Capital Corp.</b><br>2.44%, 03/08/05             | 24,750                      | 24,758                |
| ▶ <b>International Lease Finance Corp.</b><br>3.06%, 04/15/05          | 14,850                      | 14,921                |
|  |                             | <b>113,184</b>        |
| <b>Insurance 1.0%</b>  |                             |                       |
| ■ <b>AXA</b><br>2.40%, 03/03/05  | 14,800                      | 14,847                |
| ▶ <b>Genworth Financial, Inc.</b><br>2.64%, 03/15/05                   | 15,000                      | 15,014                |
| ▶ <b>Marsh &amp; McLennan Cos., Inc.</b><br>2.77%, 04/13/05            | 9,900                       | 9,801                 |
| ■ <b>Twin Reefs Pass-Through, Section 3c7, 144A</b><br>3.59%, 03/10/05 | 11,200                      | 11,265                |
|  |                             | <b>50,927</b>         |
| <b>Real Estate Investment Trust 1.5%</b>                               |                             |                       |
| ■ <b>Duke Realty Corp.</b><br>2.78%, 06/22/05                          | 16,200                      | 16,205                |
| <b>Istar Financial, Inc.</b>   |                             |                       |
| ▲▶ 3.26%, 03/01/05   | 6,950                       | 6,967                 |
| ▶ Series B<br>3.72%, 03/14/05  | 25,575                      | 26,065                |
| ▶ <b>Westfield Capital Corp., 144A</b><br>3.05%, 05/02/05              | 23,400                      | 23,443                |
|  |                             | <b>72,680</b>         |
| <b>Industrial 18.7%</b>  |                             |                       |
| <b>Basic Industry 1.1%</b>   |                             |                       |
| <b>FMC Corp.</b>   |                             |                       |
| ■ 10.25%, 11/01/09   | 14,875                      | 16,920                |
| Series A<br>6.75%, 05/05/05  | 1,600                       | 1,612                 |
| ■ <b>Methanex Corp.</b><br>7.75%, 08/15/05                             | 16,335                      | 16,662                |
| <b>Temple - Inland, Inc.</b><br>5.00%, 05/17/07                        | 9,900                       | 10,019                |

## Portfolio Holdings continued

| Security Series<br>Rate, Maturity Date                                     | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) | Security Series<br>Rate, Maturity Date                            | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|--|-----------------------------|-----------------------|---|-----------------------------|-----------------------|
| ■ Westlake Chemical Corp.<br>8.75%, 07/15/11                               | 4,950                       | 5,544                 | ■ Consumer Cyclical 7.0%<br>■ Autonation, Inc.<br>9.00%, 08/01/08 | 11,550                      | 13,109                |
|  |                             | <b>50,757</b>         | ■ Boyd Gaming Corp.<br>9.25%, 08/01/09                            | 8,367                       | 8,974                 |
| ■ Capital Goods 0.5%<br>Ball Corp.<br>7.75%, 08/01/06                      | 12,719                      | 13,355                | ■ Caesars Entertainment, Inc.<br>8.50%, 11/15/06                  | 10,800                      | 11,596                |
| ■ Bombardier Capital, Inc., 144A<br>4.92%, 03/30/05                        | 9,955                       | 9,934                 | 9.38%, 02/15/07   | 5,000                       | 5,475                 |
|  |                             | <b>23,289</b>         | ■ Centex Corp.<br>9.75%, 06/15/05                                 | 8,400                       | 8,532                 |
| ■ Communications 5.3%<br>▶ America Movil SA de CV, 144A<br>3.33%, 04/27/05 | 31,500                      | 31,673                | ▶ Series D<br>4.71%, 04/11/05                                     | 14,925                      | 15,306                |
| ▶ BellSouth Corp.<br>2.92%, 05/16/05                                       | 19,900                      | 19,913                | ■ Cummins, Inc.<br>6.45%, 03/01/05                                | 1,700                       | 1,700                 |
| ▶ Cox Communications, Inc., 144A<br>3.04%, 03/14/05                        | 24,900                      | 25,065                | 9.50%, 12/01/10   | 17,485                      | 19,692                |
| ■ Directv Holdings/Finance<br>8.38%, 03/15/13                              | 8,000                       | 9,080                 | ■ D. R. Horton, Inc.<br>9.38%, 03/15/11                           | 19,725                      | 21,596                |
| ■ Echostar DBS Corp.<br>5.26%, 04/01/05                                    | 6,750                       | 6,986                 | 8.50%, 04/15/12   | 12,125                      | 13,514                |
| ■ 9.13%, 01/15/09  | 16,177                      | 17,572                | ▶ Daimler-Chrysler, N.A. Holdings<br>2.94%, 03/10/05              | 25,140                      | 25,297                |
| ■ Intelsat Bermuda Ltd., 144A<br>7.79%, 07/15/05                           | 9,250                       | 9,551                 | ▶ Ford Motor Credit Co.<br>3.75%, 05/16/05                        | 10,000                      | 10,023                |
| ■ Rogers Cable Systems, Ltd.<br>Series B<br>10.00%, 03/15/05               | 22,577                      | 22,803                | ■ General Motors Acceptance Corp.<br>1.50%, 03/15/05              | 500                         | 494                   |
| ■ Rogers Wireless, Inc.<br>5.53%, 03/15/05                                 | 2,990                       | 3,169                 | 3.70%, 05/18/05   | 14,950                      | 14,958                |
| ■ TCI Communications Financing III<br>9.65%, 03/31/27                      | 23,310                      | 26,646                | ■ General Motors Acceptance Corp.<br>2.41%, 10/20/05              | 19,950                      | 20,041                |
| ■ Telecorp PCS, Inc.<br>10.63%, 07/15/10                                   | 9,556                       | 10,301                | ■ Hyatt Equities, L.L.C., 144A<br>6.88%, 06/15/07                 | 1,295                       | 1,345                 |
| ■ Telefonos de Mexico SA<br>8.25%, 01/26/06                                | 19,000                      | 19,816                | ■ KB Homes<br>9.50%, 02/15/11                                     | 14,040                      | 15,366                |
| ▶ Verizon Wireless Capital, 144A<br>2.93%, 05/23/05                        | 52,590                      | 52,591                | ■ Lennar Corp.<br>Series B<br>3.26%, 03/21/05                     | 22,875                      | 22,989                |
| ■ WMG Holdings Corp., 144A<br>6.91%, 03/15/05                              | 5,000                       | 5,075                 | ■ Lennar Corp., 144A<br>Series B<br>9.95%, 05/01/10               | 3,452                       | 3,657                 |
|  |                             | <b>260,241</b>        | ■ Mandalay Resort Group<br>6.45%, 02/01/06                        | 13,685                      | 14,027                |
|  |                             |                       | ■ MGM Mirage, Inc.<br>7.25%, 10/15/06                             | 6,500                       | 6,809                 |
|  |                             |                       | ■ 6.75%, 08/01/07   | 6,000                       | 6,300                 |
|  |                             |                       | 6.75%, 02/01/08   | 300                         | 315                   |



| Security Series<br>Rate, Maturity Date                                  | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|---|-----------------------------|-----------------------|
| ■ <b>Royal Caribbean Cruises</b><br>6.75%, 03/15/08                     | 4,255                       | 4,553                 |
| ■ <b>Ryland Group, Inc.</b><br>9.75%, 09/01/10                          | 2,800                       | 2,987                 |
| ■ 9.13%, 06/15/11   | 21,362                      | 23,505                |
| ■ <b>Standard Pacific Corp.</b><br>9.50%, 09/15/10                      | 13,860                      | 14,917                |
| ■ <b>Starwood Hotel Resorts</b><br>7.38%, 05/01/07                      | 6,000                       | 6,405                 |
| ■ <b>Toll Corp.</b><br>8.00%, 05/01/09                                  | 5,800                       | 6,032                 |
| ■ 8.25%, 02/01/11   | 22,735                      | 24,582                |
|   |                             | <b>344,096</b>        |
| ■ <b>Consumer Non-Cyclical 2.1%</b>                                     |                             |                       |
| ■ <b>Altria Group, Inc.</b><br>7.00%, 07/15/05                          | 19,870                      | 20,119                |
| ■ <b>Bausch &amp; Lomb, Inc.</b><br>6.50%, 08/01/05                     | 27,205                      | 27,571                |
| ▶ <b>Clorox Co., 144A</b><br>2.54%, 03/14/05                            | 14,900                      | 14,913                |
| ▶ <b>Evangelical Lutheran Good Samaritan Society</b><br>3.42%, 05/24/05 | 19,800                      | 19,815                |
| ■ <b>HCA, Inc.</b><br>6.91%, 06/15/05                                   | 5,000                       | 5,069                 |
| ▶ <b>Stater Brothers Holdings</b><br>5.99%, 03/15/05                    | 12,950                      | 13,371                |
|   |                             | <b>100,858</b>        |
| ■ <b>Energy 0.7%</b>  |                             |                       |
| ■ <b>Husky Oil Ltd.</b><br>8.90%, 08/15/28                              | 10,301                      | 11,568                |
| ■ <b>Pogo Producing Co.</b><br>Series B<br>8.25%, 04/15/11              | 22,156                      | 23,818                |
|   |                             | <b>35,386</b>         |
| ■ <b>Technology 0.3%</b>  |                             |                       |
| ■ <b>Freescall Semiconductor, 144A</b><br>5.41%, 04/15/05               | 11,900                      | 12,480                |
| ■ <b>Transportation 1.7%</b>  |                             |                       |
| ▶ <b>CSX Corp.</b><br>3.05%, 08/03/06                                   | 29,860                      | 29,889                |
| ▶ <b>Fedex Corp.</b><br>2.84%, 04/01/05                                 | 22,500                      | 22,498                |

| Security Series<br>Rate, Maturity Date                               | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|--|-----------------------------|-----------------------|
| ■ <b>Hertz Corp.</b><br>3.97%, 05/05/05                              | 15,980                      | 16,021                |
| 8.25%, 06/01/05  | 10,500                      | 10,597                |
| ■ <b>Union Pacific Corp.</b><br>8.35%, 05/01/25                      | 4,950                       | 5,199                 |
|  |                             | <b>84,204</b>         |
| ■ <b>Sovereign 0.1%</b>  |                             |                       |
| ▶ <b>Pemex Project Funding Master Trust, 144A</b><br>4.46%, 04/15/05 | 6,270                       | 6,662                 |
| ■ <b>Utilities 5.6%</b>  |                             |                       |
| ■ <b>Appalachian Power Co.</b><br>2.30%, 03/29/05                    | 8,000                       | 8,016                 |
| 4.80%, 06/15/05  | 19,700                      | 19,791                |
| ▶ <b>Atmos Energy Corp.</b><br>2.00%, 04/15/05                       | 19,900                      | 19,914                |
| ■ <b>Columbia Energy Group</b><br>Series D<br>7.05%, 11/28/07        | 1,405                       | 1,436                 |
| ▲ <b>Delek &amp; Avner-Yam, 144A</b><br>4.02%, 05/02/05              | 9,950                       | 9,950                 |
| ■ <b>DTE Energy Co.</b><br>3.35%, 03/01/05                           | 9,400                       | 9,429                 |
| ■ <b>Duke Energy Corp.</b><br>2.89%, 03/08/05                        | 21,000                      | 21,044                |
| ■ <b>Energen Corp.</b><br>3.14%, 05/16/05                            | 9,900                       | 9,908                 |
| ■ <b>Entergy Gulf States</b><br>2.80%, 03/01/05                      | 34,275                      | 34,303                |
| ■ <b>Nisource Finance Corp.</b><br>3.43%, 05/23/05                   | 32,720                      | 32,864                |
| ■ <b>PG&amp;E Corp.</b><br>3.26%, 04/04/05                           | 3,713                       | 3,716                 |
| ■ <b>Pinnacle West Capital Corp.</b><br>3.54%, 05/02/05              | 10,660                      | 10,668                |
| ■ <b>Reliant Energy Resources</b><br>Series B<br>8.13%, 07/15/05     | 25,525                      | 25,975                |
| ■ <b>Southern California Edison</b><br>2.55%, 03/14/05               | 50,000                      | 49,970                |
| 2.93%, 03/14/05  | 7,120                       | 7,134                 |

## Portfolio Holdings continued

| Security Series                      | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) | Security Series                                | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|--------------------------------------|-----------------------------|-----------------------|--|-----------------------------|-----------------------|
| Rate, Maturity Date                  |                             |                       | Rate, Maturity Date                            |                             |                       |
| ■ <b>TXU Energy Co., L.L.C. 144A</b> |                             |                       | ■ Series 2003-IA1 Class M2                     |                             |                       |
| 3.42%, 04/14/05                      | 4,950                       | 4,963                 | 4.30%, 03/28/05                                | 3,051                       | 3,053                 |
|                                      |                             | <b>269,081</b>        | Series 2004-R10 Class M1                       | 10,550                      | 10,615                |
|                                      |                             |                       | 3.35%, 11/25/34                                |                             |                       |
|                                      |                             |                       | Series 2004-R10 Class M6                       | 7,050                       | 7,265                 |
|                                      |                             |                       | 3.21%, 11/25/34                                |                             |                       |
|                                      |                             |                       | Series 2004-R10 Class M7                       | 6,900                       | 7,101                 |
|                                      |                             |                       | 3.64%, 11/25/34                                |                             |                       |
|                                      |                             |                       | Series 2004-R10 Class M8                       | 1,950                       | 1,999                 |
|                                      |                             |                       | 3.84%, 11/25/34                                |                             |                       |
|                                      |                             |                       | ■ Series 2004-R8 Class M7                      | 4,450                       | 4,543                 |
|                                      |                             |                       | 4.58%, 03/28/05                                |                             |                       |
|                                      |                             |                       | ■ Series 2004-R8 Class M9                      | 5,000                       | 4,642                 |
|                                      |                             |                       | 5.40%, 03/28/05                                |                             |                       |
|                                      |                             |                       | <b>Amortizing Residential Collateral Trust</b> |                             |                       |
|                                      |                             |                       | ■ Series 2002-BC1 Class M2                     | 10,000                      | 10,040                |
|                                      |                             |                       | 3.75%, 03/28/05                                |                             |                       |
|                                      |                             |                       | Series 2002-BC9 Class M2                       | 18,000                      | 18,431                |
|                                      |                             |                       | 4.90%, 12/25/32                                |                             |                       |
|                                      |                             |                       | <b>AQ Finance NIM Trust</b>                    |                             |                       |
|                                      |                             |                       | Series 2003-N11A                               | 553                         | 552                   |
|                                      |                             |                       | 7.14%, 08/25/33                                |                             |                       |
|                                      |                             |                       | <b>Argent NIM Trust</b>                        |                             |                       |
|                                      |                             |                       | Series 2003-N7 Class 2A1                       | 565                         | 565                   |
|                                      |                             |                       | 5.75%, 03/27/34                                |                             |                       |
|                                      |                             |                       | Series 2003-N7 Class 2A2                       | 2,000                       | 2,005                 |
|                                      |                             |                       | 9.75%, 03/27/34                                |                             |                       |
|                                      |                             |                       | <b>Argent Securities, Inc.</b>                 |                             |                       |
|                                      |                             |                       | ■ Series 2003-W7 Class M2                      | 15,750                      | 15,982                |
|                                      |                             |                       | 4.40%, 03/28/05                                |                             |                       |
|                                      |                             |                       | Series 2003-W9 Class M2                        | 19,695                      | 20,142                |
|                                      |                             |                       | 4.37%, 03/25/34                                |                             |                       |
|                                      |                             |                       | ■ <b>Aria CDO I (Jersey) Ltd.</b>              |                             |                       |
|                                      |                             |                       | Series IA-3 Class B1U5                         | 39,750                      | 39,980                |
|                                      |                             |                       | 3.13%, 04/07/05                                |                             |                       |
|                                      |                             |                       | <b>Asset Backed Funding Certificates</b>       |                             |                       |
|                                      |                             |                       | ■ Series 2003-AHL1 Class M1                    | 7,500                       | 7,559                 |
|                                      |                             |                       | 3.50%, 03/28/05                                |                             |                       |
|                                      |                             |                       | Series 2003-OPT1                               | 2,408                       | 2,406                 |
|                                      |                             |                       | 6.90%, 07/26/33                                |                             |                       |
|                                      |                             |                       | ■ Series 2003-OPT1 Class M2                    | 5,000                       | 5,060                 |
|                                      |                             |                       | 4.20%, 03/28/05                                |                             |                       |
|                                      |                             |                       | Series 2003-WMC1 Class A3                      | 12,549                      | 12,701                |
|                                      |                             |                       | 3.20%, 08/25/33                                |                             |                       |
|                                      |                             |                       | ■ Series 2004-HE1 Class M8                     | 4,022                       | 3,660                 |
|                                      |                             |                       | 6.15%, 03/28/05                                |                             |                       |

**Asset-Backed Obligations** 30.4% of net assets

**ABSC NIMS Trust**

Series 2004-HE7 Class A1  
5.00%, 10/25/34 4,807 4,829

**ACE Securities Corp.**

■ Series 2002-HE-1 Class M2  
3.85%, 03/28/05 5,000 5,003

■ Series 2002-HE3 Class M2  
4.85%, 03/28/05 15,000 15,139

■ Series 2003-HS1 Class M3  
5.15%, 03/28/05 4,081 4,220

■ Series 2004-FM1 Class M1  
3.25%, 03/28/05 10,000 10,033

**■ Aegis Asset Backed Securities Trust**

Series 2003-2 Class A1  
3.05%, 03/28/05 25,444 25,509

**Alter Moneta Receivables, L.L.C.**

Series 2003-1  
2.56%, 03/15/11 3,046 3,032

**Americredit Automobile Receivables Trust**

Series 2001-1 Class D  
6.98%, 07/06/07 1,400 1,415

Series 2002-1 Class D  
6.53%, 06/06/08 6,450 6,606

**Americredit Finance NIM Trust**

Series 2004-RN5 Class A  
5.19%, 07/25/34 2,816 2,808

**Ameritrust Finance NIM Trust**

■ Series 2001-RN4 Class A  
4.60%, 03/25/05 3,525 3,512

Series 2004-RN9 Series N1  
4.80%, 11/25/34 9,964 9,950

**Ameritrust Mortgage Securities, Inc.**

■ Series 2003-6 Class M2  
4.50%, 03/28/05 5,000 5,098

■ Series 2003-AR2 Class M2  
4.68%, 03/28/05 5,000 5,109

■ Series 2003-AR3 Class M2  
4.70%, 03/28/05 5,000 5,136

| Security Series<br>Rate, Maturity Date              | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|---|-----------------------------|-----------------------|
| ► Series 2004-OPT2 Class M2<br>3.65%, 03/28/05      | 11,576                      | 11,583                |
| <b>Asset Backed Funding Corp. NIM Trust</b>         |                             |                       |
| Series 2004-OPT5 Class N1<br>4.45%, 09/28/34        | 16,366                      | 16,344                |
| <b>Asset Backed Securities Corp. Home Equity</b>    |                             |                       |
| ► Series 2001-HE3 Class M2<br>3.64%, 03/15/05       | 1,613                       | 1,616                 |
| ► Series 2002-HE3 Class M2<br>4.14%, 03/15/05       | 6,830                       | 6,855                 |
| ► Series 2003-HE1 Class M2<br>4.94%, 03/15/05       | 14,850                      | 15,460                |
| ► Series 2003-HE2 Class M2<br>4.49%, 03/15/05       | 4,460                       | 4,531                 |
| ► Series 2003-HE2 Class M3<br>4.84%, 03/15/05       | 8,035                       | 8,201                 |
| <b>Asset Backed Securities Corp. NIMS Trust</b>     |                             |                       |
| Series 2004-HE3 Class A1<br>5.00%, 05/25/34         | 5,831                       | 5,799                 |
| <b>Banc of America Funding Corp.</b>                |                             |                       |
| Series 2004-A Class 4A1<br>5.87%, 06/20/32          | 17,877                      | 18,322                |
| ► <b>Bear Stearns Asset Backed Securities, Inc.</b> |                             |                       |
| Series 1999-1 Class MV1<br>3.63%, 03/28/05          | 8,417                       | 8,427                 |
| ► <b>Capital One Master Trust</b>                   |                             |                       |
| Series 2001-2 Class C<br>3.69%, 03/15/05            | 14,920                      | 14,993                |
| <b>Capital One Multi-Asset Execution Trust</b>      |                             |                       |
| ► Series 2003-B6 Class B6<br>3.12%, 03/15/05        | 20,000                      | 20,225                |
| ► Series 2003-C1 Class C1<br>5.14%, 03/15/05        | 3,500                       | 3,717                 |
| <b>Capital One Prime Auto Receivables Trust</b>     |                             |                       |
| Series 2004-2 Class B<br>3.95%, 05/16/11            | 13,673                      | 13,647                |
| ► <b>CARSS Finance Ltd. Partnership</b>             |                             |                       |
| Series 2004-A Class B2<br>3.54%, 03/15/05           | 5,241                       | 5,248                 |
| <b>CDC Mortgage Capital Trust</b>                   |                             |                       |
| ► Series 2003-HE1 Class M1<br>3.55%, 03/28/05       | 18,000                      | 18,104                |
| ► Series 2003-HE2 Class M2<br>4.55%, 03/28/05       | 5,000                       | 5,172                 |

| Security Series<br>Rate, Maturity Date            | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|---|-----------------------------|-----------------------|
| ► Series 2003-HE4 Class M1<br>3.30%, 03/28/05     | 5,700                       | 5,748                 |
| ► Series 2003-HE4 Class M2<br>4.30%, 03/28/05     | 4,000                       | 4,129                 |
| ► <b>Centex Home Equity</b>                       |                             |                       |
| Series 2003-B Class M2<br>4.35%, 03/28/05         | 6,500                       | 6,644                 |
| ► <b>Chase Credit Card Master Trust</b>           |                             |                       |
| Series 2002-4 Class C<br>3.43%, 03/15/05          | 14,000                      | 14,037                |
| <b>Chase Funding Loan Acquisition Trust</b>       |                             |                       |
| ► Series 2001-C3 Class M1<br>3.58%, 03/28/05      | 3,047                       | 3,051                 |
| ► Series 2002-C1 Class IIM2<br>3.75%, 03/28/05    | 5,000                       | 5,018                 |
| ► <b>Chase Funding Mortgage Loan Asset-Backed</b> |                             |                       |
| Series 2003-2 Class 2A2<br>2.93%, 03/28/05        | 16,770                      | 16,817                |
| <b>Chase Funding Net Interest Margin</b>          |                             |                       |
| Series 2003-4A<br>6.75%, 07/27/33                 | 310                         | 310                   |
| <b>Chase Funding Net Interest Margin, 144A</b>    |                             |                       |
| Series 2004-1A<br>3.75%, 02/27/34                 | 2,163                       | 2,160                 |
| <b>Chec Loan Trust</b>                            |                             |                       |
| Series 2004-2 Class M1<br>3.29%, 10/25/34         | 8,750                       | 8,822                 |
| <b>CIT Marine Trust</b>                           |                             |                       |
| Series 1999-A Class A4<br>6.25%, 11/15/19         | 2,900                       | 2,966                 |
| <b>Countrywide Asset Backed Certificates</b>      |                             |                       |
| ► Series 2002-6 Class M1<br>3.75%, 03/28/05       | 3,000                       | 3,028                 |
| ► Series 2002-6 Class M2<br>4.75%, 03/28/05       | 4,800                       | 4,891                 |
| Series 2003-2 Class M2<br>4.19%, 03/25/33         | 225                         | 230                   |
| <b>Distribution Financial Services Trust</b>      |                             |                       |
| Series 2001-1 Class-D<br>7.73%, 11/15/22          | 8,250                       | 8,224                 |
| ► <b>Fieldstone Mortgage Investment Corp.</b>     |                             |                       |
| Series 2004-2 Class M3<br>4.05%, 03/28/05         | 2,000                       | 2,001                 |

**Portfolio Holdings** continued

| <b>Security Series</b><br><b>Rate, Maturity Date</b>          | <b>Face Amount</b><br>(\$ x 1,000) | <b>Value</b><br>(\$ x 1,000) | <b>Security Series</b><br><b>Rate, Maturity Date</b> | <b>Face Amount</b><br>(\$ x 1,000) | <b>Value</b><br>(\$ x 1,000) |
|---|------------------------------------|------------------------------|--|------------------------------------|------------------------------|
| <b>First Franklin Mortgage Loan Asset Backed Certificates</b> |                                    |                              | <b>► Series 2003-10 Class 1A1</b>                    |                                    |                              |
| ► Series 1997-FF3 Class M1                                    |                                    |                              | 3.00%, 03/28/05                                      | 8,335                              | 8,341                        |
| 3.02%, 03/21/05   | 1,534                              | 1,535                        | <b>IndyMac Home Equity Loan Asset-Backed Trust</b>   |                                    |                              |
| Series 2003-FF3 Class M4                                      |                                    |                              | Series 2004-B Class M4                               |                                    |                              |
| 5.90%, 07/25/33   | 5,208                              | 5,427                        | 3.80%, 11/25/34                                      | 14,500                             | 14,593                       |
| <b>First Franklin NIM Trust</b>                               |                                    |                              | <b>IndyMac NIM Trust SPMD</b>                        |                                    |                              |
| Series 2004-FF1 Class N1                                      |                                    |                              | Series 2004-B  |                                    |                              |
| 4.50%, 11/25/34   | 3,252                              | 3,249                        | 5.75%, 11/25/34                                      | 7,110                              | 7,081                        |
| Series 2004-FF10 Class N1                                     |                                    |                              | <b>Irwin Home Equity</b>                             |                                    |                              |
| 4.45%, 11/26/34   | 8,263                              | 8,264                        | Series 2003-1 Class M2                               |                                    |                              |
| Series 2004-FF4A Class N                                      |                                    |                              | 4.65%, 02/25/08                                      | 5,000                              | 5,129                        |
| 5.75%, 06/25/34   | 4,744                              | 4,738                        | <b>Long Beach Asset Holdings, Corp.</b>              |                                    |                              |
| Series 2004-FF8A  |                                    |                              | Series 2003-4 Class N1                               |                                    |                              |
| 5.25%, 10/25/34   | 9,446                              | 9,488                        | 6.54%, 08/25/33                                      | 23                                 | 23                           |
| <b>Fremont Home Loan Trust</b>                                |                                    |                              | Series 2004-5  |                                    |                              |
| ► Series 2003-B Class M2                                      |                                    |                              | 5.00%, 09/25/34                                      | 1,283                              | 1,279                        |
| 4.27%, 03/28/05   | 13,000                             | 13,363                       | Series 2004-6 Class N1                               |                                    |                              |
| ► Series 2004-A Class M2                                      |                                    |                              | 4.50%, 11/25/34                                      | 3,920                              | 3,922                        |
| 3.80%, 03/07/05   | 5,000                              | 5,003                        | <b>Long Beach Mortgage Loan Trust</b>                |                                    |                              |
| <b>Fremont NIM Trust</b>                                      |                                    |                              | ► Series 2003-2 Class M1                             |                                    |                              |
| Series 2004-D Class N1  |                                    |                              | 3.47%, 03/28/05                                      | 8,000                              | 8,099                        |
| 4.50%, 06/25/06   | 8,249                              | 8,249                        | ► Series 2003-2 Class M3                             |                                    |                              |
| Series 2005-A   |                                    |                              | 4.90%, 03/28/05                                      | 2,190                              | 2,254                        |
| 3.75%, 01/25/35   | 13,900                             | 13,845                       | ► Series 2004-1 Class M6                             |                                    |                              |
| ► <b>GE Commercial Equipment Financing L.L.C.</b>             |                                    |                              | 4.05%, 03/28/05                                      | 8,000                              | 8,140                        |
| Series 2004-1 Class C   |                                    |                              | <b>Main Street Warehouse Funding Trust</b>           |                                    |                              |
| 3.01%, 03/21/05   | 7,600                              | 7,604                        | ► Series 2004-MSC                                    |                                    |                              |
| ► <b>GSamp Trust</b>  |                                    |                              | 5.40%, 03/28/05                                      | 9,000                              | 9,103                        |
| Series 2002-WMC1 Class B1                                     |                                    |                              | ► Series 2004-MSD                                    |                                    |                              |
| 4.70%, 03/21/05   | 7,006                              | 7,042                        | 4.95%, 03/28/05                                      | 18,500                             | 18,529                       |
| <b>Global Signal Trust</b>                                    |                                    |                              | <b>Master Asset Backed Securities Trust</b>          |                                    |                              |
| Series 2004-2A Class C  |                                    |                              | ► Series 2002-OPT1 Class M2                          |                                    |                              |
| 4.70%, 12/15/14   | 7,000                              | 6,969                        | 4.60%, 03/28/05                                      | 10,000                             | 10,159                       |
| ► <b>Home Equity Asset Trust</b>                              |                                    |                              | ► Series 2003-OPT1 Class A2                          |                                    |                              |
| Series 2004-8 Class M1  |                                    |                              | 3.07%, 03/25/05                                      | 6,426                              | 6,448                        |
| 3.23%, 03/28/05   | 22,000                             | 22,227                       | <b>MBNA Credit Card Master Note Trust</b>            |                                    |                              |
| <b>Home Equity Mortgage Trust</b>                             |                                    |                              | ► Series 2003-B3 Class B3                            |                                    |                              |
| Series 2002-5 Class M2  |                                    |                              | 2.97%, 03/15/05                                      | 6,000                              | 6,036                        |
| 5.10%, 04/25/33   | 10,000                             | 10,105                       | ► Series 2003-C3 Class C3                            |                                    |                              |
| ► <b>Household Mortgage Loan Trust</b>                        |                                    |                              | 3.94%, 03/15/05                                      | 10,920                             | 11,175                       |
| Series 2003-HC2 Class M                                       |                                    |                              | <b>MBNA Master Credit Card Trust</b>                 |                                    |                              |
| 3.01%, 03/21/05   | 5,081                              | 5,089                        | ► Series 1999-L Class C                              |                                    |                              |
| <b>Impac CMB Trust</b>  |                                    |                              | 3.67%, 03/15/05                                      | 8,000                              | 8,111                        |
| ► Series 2002-7 Class A                                       |                                    |                              | ► Series 2000-H Class B                              |                                    |                              |
| 3.08%, 03/28/05   | 26,771                             | 26,839                       | 3.19%, 03/15/05                                      | 14,500                             | 14,708                       |

| Security Series<br>Rate, Maturity Date         | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) | Security Series<br>Rate, Maturity Date      | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|--|-----------------------------|-----------------------|---|-----------------------------|-----------------------|
| <b>Merrill Lynch Mortgage Investors, Inc.</b>  |                             |                       | <b>Novastar Home Equity Loan</b>            |                             |                       |
| ► Series 2003-WMC2 Class M1<br>3.50%, 03/28/05 | 5,000                       | 5,025                 | ► Series 2003-3 Class B2<br>6.55%, 03/28/05 | 4,350                       | 4,621                 |
| ► Series 2003-WMC3 Class A2<br>3.01%, 03/28/05 | 15,982                      | 16,010                | ► Series 2003-3 Class M1<br>3.40%, 03/28/05 | 4,700                       | 4,752                 |
| ► Series 2003-WMC3 Class M3<br>4.30%, 03/28/05 | 2,000                       | 2,033                 | ► Series 2003-3 Class M2<br>4.30%, 03/28/05 | 10,000                      | 10,355                |
| ► Series 2003-WMC3 Class M4<br>4.53%, 03/28/05 | 2,913                       | 2,989                 | ► Series 2003-4 Class B1<br>5.15%, 03/28/05 | 2,500                       | 2,619                 |
| ► Series 2004-WMC1 Class A2<br>2.95%, 03/28/05 | 15,442                      | 15,484                | ► Series 2003-4 Class M1<br>3.36%, 03/28/05 | 20,000                      | 20,204                |
| <b>MMCA Automobile Trust</b>                   |                             |                       | ► Series 2004-1 Class B1<br>4.35%, 03/28/05 | 5,950                       | 5,964                 |
| Series 2002-5 Class C<br>4.74%, 03/15/05       | 2,157                       | 2,181                 | ► Series 2004-1 Class B2<br>4.45%, 03/28/05 | 5,800                       | 5,808                 |
| <b>Morgan Stanley ABS Capital I</b>            |                             |                       | ► Series 2004-2 Class B1<br>4.60%, 03/28/05 | 7,900                       | 8,078                 |
| ► Series 2003-HE3 Class M1<br>3.33%, 03/28/05  | 9,403                       | 9,476                 | ► Series 2004-2 Class M4<br>3.85%, 03/28/05 | 13,000                      | 13,129                |
| ► Series 2003-NC6 Class M1<br>3.45%, 03/28/05  | 17,500                      | 17,722                | ► Series 2004-4 Class B1<br>2.05%, 03/28/05 | 10,000                      | 10,096                |
| ► Series 2004-HE1 Class B2<br>4.55%, 03/28/05  | 6,000                       | 6,004                 | ► Series 2005-1 Class B4<br>8.34%, 03/28/05 | 4,000                       | 3,665                 |
| ► Series 2004-HE8 Class M1<br>3.29%, 03/28/05  | 19,810                      | 19,938                | ► Series 2005-1 Class M4<br>3.27%, 03/28/05 | 8,000                       | 8,000                 |
| ► Series 2004-HE9 Class M4<br>3.65%, 03/28/05  | 15,000                      | 15,071                | <b>Novastar NIM Trust</b>                   |                             |                       |
| Series 2004-NC1N<br>7.00%, 12/25/33            | 2,586                       | 2,576                 | Series 2003-N1<br>7.39%, 06/01/33           | 136                         | 136                   |
| Series 2004-NC2N<br>6.25%, 12/25/33            | 1,732                       | 1,732                 | Series 2004-N1<br>4.46%, 02/25/34           | 3,430                       | 3,434                 |
| Series 2004-NC3N<br>6.00%, 03/25/34            | 1,883                       | 1,880                 | Series 2004-N2<br>4.46%, 07/25/34           | 7,712                       | 7,676                 |
| <b>Morgan Stanley Auto Loan Trust</b>          |                             |                       | <b>Novastar NIM Trust, 144A</b>             |                             |                       |
| Series 2003-HB1 Class B<br>2.22%, 04/15/11     | 5,330                       | 5,244                 | Series 2004-N3<br>3.97%, 03/25/35           | 12,463                      | 12,454                |
| Series 2004-HB1 Class C<br>2.88%, 10/15/11     | 3,281                       | 3,260                 | <b>► ODIN CDO I (Cayman Islands) Ltd.</b>   |                             |                       |
| Series 2004-HB2 Class C<br>3.24%, 03/15/12     | 4,980                       | 4,948                 | Series 1A Class B1U5<br>3.91%, 03/22/05     | 19,900                      | 19,900                |
| Series 2004-HB2 Class D<br>3.59%, 03/15/12     | 990                         | 988                   | <b>OPTEUM NIM Trust</b>                     |                             |                       |
| <b>New Century Home Equity Loan Trust</b>      |                             |                       | Series 2005-1<br>6.00%, 02/25/35            | 3,713                       | 3,713                 |
| ► Series 2003-3 Class M3<br>5.03%, 03/28/05    | 7,686                       | 7,996                 | <b>Option One Mortgage Loan Trust</b>       |                             |                       |
| ► Series 2004-2 Class A3<br>2.90%, 03/28/05    | 19,144                      | 19,156                | ► Series 2002-2 Class M3<br>4.50%, 03/28/05 | 1,750                       | 1,754                 |
| ► Series 2004-3 Class M1<br>3.27%, 03/28/05    | 14,000                      | 14,080                | ► Series 2002-4 Class M1<br>3.25%, 03/28/05 | 13,938                      | 14,002                |

**Portfolio Holdings** continued

| <b>Security Series</b><br><b>Rate, Maturity Date</b> | <b>Face Amount</b><br>(\$ x 1,000) | <b>Value</b><br>(\$ x 1,000) | <b>Security Series</b><br><b>Rate, Maturity Date</b> | <b>Face Amount</b><br>(\$ x 1,000) | <b>Value</b><br>(\$ x 1,000) |
|--|------------------------------------|------------------------------|--|------------------------------------|------------------------------|
| ► Series 2003-1 Class M1<br>3.55%, 03/28/05          | 17,700                             | 17,871                       | <b>Securitized Asset Backed NIM Trust</b>            |                                    |                              |
| ► Series 2003-1 Class M2<br>4.60%, 03/28/05          | 250                                | 255                          | Series 2004-DO2<br>5.50%, 09/25/34                   | 7,290                              | 7,231                        |
| ► Series 2003-2 Class M1<br>3.30%, 03/28/05          | 15,000                             | 15,109                       | Series 2004-NC2 Class N<br>5.75%, 07/25/34           | 6,323                              | 6,322                        |
| ► Series 2003-3 Class N<br>2.96%, 03/28/05           | 255                                | 255                          | Series 2004-OP2 Class N<br>5.50%, 08/25/34           | 6,884                              | 6,845                        |
| ► Series 2004-1 Class M2<br>3.75%, 03/28/05          | 3,800                              | 3,844                        | <b>Sharps SP I L.L.C. Net Interest Margin Trust</b>  |                                    |                              |
| ► Series 2004-1 Class M3<br>4.00%, 03/28/05          | 5,000                              | 5,075                        | Series 2004-FM1N CLass N<br>6.16%, 09/25/34          | 1,540                              | 1,539                        |
| ► Series 2004-2 Class M1<br>3.18%, 03/28/05          | 7,000                              | 7,030                        | Series 2004-HE2N Class NA<br>5.43%, 10/25/34         | 5,582                              | 5,547                        |
| ► <b>Overture CDO (Jersey) Ltd.</b>                  |                                    |                              | Series 2004-HE3N Class NA<br>5.19%, 11/25/34         | 9,200                              | 9,188                        |
| Series IA Class B1<br>2.94%, 07/08/05                | 1,650                              | 1,663                        | Series 2004-OP1N CLass NA<br>5.19%, 04/25/34         | 3,308                              | 3,315                        |
| ► <b>Park Place Securities NIM Trust</b>             |                                    |                              | ► <b>Structured Asset Investment Loan Trust</b>      |                                    |                              |
| Series 2004-WHQ2 Class A<br>4.00%, 02/25/35          | 5,914                              | 5,906                        | Series 2003-BC1 Class A2<br>2.99%, 03/28/05          | 25,618                             | 25,684                       |
| <b>Residential Asset Securities Corp.</b>            |                                    |                              | <b>Structured Asset Securities Corp.</b>             |                                    |                              |
| ► Series 2003-KS6 Class M2<br>4.15%, 03/28/05        | 15,300                             | 15,517                       | ► Series 1998-8 Class B<br>3.95%, 03/28/05           | 403                                | 403                          |
| ► Series 2004-KS2 Class M22<br>3.65%, 03/28/05       | 9,000                              | 9,006                        | ► Series 2004-S2 Class M2<br>3.25%, 03/28/05         | 14,600                             | 14,609                       |
| <b>Residential Asset Securities NIM Corp.</b>        |                                    |                              | ► <b>Terrapin Funding, L.L.C.</b>                    |                                    |                              |
| Series 2005-NT1<br>4.25%, 02/25/35                   | 9,693                              | 9,678                        | Series 2003-1A Class B1<br>3.89%, 03/08/05           | 20,000                             | 20,074                       |
| <b>Ryder Vehicle Lease Trust</b>                     |                                    |                              | <b>UCFC Home Equity Loan</b>                         |                                    |                              |
| Series 2001-A Class CTFS<br>6.75%, 03/15/12          | 10,000                             | 10,327                       | Series 1998-B Class A7<br>6.53%, 10/15/29            | 9,800                              | 10,003                       |
| <b>Sail Net Interest Margin Notes</b>                |                                    |                              | <b>WFS Financial Owner Trust</b>                     |                                    |                              |
| Series 2003-12A Class A<br>7.35%, 11/27/33           | 871                                | 868                          | Series 2002-2 Class A4<br>4.50%, 02/20/10            | 1,200                              | 1,211                        |
| Series 2004-AA Class A<br>4.50%, 10/27/34            | 8,695                              | 8,691                        | Series 2004-1 Class A4<br>2.81%, 08/22/11            | 1,000                              | 976                          |
| Series 2005-1A Class A<br>4.25%, 02/27/35            | 9,900                              | 9,865                        | Series 2004-1 Class C<br>2.49%, 08/22/11             | 5,069                              | 4,988                        |
| ► <b>SAKS Credit Card Master Trust</b>               |                                    |                              | Series 2004-3 Class 3D<br>4.07%, 02/17/12            | 1,975                              | 1,974                        |
| Series 2001-2 Class B<br>3.24%, 03/15/05             | 2,800                              | 2,820                        | Series 2004-3 Class C<br>3.60%, 02/17/12             | 12,800                             | 12,695                       |
| ► <b>Saxon Asset Securities Trust</b>                |                                    |                              | Series 2004-4 Class C<br>3.21%, 05/17/12             | 12,800                             | 12,680                       |
| Series 2004-1 Class M2<br>3.78%, 03/28/05            | 12,650                             | 12,764                       | <b>Whole Auto Loan Trust</b>                         |                                    |                              |
|  |                                    |                              | Series 2003-1 Class B<br>2.24%, 03/15/10             | 11,920                             | 11,781                       |
|  |                                    |                              |  |                                    | <b>1,481,948</b>             |

| Security Series     | Face Value<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|---------------------|----------------------------|-----------------------|
| Rate, Maturity Date |                            |                       |

**Mortgage-Backed Securities 15.6% of net assets**
**Collateralized Mortgage Obligations 9.4%**
**Bank of America Mortgage Securities**

|                         |        |        |
|-------------------------|--------|--------|
| Series 2002-J Class A2  |        |        |
| 4.88%, 09/25/32         | 2,582  | 2,581  |
| Series 2003-C Class 2A1 |        |        |
| 3.93%, 04/25/33         | 5,395  | 5,349  |
| Series 2003-D Class 2A2 |        |        |
| 3.60%, 03/25/08         | 5,028  | 4,954  |
| Series 2004-A Class 2A2 |        |        |
| 4.18%, 02/25/34         | 24,884 | 24,640 |
| Series 2004-I Class 1A2 |        |        |
| 4.19%, 09/25/34         | 17,653 | 17,625 |
| Series 2004-J Class 2A1 |        |        |
| 4.82%, 11/25/34         | 34,598 | 34,741 |

**Countrywide Home Loans**

|                            |       |       |
|----------------------------|-------|-------|
| Series 2001-HYB2 Class 2A1 |       |       |
| 6.35%, 11/30/31            | 490   | 492   |
| Series 2002-1 Class 1A1    |       |       |
| 5.36%, 12/19/31            | 877   | 887   |
| Series 2002-HYB2 Class 4A1 |       |       |
| 5.00%, 08/20/32            | 572   | 579   |
| Series 2003-HYB1 Class 1A1 |       |       |
| 3.85%, 05/19/33            | 6,589 | 6,527 |

**Countrywide Home Loans**

|                            |        |        |
|----------------------------|--------|--------|
| Series 2004-HYB5 Class 3A1 |        |        |
| 4.78%, 04/20/35            | 60,345 | 60,508 |

**CS First Boston Mortgage Securities Corp.**

|                             |        |        |
|-----------------------------|--------|--------|
| ► Series 2000-HE1 Class M2  |        |        |
| 3.66%, 03/15/05             | 2,575  | 2,578  |
| ► Series 2001-HE17 Class M1 |        |        |
| 3.37%, 03/28/05             | 7,400  | 7,485  |
| Series 2002-AR27 Class 1A1  |        |        |
| 5.42%, 10/25/32             | 1,994  | 2,045  |
| Series 2002-AR28 Class 1A2  |        |        |
| 4.98%, 11/25/32             | 2,062  | 2,101  |
| Series 2004-AR7 Class 2A1   |        |        |
| 4.88%, 11/25/34             | 30,451 | 30,589 |

**Fannie Mae**

|                           |       |       |
|---------------------------|-------|-------|
| Series 2003-22 Class UK   |       |       |
| 4.00%, 09/25/31           | 7,959 | 7,833 |
| ► Series 2003-37 Class FK |       |       |
| 3.33%, 03/28/05           | 3,947 | 3,951 |

| Security Series     | Face Value<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|---------------------|----------------------------|-----------------------|
| Rate, Maturity Date |                            |                       |

**Fannie Mae (Interest Only)**

|                         |        |       |
|-------------------------|--------|-------|
| Series 2003-57 Class IB |        |       |
| 5.00%, 06/25/18         | 30,438 | 4,019 |

**Fifth Third Mortgage Loan Trust**

|                               |       |       |
|-------------------------------|-------|-------|
| ► Series 2002-FTB1 Class 3A1  |       |       |
| 3.91%, 03/01/05               | 2,499 | 2,525 |
| ► Series 2002-FTB1 Series 2A1 |       |       |
| 6.27%, 03/01/05               | 3,586 | 3,582 |

**Freddie Mac**

|                   |     |     |
|-------------------|-----|-----|
| Series 61 Class D |     |     |
| 9.30%, 11/15/20   | 599 | 599 |

**GSR Mortgage Loan Trust**

|                           |        |       |
|---------------------------|--------|-------|
| Series 2002-3F Class 2AB3 |        |       |
| 5.50%, 12/25/31           | 1      | 1     |
| Series 2004-7 Class 1A2   |        |       |
| 3.49%, 06/25/34           | 10,219 | 9,972 |

**IndyMac Index Mortgage Loan Trust (Interest Only)**

|                           |         |       |
|---------------------------|---------|-------|
| Series 2004-AR1 Class AX1 |         |       |
| 0.80%, 04/24/34           | 343,073 | 3,695 |

**Master Adjustable Rate Mortgages Trust**

|                         |       |       |
|-------------------------|-------|-------|
| Series 2002-4 Class 1A1 |       |       |
| 5.27%, 11/25/32         | 1,375 | 1,391 |
| Series 2002-4 Class 2A1 |       |       |
| 5.48%, 11/25/32         | 1,704 | 1,742 |
| Series 2002-4 Class 3A1 |       |       |
| 5.27%, 11/25/32         | 1,812 | 1,831 |
| Series 2003-1 Class 1A1 |       |       |
| 4.15%, 12/25/32         | 186   | 186   |

**Morgan Stanley Mortgage Loan Trust**

|                           |        |        |
|---------------------------|--------|--------|
| Series 2004-5AR Class 3A4 |        |        |
| 4.66%, 07/25/34           | 11,897 | 11,925 |
| Series 2004-8AR Class 3A  |        |        |
| 5.08%, 10/25/34           | 19,939 | 20,079 |
| Series 2004-8AR Class 4A1 |        |        |
| 5.47%, 10/25/34           | 9,165  | 9,203  |
| Series 2004-9 Class 2A    |        |        |
| 6.42%, 11/25/34           | 16,517 | 17,119 |

**Residential Accredit Loans, Inc.**

|                            |       |       |
|----------------------------|-------|-------|
| Series 1999-QS8 Class A1   |       |       |
| 6.50%, 06/25/14            | 2,729 | 2,742 |
| Series 2004-QA3 Class NB21 |       |       |
| 4.55%, 08/25/34            | 9,347 | 9,224 |

**Residential Asset Securitization Trust**

|                         |        |        |
|-------------------------|--------|--------|
| Series 2004-A6 Class A1 |        |        |
| 5.00%, 08/25/19         | 13,396 | 13,427 |



**Portfolio Holdings** continued

| Security Series                                     | Face Value<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|---|----------------------------|-----------------------|
| <b>Residential Funding Securities Corp.</b>         |                            |                       |
| Series 2001-RM1 Class A                             |                            |                       |
| 6.18%, 12/25/29                                     | 158                        | 158                   |
| <b>Sequoia Mortgage Trust (Interest Only)</b>       |                            |                       |
| Series 2003-8 Class X1                              |                            |                       |
| 0.80%, 01/20/34                                     | 235,575                    | 2,293                 |
| <b>Thornburg Mortgage Securities Trust</b>          |                            |                       |
| Series 2004-1 Class II2A                            |                            |                       |
| 3.37%, 04/25/34                                     | 23,689                     | 22,814                |
| <b>Washington Mutual</b>                            |                            |                       |
| Series 2002-AR19 Class A7                           |                            |                       |
| 4.68%, 01/01/33                                     | 4,944                      | 4,971                 |
| Series 2003-AR1 Class A6                            |                            |                       |
| 4.56%, 01/25/33                                     | 2,543                      | 2,547                 |
| Series 2003-AR8 Class A                             |                            |                       |
| 4.03%, 08/25/33                                     | 9,019                      | 8,947                 |
| Series 2003-AR9 Class 1A2A                          |                            |                       |
| 2.34%, 09/25/33                                     | 7,859                      | 7,836                 |
| <b>Wells Fargo Mortgage Backed Securities Trust</b> |                            |                       |
| Series 2003-N Class 2A2                             |                            |                       |
| 4.76%, 12/25/33                                     | 14,111                     | 13,754                |
| Series 2003-O Class 2A1                             |                            |                       |
| 4.64%, 01/25/34                                     | 27,089                     | 26,320                |
| Series 2004-K Class 2A5                             |                            |                       |
| 4.75%, 07/25/34                                     | 19,409                     | 19,396                |
| Series 2004-T Class A1                              |                            |                       |
| 3.46%, 09/25/34                                     | 22,006                     | 21,728                |
|   |                            | <b>459,491</b>        |

**U.S. Government Agency Mortgages 6.2%**

|                                |        |        |
|--------------------------------|--------|--------|
| <b>Fannie Mae</b>              |        |        |
| 3.86%, 05/01/19                | 6,101  | 6,224  |
| 4.04%, 05/01/34                | 20,528 | 20,884 |
| 4.08%, 08/01/35                | 9,682  | 9,948  |
| 5.15%, 01/31/31                | 1,661  | 1,704  |
| 5.53%, 10/01/31                | 2,809  | 2,891  |
| 5.56%, 11/01/31                | 1,143  | 1,179  |
| 5.80%, 06/01/31                | 467    | 481    |
| 5.78%, 11/01/31                | 704    | 727    |
| 6.05%, 07/01/31 to<br>08/01/31 | 1,556  | 1,607  |
| 6.10%, 07/01/31                | 759    | 785    |
| 6.24%, 08/01/39                | 1,430  | 1,482  |
| 6.50%, 04/01/08 to<br>11/01/19 | 53,448 | 56,179 |

| Security Series                | Face Value<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|--------------------------------|----------------------------|-----------------------|
| 7.00%, 01/01/06 to<br>02/01/20 | 154,653                    | 162,135               |
| 7.00%, 07/01/34 to<br>09/01/34 | 29,589                     | 31,227                |
| 9.30%, 11/15/20                | 599                        | 599                   |
| <b>Freddie Mae</b>             |                            |                       |
| 5.45%, 10/01/31                | 1,389                      | 1,406                 |
| 5.50%, 08/01/11                | 984                        | 1,013                 |
| 6.00%, 05/01/08                | 242                        | 246                   |
| 6.10%, 07/01/29                | 2,207                      | 2,311                 |
| 6.53%, 04/01/31                | 1,060                      | 1,087                 |
|                                |                            | <b>304,115</b>        |

**Municipal Bonds 0.2% of net assets****California Department of Water Resources**

|                                      |       |              |
|--------------------------------------|-------|--------------|
| Power Supply Revenue Bonds, Series E |       |              |
| 3.98%, 05/01/05                      | 9,500 | <b>9,510</b> |

**U.S. Government Securities 0.0% of net assets****U.S. Treasury Bills**

|                   |       |              |
|-------------------|-------|--------------|
| ■ 2.20%, 03/10/05 | 50    | 50           |
| ■ 2.54%, 05/19/05 | 1,000 | 994          |
|                   |       | <b>1,044</b> |

**Commercial Paper & Other Corporate Obligations**

2.6% of net assets

**Cox Communications, Inc., Section 4(2)**

|                 |        |        |
|-----------------|--------|--------|
| 2.75%, 03/01/05 | 38,500 | 38,500 |
|-----------------|--------|--------|

**General Motors Acceptance Corp.**

|                 |        |        |
|-----------------|--------|--------|
| 2.62%, 03/03/05 | 11,350 | 11,348 |
| 2.72%, 03/11/05 | 25,000 | 24,981 |

**Kinder Morgan Energy Partners, Section 4(2)**

|                 |        |        |
|-----------------|--------|--------|
| 2.58%, 03/04/05 | 30,500 | 30,494 |
|-----------------|--------|--------|

**Viacom, Inc.**

|                 |        |                |
|-----------------|--------|----------------|
| 2.63%, 03/02/05 | 20,500 | 20,498         |
|                 |        | <b>125,821</b> |



| Security and Number of Shares                         | Value<br>(\$ x 1,000) |
|---|-----------------------|
| <b>Preferred Stock 5.8% of net assets</b>             |                       |
| ■ <b>ABN AMRO North America Capital Funding, 144A</b> |                       |
| 555,000   | 54,259                |
| ■ <b>ABN AMRO XIX Custodial Receipts, Series MM19</b> |                       |
| 130,000   | 13,125                |
| ■ <b>Chase Capital VIII</b>                           |                       |
| 150,000   | 3,869                 |
| ■ <b>Fannie Mae, Series J</b>                         |                       |
| 1,308,000   | 65,091                |
| ■ <b>Fannie Mae, Series K</b>                         |                       |
| 641,300   | 32,066                |
| ■ <b>Fannie Mae, Series O</b>                         |                       |
| 50,000  | 2,777                 |
| ■ <b>RC Trust I</b>                                   |                       |
| 465,050   | 24,018                |
| ■ <b>SG Preferred Capital II</b>                      |                       |
| 200,000   | 20,503                |
| ■ <b>Shell Frontier Oil &amp; Gas, Series A</b>       |                       |
| 120,000   | 12,000                |

| Security and Number of Shares                   | Value<br>(\$ x 1,000) |
|---|-----------------------|
| ■ <b>Shell Frontier Oil &amp; Gas, Series B</b> |                       |
| 120,000   | 12,000                |
| ■ <b>Shell Frontier Oil &amp; Gas, Series C</b> |                       |
| 120,000   | 12,000                |
| ■ <b>Shell Frontier Oil &amp; Gas, Series D</b> |                       |
| 58,000  | 5,800                 |
| ■ <b>Zurich Regcaps Funding Trust III, 144A</b> |                       |
| 175,000   | 17,346                |
| ■ <b>Zurich Regcaps Funding Trust IV, 144A</b>  |                       |
| 40,000  | 3,912                 |
| ■ <b>Zurich Regcaps Funding Trust V 144A</b>    |                       |
| 50,000  | 4,848                 |
|   | <b>283,614</b>        |

**Other Investment Companies 0.0% of net assets**

|   |         |            |
|---|---------|------------|
| ■ <b>Provident Institutional Funds—<br/>Fed Funds Portfolio</b> | 171,741 | <b>172</b> |
|---|---------|------------|

End of investments.

In addition to the above, the fund held the following at 2/28/05. All numbers are x 1,000 except number of futures contracts.

| <b>Futures Contracts</b>                                 |                        |                   |                     |
|--|------------------------|-------------------|---------------------|
|  | Number of<br>Contracts | Contract<br>Value | Unrealized<br>Gains |
| 5 Year, Short<br>U.S. Treasury Note,<br>expires 06/21/05 | 1,225                  | 131,783           | 793                 |
| 2 Year, Short<br>U.S. Treasury Note,<br>expires 06/30/05 | 550                    | 114,065           | 309                 |
|  |                        |                   | <b>1,102</b>        |

## Statement of

**Assets and Liabilities**

As of February 28, 2005; unaudited. All numbers are x 1,000 except NAV.

**Assets**

|                              |                  |
|------------------------------|------------------|
| Investments, at value        | \$4,946,108      |
| Receivables:                 |                  |
| Fund shares sold             | 17,352           |
| Interest                     | 23,908           |
| Dividends                    | 1,796            |
| Due from brokers for futures | 618              |
| Investments matured          | 1,318            |
| Prepaid expenses             | + 329            |
| <b>Total assets</b>          | <b>4,991,429</b> |

**Liabilities**

|   |                |
|---|----------------|
| Payables:                                   |                |
| Fund shares redeemed                        | 25,435         |
| Dividends to shareholders                   | 2,591          |
| Investments bought                          | 79,720         |
| Investment adviser and administrator fees   | 124            |
| Transfer agent and shareholder service fees | 50             |
| Accrued expenses                            | + 314          |
| <b>Total liabilities</b>                    | <b>108,234</b> |

**Net Assets**

|                          |                    |
|--------------------------|--------------------|
| <b>Total assets</b>      | 4,991,429          |
| <b>Total liabilities</b> | - 108,234          |
| <b>Net assets</b>        | <b>\$4,883,195</b> |

**Net Assets by Source**

|  |           |
|--|-----------|
| Capital received from investors                  | 4,940,394 |
| Distributions in excess of net investment income | (2,473)   |
| Net realized capital losses                      | (62,919)  |
| Net unrealized capital gains                     | 8,193     |

**Net Asset Value (NAV) by Share Class**

| Share Class     | Net Assets  | ÷ | Shares Outstanding | = | NAV    |
|-----------------|-------------|---|--------------------|---|--------|
| Investor Shares | \$774,639   |   | 79,927             |   | \$9.69 |
| Select Shares   | \$4,108,556 |   | 423,986            |   | \$9.69 |

Unless stated, all numbers are x 1,000.

The amortized cost of the fund's securities was \$4,939,017.

Includes certain restricted but deemed liquid 144A and Section 4(2) securities worth \$529,373, or 10.8% of the fund's total net assets.

Not counting short-term obligations and government securities, the fund's security transactions during the period were:

|                  |           |
|------------------|-----------|
| Purchases        | \$933,363 |
| Sales/maturities | \$652,572 |

The fund's long-term government security transactions were:

|                  |           |
|------------------|-----------|
| Purchases        | \$267,531 |
| Sales/maturities | \$48,090  |

The fund's total security transactions with other Schwab Funds during the period were \$24,822.

These derive from investments, futures and short sales.

**Federal Tax Data**

|   |                |
|---|----------------|
| <b>Portfolio cost</b>                   | \$4,939,028    |
| <b>Net unrealized gains and losses:</b> |                |
| Gains                                   | \$22,309       |
| Losses                                  | + (15,229)     |
|   | <b>\$7,080</b> |

**As of August 31, 2004:****Undistributed earnings:**

|                         |         |
|-------------------------|---------|
| Ordinary income         | \$1,842 |
| Long-term capital gains | \$-     |

**Unused capital losses:**

|                   |                 |
|-------------------|-----------------|
| Expires 08/31 of: |                 |
| 2009              | \$1,318         |
| 2010              | 2,061           |
| 2011              | 47,204          |
| 2012              | + 7,223         |
|                   | <b>\$57,806</b> |

**Deferred capital losses** \$5,250

## Statement of

**Operations**

For September 1, 2004 through February 28, 2005; unaudited. All numbers are x 1,000.

Unless stated, all numbers are x 1,000.

**Investment Income**

|                                |               |
|--------------------------------|---------------|
| Interest                       | \$65,416      |
| Dividends                      | 4,729         |
| <b>Total investment income</b> | <b>70,145</b> |

**Net Realized Gains and Losses**

|   |              |
|---|--------------|
| Net realized losses on investments sold | (2,405)      |
| Net realized gains on futures contracts | + 1,981      |
| <b>Net realized losses</b>              | <b>(424)</b> |

**Net Unrealized Gains and Losses**

|   |                |
|---|----------------|
| Net unrealized losses on investments      | (5,224)        |
| Net unrealized gains on futures contracts | + 1,664        |
| <b>Net unrealized losses</b>              | <b>(3,560)</b> |

**Expenses**

|  |               |
|--|---------------|
| Investment adviser and administrator fees    | 6,683         |
| Transfer agent and shareholder service fees: |               |
| Investor Shares                              | 890           |
| Select Shares                                | 1,831         |
| Trustees' fees                               | 10            |
| Custodian and portfolio accounting fees      | 216           |
| Professional fees                            | 25            |
| Registration fees                            | 357           |
| Shareholder reports                          | 69            |
| Other expenses                               | + 34          |
| <b>Total expenses</b>                        | <b>10,115</b> |

**Increase in Net Assets from Operations**

|   |                 |
|---|-----------------|
| <b>Total investment income</b>                | 70,145          |
| <b>Total expenses</b>                         | - 10,115        |
| <b>Net investment income</b>                  | <b>60,030</b>   |
| <b>Net realized losses</b>                    | (424)           |
| <b>Net unrealized losses</b>                  | + (3,560)       |
| <b>Increase in net assets from operations</b> | <b>\$56,046</b> |

Calculated as a percentage of average daily net assets: 0.35% of the first \$500 million and 0.30% of assets beyond that. These fees are paid to Charles Schwab Investment Management, Inc. (CSIM).

Calculated as a percentage of average daily net assets: for transfer agent services, 0.05% of the fund's assets; for shareholder services, 0.20% and 0.05% of the assets of each respective share class. These fees are paid to Charles Schwab & Co., Inc. (Schwab).

For the fund's independent trustees only.

These add up to a net loss on investments of \$3,984.

## Statements of

**Changes in Net Assets**

For the current and prior report periods. All numbers are x 1,000.  
Figures for current period are unaudited.

Unless stated, all numbers are x 1,000.

**Operations**

|   | 9/1/04-2/28/05 | 9/1/03-8/31/04 |
|---|----------------|----------------|
| Net investment income                         | \$60,030       | \$62,203       |
| Net realized losses                           | (424)          | (6,688)        |
| Net unrealized gains or losses                | + (3,560)      | 6,618          |
| <b>Increase in net assets from operations</b> | <b>56,046</b>  | <b>62,133</b>  |

**Distributions Paid****Dividends from Net Investment Income**

|   |                 |                 |
|---|-----------------|-----------------|
| Investor Shares                                   | 9,736           | 11,983          |
| Select Shares                                     | + 52,927        | 52,025          |
| <b>Total dividends from net investment income</b> | <b>\$62,663</b> | <b>\$64,008</b> |

The tax-basis components of distributions for the period ended 08/31/04 are:

|                         |          |
|-------------------------|----------|
| Ordinary income         | \$64,008 |
| Long-term capital gains | \$—      |

**Transactions in Fund Shares**

|  | 9/1/04-2/28/05   |                      | 9/1/03-8/31/04   |                      |
|--|------------------|----------------------|------------------|----------------------|
|  | SHARES           | VALUE                | SHARES           | VALUE                |
| <b>Shares Sold</b>                     |                  |                      |                  |                      |
| Investor Shares                        | 42,363           | \$410,841            | 55,532           | \$539,356            |
| Select Shares                          | + 276,063        | 2,677,044            | 301,776          | 2,930,949            |
| <b>Total shares sold</b>               | <b>318,426</b>   | <b>\$3,087,885</b>   | <b>357,308</b>   | <b>\$3,470,305</b>   |
| <b>Shares Reinvested</b>               |                  |                      |                  |                      |
| Investor Shares                        | 820              | \$7,949              | 1,086            | \$10,543             |
| Select Shares                          | + 4,190          | 40,617               | 4,472            | 43,409               |
| <b>Total shares reinvested</b>         | <b>5,010</b>     | <b>\$48,566</b>      | <b>5,558</b>     | <b>\$53,952</b>      |
| <b>Shares Redeemed</b>                 |                  |                      |                  |                      |
| Investor Shares                        | (29,053)         | (\$281,714)          | (33,055)         | (\$321,044)          |
| Select Shares                          | + (168,467)      | (1,633,182)          | (146,165)        | (1,419,256)          |
| <b>Total shares redeemed</b>           | <b>(197,520)</b> | <b>(\$1,914,896)</b> | <b>(179,220)</b> | <b>(\$1,740,300)</b> |
| <b>Net transactions in fund shares</b> | <b>125,916</b>   | <b>\$1,221,555</b>   | <b>183,646</b>   | <b>\$1,783,957</b>   |

**Shares Outstanding and Net Assets**

|                      | 9/1/04-2/28/05 |                    | 9/1/03-8/31/04 |                    |
|----------------------|----------------|--------------------|----------------|--------------------|
|                      | SHARES         | NET ASSETS         | SHARES         | NET ASSETS         |
| Beginning of period  | 377,997        | \$3,668,257        | 194,351        | \$1,886,175        |
| Total increase       | + 125,916      | 1,214,938          | 183,646        | 1,782,082          |
| <b>End of period</b> | <b>503,913</b> | <b>\$4,883,195</b> | <b>377,997</b> | <b>\$3,668,257</b> |

Figures for shares represent shares sold plus shares reinvested, minus shares redeemed. Figures for net assets represent the changes in net assets from operations plus the changes in value of transactions in fund shares, minus distributions paid.

Includes distributions in excess of net investment income in the amount of \$2,473 for the current period and net investment income not yet distributed in the amount of \$160 for the prior period.

# Schwab Short-Term Bond Market Fund™

## Financial Statements

### Financial Highlights

|   | 9/1/04–<br>2/28/05* | 9/1/03–<br>8/31/04 | 9/1/02–<br>8/31/03 | 9/1/01–<br>8/31/02 | 9/1/00–<br>8/31/01 | 9/1/99–<br>8/31/00 |
|---|---------------------|--------------------|--------------------|--------------------|--------------------|--------------------|
| <b>Per-Share Data (\$)</b>                      |                     |                    |                    |                    |                    |                    |
| Net asset value at beginning of period          | 10.21               | 10.14              | 10.07              | 10.08              | 9.65               | 9.66               |
| Income from investment operations:              |                     |                    |                    |                    |                    |                    |
| Net investment income                           | 0.14                | 0.28               | 0.34               | 0.50               | 0.59               | 0.57               |
| Net realized and unrealized gains or losses     | (0.14)              | 0.07               | 0.07               | (0.02)             | 0.43               | (0.01)             |
| Total income or loss from investment operations | (0.00) <sup>1</sup> | 0.35               | 0.41               | 0.48               | 1.02               | 0.56               |
| Less distributions:                             |                     |                    |                    |                    |                    |                    |
| Dividends from net investment income            | (0.14)              | (0.28)             | (0.34)             | (0.49)             | (0.59)             | (0.57)             |
| Distributions from net realized gains           | (0.02)              | —                  | —                  | —                  | —                  | —                  |
| Total distributions                             | (0.16)              | (0.28)             | (0.34)             | (0.49)             | (0.59)             | (0.57)             |
| Net asset value at end of period                | 10.05               | 10.21              | 10.14              | 10.07              | 10.08              | 9.65               |
| Total return (%)                                | (0.02) <sup>2</sup> | 3.46               | 4.16               | 4.88               | 10.84              | 5.97               |
| <b>Ratios/Supplemental Data (%)</b>             |                     |                    |                    |                    |                    |                    |
| Ratios to average net assets:                   |                     |                    |                    |                    |                    |                    |
| Net operating expenses                          | 0.55 <sup>3</sup>   | 0.53               | 0.43               | 0.35               | 0.35               | 0.36 <sup>4</sup>  |
| Gross operating expenses                        | 0.56 <sup>3</sup>   | 0.57               | 0.58               | 0.63               | 0.66               | 0.68               |
| Net investment income                           | 2.76 <sup>3</sup>   | 2.69               | 3.34               | 4.95               | 5.90               | 5.91               |
| Portfolio turnover rate                         | 56 <sup>2</sup>     | 114                | 124                | 150                | 248                | 129                |
| Net assets, end of period (\$ x 1,000,000)      | 706                 | 728                | 648                | 493                | 369                | 219                |

\* Unaudited.

<sup>1</sup> Per-share amount was less than \$0.01.

<sup>2</sup> Not annualized.

<sup>3</sup> Annualized.

<sup>4</sup> The ratio of net operating expenses would have been 0.35% if certain non-routine expenses (proxy fees) had not been included.

**Portfolio Holdings** as of February 28, 2005, unaudited

This section shows all the securities in the fund's portfolio and their value, as of the report date.

The fund files its complete schedule of portfolio holdings with the SEC for the first and third quarters of each fiscal year on Form N-Q. The fund's Forms N-Q is available on the SEC's website at <http://www.sec.gov> and may be reviewed and copied at the SEC's Public Reference Room in Washington, D.C. Call 1-800-SEC-0330 for information on the operation of the Public Reference Room. The schedule of portfolio holdings filed on a fund's most recent Form N-Q is available by visiting Schwab's website at [www.schwab.com/schwabfunds](http://www.schwab.com/schwabfunds).

We use the symbol below to designate certain characteristics of the securities.

- ▲ Delayed-delivery security
- Variable-rate security
- Callable security
- All or a portion of this security is held as collateral for futures contracts and delayed-delivery security
- ◆ All or a portion of the security is on loan

For fixed-rate obligations, the rate shown is the interest rate (the rate established when the obligation was issued) and the maturity date shown is the stated legal maturity. For variable-rate obligations, the rate shown is the rate as of the report date, and the maturity

shown is the later of the next interest rate change date or demand date.

| Holdings by Category   | Cost<br>(\$x1,000) | Value<br>(\$x1,000) |
|--|--------------------|---------------------|
| <b>47.8% U.S. Government Securities</b>                        | 342,215            | 337,723             |
| <b>23.3% Corporate Bonds</b>                                   | 165,101            | 164,578             |
| <b>16.7% Mortgage-Backed Securities</b>                        | 119,038            | 117,723             |
| <b>8.9% Asset-Backed Obligations</b>                           | 62,614             | 62,738              |
| <b>0.4% Commercial Paper &amp; Other Corporate Obligations</b> | 3,000              | 3,000               |
| <b>2.2% Preferred Stock</b>                                    | 15,373             | 15,624              |
| <b>0.2% Other Investment Companies</b>                         | 975                | 975                 |
| <b>99.5% Total Investments</b>                                 | <b>708,316</b>     | <b>702,361</b>      |
| <b>32.0% Collateral Invested for Securities on Loan</b>        | 226,342            | 226,342             |
| <b>(31.5%) Other Assets and Liabilities</b>                    |                    | (222,475)           |
| <b>100.0% Net Assets</b>                                       |                    | <b>706,228</b>      |

| Security Series     | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|---------------------|-----------------------------|-----------------------|
| Rate, Maturity Date |                             |                       |

**U.S. Government Securities** 47.8% of net assets**U.S. Government Agency Securities** 19.7%**Fannie Mae**

|                   |        |        |
|-------------------|--------|--------|
| ◆ 4.38%, 10/15/06 | 20,000 | 20,229 |
| 2.63%, 11/15/06   | 12,000 | 11,800 |
| 5.00%, 01/15/07   | 5,000  | 5,116  |
| ◆ 3.13%, 12/15/07 | 20,000 | 19,581 |
| ◆ 6.63%, 09/15/09 | 11,500 | 12,616 |

**Federal Home Loan Bank**

|                   |        |        |
|-------------------|--------|--------|
| 4.13%, 11/15/06   | 25,000 | 25,184 |
| ■ 3.38%, 09/14/07 | 35,000 | 34,641 |

| Security Series     | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|---------------------|-----------------------------|-----------------------|
| Rate, Maturity Date |                             |                       |

**Freddie Mac**

|                 |        |                |
|-----------------|--------|----------------|
| 3.50%, 09/15/07 | 10,000 | 9,929          |
|                 |        | <b>139,096</b> |

**U.S. Treasury Obligations** 28.1%**U.S. Treasury Bills**

|                   |     |     |
|-------------------|-----|-----|
| ■ 2.19%, 03/10/05 | 170 | 170 |
| ■ 2.55%, 05/19/05 | 135 | 134 |

**U.S. Treasury Notes**

|                   |        |        |
|-------------------|--------|--------|
| ◆ 6.88%, 05/15/06 | 1,500  | 1,562  |
| ◆ 2.50%, 05/31/06 | 4,450  | 4,404  |
| ◆ 7.00%, 07/15/06 | 10,000 | 10,477 |
| ◆ 2.75%, 07/31/06 | 2,000  | 1,982  |
| ◆ 2.38%, 08/15/06 | 32,800 | 32,316 |
| ◆ 2.38%, 08/31/06 | 2,000  | 1,969  |

| Security Series     | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|---------------------|-----------------------------|-----------------------|
| Rate, Maturity Date |                             |                       |
| ◆ 6.50%, 10/15/06   | 9,000                       | 9,425                 |
| ◆ 2.63%, 11/15/06   | 8,800                       | 8,672                 |
| ◆ 2.25%, 02/15/07   | 25,000                      | 24,386                |
| ◆ 6.25%, 02/15/07   | 5,000                       | 5,255                 |
| ◆ 3.13%, 05/15/07   | 15,000                      | 14,844                |
| ◆ 4.38%, 05/15/07   | 5,500                       | 5,588                 |
| ◆ 3.25%, 08/15/07   | 6,000                       | 5,943                 |
| ◆ 2.63%, 05/15/08   | 21,000                      | 20,274                |
| ◆ 5.63%, 05/15/08   | 1,000                       | 1,055                 |
| ◆ 3.25%, 08/15/08   | 11,000                      | 10,801                |
| ◆ 3.13%, 09/15/08   | 3,000                       | 2,930                 |
| ◆ 3.38%, 11/15/08   | 3,000                       | 2,950                 |
| ◆ 3.38%, 12/15/08   | 5,000                       | 4,914                 |
| ◆ 3.88%, 05/15/09   | 2,000                       | 1,998                 |
| ◆ 4.00%, 06/15/09   | 1,500                       | 1,504                 |
| ◆ 3.63%, 07/15/09   | 2,700                       | 2,665                 |
| ◆ 3.50%, 11/15/09   | 2,500                       | 2,450                 |
| ◆ 3.50%, 12/15/09   | 11,600                      | 11,353                |
| ◆ 3.63%, 01/15/10   | 8,750                       | 8,606                 |
|                     |                             | <b>198,627</b>        |

**Corporate Bonds** 23.3% of net assets

**Finance 9.1%**
**Banking 4.6%**

|  |       |       |
|--|-------|-------|
| ◆ <b>Bumiputra-Commerce Bank</b>           |       |       |
| 5.13%, 10/16/13                            | 2,000 | 2,028 |
| ◆ <b>Citigroup</b>                         |       |       |
| 2.59%, 03/09/05                            | 5,000 | 5,014 |
| ◆ <b>Deutsche Bank Capital Trust, 144A</b> |       |       |
| Class B                                    |       |       |
| 4.35%, 03/30/05                            | 8,000 | 8,040 |
| ◆ <b>Doral Financial Corp.</b>             |       |       |
| 3.50%, 04/20/05                            | 2,000 | 2,000 |
| ◆ <b>Industrial Bank of Korea, 144A</b>    |       |       |
| 4.00%, 05/19/14                            | 500   | 485   |
| ◆ <b>JP Morgan Chase &amp; Co.</b>         |       |       |
| 2.75%, 04/04/05                            | 5,000 | 5,016 |
| ◆ <b>Popular North America, Inc.</b>       |       |       |
| 3.88%, 10/01/08                            | 4,000 | 3,952 |
| ◆ <b>RBS Capital Trust IV</b>              |       |       |
| 3.36%, 03/30/05                            | 2,000 | 2,038 |

| Security Series                            | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|--|-----------------------------|-----------------------|
| Rate, Maturity Date                        |                             |                       |
| ◆ <b>Sovereign Bank</b>                    |                             |                       |
| 4.38%, 11/03/08                            | 3,800                       | 3,753                 |
|  |                             | <b>32,326</b>         |
| <b>Brokerage 1.9%</b>                      |                             |                       |
| ◆ <b>Credit Suisse Financial Products</b>  |                             |                       |
| 3.19%, 03/07/05                            | 3,000                       | 3,006                 |
| ◆ <b>Goldman Sachs Group, Inc.</b>         |                             |                       |
| 3.02%, 04/25/05                            | 5,000                       | 5,031                 |
| <b>Morgan Stanley</b>                      |                             |                       |
| 2.94%, 01/15/10                            | 5,275                       | 5,293                 |
|  |                             | <b>13,330</b>         |
| <b>Finance Companies 2.2%</b>              |                             |                       |
| ■ <b>Capital One Financial</b>             |                             |                       |
| 7.13%, 08/01/08                            | 4,470                       | 4,823                 |
| ◆ <b>General Electric Capital Corp.</b>    |                             |                       |
| 2.61%, 03/15/05                            | 5,000                       | 5,012                 |
| <b>HSBC Finance Corp.</b>                  |                             |                       |
| 3.08%, 11/16/09                            | 3,000                       | 3,014                 |
| ◆ <b>International Lease Finance Corp.</b> |                             |                       |
| 3.06%, 04/15/05                            | 3,000                       | 3,014                 |
|  |                             | <b>15,863</b>         |

**Insurance 0.2%**

|   |       |       |
|---|-------|-------|
| ◆ <b>Twin Reefs Pass-Through, Section 3c7, 144A</b> |       |       |
| 3.59%, 03/10/05                                     | 1,500 | 1,509 |
| <b>Real Estate Investment Trust 0.2%</b>            |       |       |
| ▲ <b>Istar Financial, Inc.</b>                      |       |       |
| 3.26%, 03/01/05                                     | 1,000 | 1,002 |

**Industrial 11.5%**
**Basic Industry 0.2%**

|   |       |               |
|---|-------|---------------|
| ◆ <b>FMC Corp.</b>                              |       |               |
| 10.25%, 11/01/09                                | 1,000 | 1,138         |
| <b>Capital Goods 1.7%</b>                       |       |               |
| <b>BAE Asset Systems 2001 Asset Trust, 144A</b> |       |               |
| Series 2001 Class G                             |       |               |
| 6.66%, 09/15/13                                 | 7,091 | 7,732         |
| <b>Georgia-Pacific Corp.</b>                    |       |               |
| 7.38%, 07/15/08                                 | 2,000 | 2,180         |
| <b>Temple - Inland, Inc.</b>                    |       |               |
| 5.00%, 05/17/07                                 | 2,000 | 2,022         |
|   |       | <b>11,934</b> |

## Portfolio Holdings continued

| Security Series<br>Rate, Maturity Date                | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) | Security Series<br>Rate, Maturity Date                          | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|---|-----------------------------|-----------------------|---|-----------------------------|-----------------------|
| <b>Communications 2.6%</b>                            |                             |                       | <b>Consumer Non-Cyclical 1.0%</b>                               |                             |                       |
| ■ America Movil SA de CV, 144A<br>3.33%, 04/27/05     | 3,000                       | 3,016                 | ■ Anheuser Busch Cos, Inc.<br>5.75%, 01/15/11                   | 1,500                       | 1,520                 |
| ■ Directv Holdings/Finance<br>8.38%, 03/15/13         | 3,000                       | 3,405                 | Manor Care, Inc.<br>8.00%, 03/01/08                             | 2,483                       | 2,724                 |
| ■ Panamsat Corp.<br>9.00%, 08/15/14                   | 1,000                       | 1,105                 | ■ Miller Brewing Co., 144A<br>4.25%, 08/15/08                   | 2,000                       | 1,996                 |
| Sprint Capital Corp.<br>7.63%, 01/30/11               | 3,000                       | 3,433                 | ■♦ Stater Brothers Holdings<br>5.99%, 03/15/05                  | 1,000                       | 1,032                 |
| ■ TCI Communications Financing III<br>9.65%, 03/31/27 | 2,500                       | 2,858                 |   |                             | <b>7,272</b>          |
| ■ Telefonos de Mexico SA, 144A<br>4.50%, 11/19/08     | 2,000                       | 2,002                 | <b>Energy 0.6%</b>  |                             |                       |
| Time Warner Entertainment Co.<br>7.25%, 09/01/08      | 2,000                       | 2,179                 | ■ Husky Oil Ltd.<br>8.90%, 08/15/28                             | 4,009                       | <b>4,502</b>          |
|   |                             | <b>17,998</b>         | <b>Transportation 0.6%</b>                                      |                             |                       |
| <b>Consumer Cyclical 4.8%</b>                         |                             |                       | ■ Hertz Corp.<br>3.97%, 05/05/05                                | 2,000                       | 2,005                 |
| ■ Autonation, Inc.<br>9.00%, 08/01/08                 | 2,000                       | 2,270                 | Union Pacific Corp.<br>7.25%, 11/01/08                          | 2,240                       | 2,461                 |
| CVS Corp., 144A<br>6.12%, 01/10/13                    | 5,973                       | 6,233                 |   |                             | <b>4,466</b>          |
| D. R. Horton, Inc.<br>5.00%, 01/15/09                 | 2,000                       | 2,023                 | <b>Utilities 2.7%</b>   |                             |                       |
| Daimler-Chrysler, N.A. Holdings<br>7.20%, 09/01/09    | 3,000                       | 3,296                 | ■ Appalachian Power Co.<br>3.60%, 05/15/08                      | 4,000                       | 3,919                 |
| ■ Ford Motor Credit Co.<br>5.80%, 01/12/09            | 3,000                       | 2,999                 | ■ Atmos Energy Corp.<br>4.00%, 10/15/09                         | 2,000                       | 1,949                 |
| General Motors Acceptance Corp.<br>6.13%, 08/28/07    | 5,000                       | 5,095                 | ■ Centerpoint Energy Resources, Inc.<br>6.50%, 02/01/08         | 3,000                       | 3,173                 |
| International Speedway Corp.<br>4.20%, 05/15/09       | 2,000                       | 1,964                 | Energy Gulf States<br>■ 2.80%, 12/01/09                         | 1,200                       | 1,201                 |
| Mandalay Resort Group<br>6.50%, 07/31/09              | 3,000                       | 3,165                 | ■ 4.88%, 11/01/11   | 2,000                       | 1,973                 |
| ■ Ryland Group, Inc.<br>9.13%, 06/15/11               | 2,000                       | 2,201                 | Ohio Edison Co.<br>4.00%, 05/01/08                              | 2,000                       | 1,980                 |
| ■ Standard Pacific Corp.<br>9.50%, 09/15/10           | 1,000                       | 1,076                 | Pacific Gas and Electric Co.<br>3.60%, 03/01/09                 | 3,000                       | 2,917                 |
| ■ Station Casinos, Inc.<br>6.00%, 04/01/12            | 1,000                       | 1,041                 | ■ Public Services Electric & Gas<br>Series C<br>4.00%, 11/01/08 | 2,000                       | 1,980                 |
| Toll Corp.<br>■ 8.00%, 05/01/09                       | 2,000                       | 2,080                 |   |                             | <b>19,092</b>         |
| ■ 8.25%, 02/01/11                                     | 650                         | 703                   |   |                             |                       |
|   |                             | <b>34,146</b>         |   |                             |                       |



| Security Series     | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|---------------------|-----------------------------|-----------------------|
| Rate, Maturity Date |                             |                       |

**Mortgage-Backed Securities 16.7% of net assets**
**Collateralized Mortgage Obligations 8.2%**
**Countrywide Home Loans**

|                            |       |       |
|----------------------------|-------|-------|
| Series 2004-HYB5 Class 3A1 |       |       |
| 4.76%, 04/20/35            | 8,833 | 8,857 |

**Freddie Mac**

|                      |       |       |
|----------------------|-------|-------|
| Series 2574 Class JM |       |       |
| 5.00%, 03/31/33      | 5,742 | 5,788 |

**Freddie Mac Structured Pass Through Securities**

|                      |        |        |
|----------------------|--------|--------|
| Series H006 Class A2 |        |        |
| 2.84%, 02/15/10      | 8,595  | 8,491  |
| Series H010 Class A3 |        |        |
| 2.72%, 04/15/10      | 15,000 | 14,523 |

**Morgan Stanley Mortgage Loan Trust**

|                           |               |       |
|---------------------------|---------------|-------|
| Series 2004-8AR Class 4A1 |               |       |
| 5.47%, 10/25/34           | 9,165         | 9,203 |
| Series 2004-9 Class 2A    |               |       |
| 6.42%, 11/25/34           | 4,991         | 5,172 |
| Series 2004-9 Class 4A    |               |       |
| 5.65%, 11/25/19           | 5,712         | 5,873 |
|                           | <b>57,907</b> |       |

**U.S. Government Agency Mortgages 8.5%**
**Fannie Mae**

|                                |               |        |
|--------------------------------|---------------|--------|
| 4.50%, 11/01/19                | 11,792        | 11,658 |
| 5.00%, 10/01/19                | 11,663        | 11,759 |
| 5.50%, 07/01/19 to<br>09/01/19 | 27,745        | 28,466 |
| 7.00%, 10/01/08 to<br>07/01/19 | 7,558         | 7,933  |
|                                | <b>59,816</b> |        |

**Asset-Backed Obligations 8.9% of net assets**
**Alter Moneta Receivables, L.L.C.**

|                 |       |       |
|-----------------|-------|-------|
| Series 2003-1   |       |       |
| 2.56%, 03/15/11 | 1,015 | 1,011 |

**Ameriquest Finance NIM Trust**

|                         |     |     |
|-------------------------|-----|-----|
| Series 2001-RN4 Class A |     |     |
| 4.60%, 03/25/05         | 755 | 753 |

**Ameriquest Mortgage Securities, Inc.**

|                         |       |       |
|-------------------------|-------|-------|
| Series 2004-R8 Class M7 |       |       |
| 4.58%, 03/28/05         | 1,000 | 1,021 |

| Security Series     | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|---------------------|-----------------------------|-----------------------|
| Rate, Maturity Date |                             |                       |

|                         |       |       |
|-------------------------|-------|-------|
| Series 2004-R8 Class M9 |       |       |
| 5.40%, 03/28/05         | 1,200 | 1,114 |

**Aria CDO I (Jersey) Ltd.**

|                        |       |       |
|------------------------|-------|-------|
| Series IA-3 Class B1U5 |       |       |
| 3.13%, 04/07/05        | 4,000 | 4,023 |

**Fremont Home Loan Trust**

|                        |       |       |
|------------------------|-------|-------|
| Series 2003-B Class M2 |       |       |
| 4.27%, 03/28/05        | 5,000 | 5,140 |

**Fremont NIM Trust**

|                        |       |       |
|------------------------|-------|-------|
| Series 2004-D Class N1 |       |       |
| 4.50%, 06/25/06        | 2,970 | 2,970 |

**Household Mortgage Loan Trust**

|                         |       |       |
|-------------------------|-------|-------|
| Series 2003-HC2 Class M |       |       |
| 3.20%, 03/21/05         | 1,503 | 1,505 |

**Long Beach Mortgage Loan Trust**

|                        |       |       |
|------------------------|-------|-------|
| Series 2003-4 Class M3 |       |       |
| 4.80%, 03/28/05        | 4,200 | 4,299 |

**Main Street Warehouse Funding Trust**

|                 |       |       |
|-----------------|-------|-------|
| Series 2004-MSD |       |       |
| 4.95%, 03/28/05 | 5,425 | 5,433 |

**Morgan Stanley ABS Capital I**

|                  |     |     |
|------------------|-----|-----|
| Series 2004-NC3N |     |     |
| 6.00%, 03/25/34  | 414 | 414 |

**Novastar Home Equity Loan**

|                        |       |       |
|------------------------|-------|-------|
| Series 2004-2 Class B1 |       |       |
| 4.60%, 03/28/01        | 2,000 | 2,045 |

|                        |       |       |
|------------------------|-------|-------|
| Series 2004-2 Class M4 |       |       |
| 3.85%, 03/28/05        | 3,000 | 3,030 |

**Novastar NIM Trust**

|                 |     |     |
|-----------------|-----|-----|
| Series 2004-N1  |     |     |
| 4.46%, 02/25/34 | 847 | 847 |

|                 |     |     |
|-----------------|-----|-----|
| Series 2004-N2  |     |     |
| 4.46%, 07/25/34 | 986 | 981 |

**Option One Mortgage Loan Trust**

|                       |     |     |
|-----------------------|-----|-----|
| Series 2003-3 Class N |     |     |
| 2.96%, 03/28/05       | 255 | 255 |

**Residential Asset Mortgage Products, Inc.**

|                          |        |       |
|--------------------------|--------|-------|
| Series 2003-RZ3 Class A3 |        |       |
| 2.14%, 02/25/30          | 10,000 | 9,935 |

**Residential Asset Securitization Trust**

|                         |       |       |
|-------------------------|-------|-------|
| Series 2004-A6 Class A1 |       |       |
| 5.00%, 08/25/19         | 9,238 | 9,260 |

**Securitized Asset Backed NIM Trust**

|                 |       |       |
|-----------------|-------|-------|
| Series 2004-DO2 |       |       |
| 5.50%, 09/25/34 | 2,333 | 2,314 |

**Portfolio Holdings** continued

| Security Series   | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|---|-----------------------------|-----------------------|
| Rate, Maturity Date   |                             |                       |
| Series 2004-OP2 Class N<br>5.50%, 08/25/34                                      | 1,377                       | 1,369                 |
| ▮ <b>Terrapin Funding, L.L.C.</b><br>Series 2003-1A Class B1<br>3.89%, 03/08/05 | 5,000                       | 5,019                 |
|   |                             | <b>62,738</b>         |

**Commercial Paper & Other Corporate Obligations**

0.4% of net assets

|  |       |              |
|--|-------|--------------|
| <b>Cox Communications, Inc., Section 4(2)</b><br>2.75%, 03/01/05 | 3,000 | <b>3,000</b> |
|--|-------|--------------|

|                               |                       |
|-------------------------------|-----------------------|
| Security and Number of Shares | Value<br>(\$ x 1,000) |
|-------------------------------|-----------------------|

**Preferred Stock** 2.2% of net assets

|   |               |
|---|---------------|
| ▮ <b>Fannie Mae, Series J</b><br>110,000                  | 5,474         |
| ▮ <b>Fannie Mae, Series O</b><br>50,000                   | 2,777         |
| ▮ <b>Shell Frontier Oil &amp; Gas, Series D</b><br>25,000 | 2,500         |
| ▮ <b>Zurich Regcaps Funding Trust IV, 144A</b><br>30,000  | 2,934         |
| ▮ <b>Zurich Regcaps Funding Trust VI, 144A</b><br>20,000  | 1,939         |
|   | <b>15,624</b> |

|                               |                       |
|-------------------------------|-----------------------|
| Security and Number of Shares | Value<br>(\$ x 1,000) |
|-------------------------------|-----------------------|

**Other Investment Companies** 0.2% of net assets

|   |         |            |
|---|---------|------------|
| <b>Provident Institutional Funds—<br/>Fed Funds Portfolio</b> | 974,707 | <b>975</b> |
|---|---------|------------|

End of investments.

| Security Series     | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|---------------------|-----------------------------|-----------------------|
| Rate, Maturity Date |                             |                       |

**Collateral Invested for Securities on Loan**

32.0% of net assets

**Short-Term Investments** 31.3%

|   |         |                |
|---|---------|----------------|
| <b>Chase Manhattan Bank Time Deposit</b><br>2.50%, 03/01/05 | 42,030  | 42,030         |
| <b>UBS Financial Services</b><br>2.59%, 03/01/05            | 52,599  | 52,599         |
| <b>WestLB Time Deposit</b><br>2.61%, 03/01/05               | 126,283 | 126,283        |
|   |         | <b>220,912</b> |

|                               |                       |
|-------------------------------|-----------------------|
| Security and Number of Shares | Value<br>(\$ x 1,000) |
|-------------------------------|-----------------------|

**Other Investment Companies** 0.7%

|   |           |              |
|---|-----------|--------------|
| <b>Institutional Money Market<br/>Trust</b> | 5,429,815 | <b>5,430</b> |
|---|-----------|--------------|

End of collateral invested for securities on loan.

In addition to the above, the fund held the following at 2/28/05. All numbers are x 1,000 except number of futures contracts.

**Futures Contracts**

|   | Number of<br>Contracts | Contract<br>Value | Unrealized<br>(Losses) |
|---|------------------------|-------------------|------------------------|
| 2 Year, Long<br>U.S. Treasury Note,<br>expires 06/30/05 | 270                    | 55,995            | <b>(160)</b>           |

## Statement of

**Assets and Liabilities**

As of February 28, 2005; unaudited. All numbers are x 1,000 except NAV.

**Assets**

|   |                |
|---|----------------|
| Investments, at value (including \$219,549 of securities on loan) | 702,361        |
| Collateral invested for securities on loan                        | 226,342        |
| Receivables:  |                |
| Fund shares sold  | 1,364          |
| Interest  | 5,473          |
| Dividends   | 112            |
| Prepaid expenses  | 30             |
| <b>Total assets</b>   | <b>935,682</b> |

**Liabilities**

|   |                |
|---|----------------|
| Collateral held for securities on loan      | 226,342        |
| Payables:                                   |                |
| Fund shares redeemed                        | 1,522          |
| Dividends to shareholders                   | 427            |
| Investments bought                          | 1,000          |
| Investment adviser and administrator fees   | 15             |
| Transfer agent and shareholder service fees | 15             |
| Due to broker for futures                   | 59             |
| Accrued expenses                            | 74             |
| <b>Total liabilities</b>                    | <b>229,454</b> |

**Net Assets**

|                          |                  |
|--------------------------|------------------|
| <b>Total assets</b>      | 935,682          |
| <b>Total liabilities</b> | 229,454          |
| <b>Net assets</b>        | <b>\$706,228</b> |

**Net Assets by Source**

|  |         |
|--|---------|
| Capital received from investors                  | 713,300 |
| Distributions in excess of net investment income | (250)   |
| Net realized capital losses                      | (707)   |
| Net unrealized capital losses                    | (6,115) |

**Net Asset Value (NAV)**

|                   |          |                           |          |            |
|-------------------|----------|---------------------------|----------|------------|
| <b>Net Assets</b> | <b>÷</b> | <b>Shares Outstanding</b> | <b>=</b> | <b>NAV</b> |
| \$706,228         |          | 70,276                    |          | \$10.05    |

Unless stated, all numbers are x 1,000.

The amortized cost of the fund's securities was \$708,316.

Includes certain restricted but deemed liquid 144A and Section 4(2) securities worth \$38,886, or 5.5% of the fund's total net assets.

Not counting short-term obligations and government securities, the fund's security transactions during the period were:

|                  |           |
|------------------|-----------|
| Purchases        | \$85,524  |
| Sales/maturities | \$113,884 |

The fund's long-term government security transactions were:

|                  |           |
|------------------|-----------|
| Purchases        | \$283,047 |
| Sales/maturities | \$242,009 |

The fund's total security transactions with other Schwab Funds during the period were \$16,274.

These derive from investments, futures and short sales.

**Federal Tax Data**

|   |                  |
|---|------------------|
| <b>Portfolio cost</b>                   | \$708,450        |
| <b>Net unrealized gains and losses:</b> |                  |
| Gains                                   | \$1,609          |
| Losses                                  | (7,698)          |
|   | <b>(\$6,089)</b> |

**As of August 31, 2004:****Undistributed earnings:**

|                         |       |
|-------------------------|-------|
| Ordinary income         | \$382 |
| Long-term capital gains | \$329 |

|                                |                |
|--------------------------------|----------------|
| <b>Capital losses utilized</b> | <b>\$3,151</b> |
|--------------------------------|----------------|

## Statement of

**Operations**

For September 1, 2004 through February 28, 2005; unaudited. All numbers are x 1,000.

Unless stated, all numbers are x 1,000.

**Investment Income**

|                                |               |
|--------------------------------|---------------|
| Interest                       | \$11,644      |
| Securities on loan             | 117           |
| Dividends                      | + 156         |
| <b>Total investment income</b> | <b>11,917</b> |

**Net Realized Gains and Losses**

|  |            |
|--|------------|
| Net realized gains on investments sold   | 936        |
| Net realized losses on futures contracts | + (260)    |
| <b>Net realized gains</b>                | <b>676</b> |

**Net Unrealized Gains and Losses**

|  |                 |
|--|-----------------|
| Net unrealized losses on investments       | (10,311)        |
| Net unrealized losses on futures contracts | + (425)         |
| <b>Net realized losses</b>                 | <b>(10,736)</b> |

**Expenses**

|   |              |
|---|--------------|
| Investment adviser and administrator fees   | 991          |
| Transfer agent and shareholder service fees | 901          |
| Trustees' fees                              | 5            |
| Custodian and portfolio accounting fees     | 34           |
| Professional fees                           | 16           |
| Registration fees                           | 21           |
| Shareholder reports                         | 48           |
| Other expenses                              | + 13         |
| Total expenses                              | 2,029        |
| Expense reduction                           | - 47         |
| <b>Net expenses</b>                         | <b>1,982</b> |

**Decrease in Net Assets from Operations**

|   |                   |
|---|-------------------|
| <b>Total investment income</b>                | <b>11,917</b>     |
| <b>Net expenses</b>                           | <b>- 1,982</b>    |
| <b>Net investment income</b>                  | <b>9,935</b>      |
| <b>Net realized gains</b>                     | <b>676</b>        |
| <b>Net unrealized losses</b>                  | <b>+ (10,736)</b> |
| <b>Decrease in net assets from operations</b> | <b>(\$125)</b>    |

Calculated as a percentage of average daily net assets: 0.30% of the first \$500 million and 0.22% of assets beyond that. These fees are paid to Charles Schwab Investment Management, Inc. (CSIM).

Calculated as a percentage of average daily net assets: for transfer agent services, 0.05% of the fund's assets; for shareholder services, 0.20% of the fund's assets. These fees are paid to Charles Schwab & Co., Inc. (Schwab).

For the fund's independent trustees only.

This reduction was made by the investment adviser (CSIM). It reflects a guarantee by CSIM and Schwab to limit the annual operating expenses of this fund through at least November 15, 2005, to 0.55% of average daily net assets. This limit excludes interest, taxes and certain non-routine expenses.

These add up to a net loss on investments of \$10,060.

## Statements of

**Changes in Net Assets**

For the current and prior report periods. All numbers are x 1,000.  
Figures for current period are unaudited.

**Operations**

|   | 9/1/04-2/28/05 | 9/1/03-8/31/04 |
|---|----------------|----------------|
| Net investment income                                     | \$9,935        | \$19,075       |
| Net realized gains  | 676            | 3,508          |
| Net unrealized gains or losses                            | + (10,736)     | 246            |
| <b>Increase or decrease in net assets from operations</b> | <b>(125)</b>   | <b>22,829</b>  |

**Distributions Paid**

|                                       |                 |                 |
|---------------------------------------|-----------------|-----------------|
| Dividends from net investment income  | \$10,191        | \$19,204        |
| Distributions from net realized gains | + 1,173         | —               |
| <b>Total distributions</b>            | <b>\$11,364</b> | <b>\$19,204</b> |

**Transactions in Fund Shares**

|  | 9/1/04-2/28/05 |                   | 9/1/03-8/31/04 |                 |
|--|----------------|-------------------|----------------|-----------------|
|  | SHARES         | VALUE             | SHARES         | VALUE           |
| Shares sold                            | 13,387         | \$136,051         | 39,870         | \$406,912       |
| Shares reinvested                      | 867            | 8,786             | 1,507          | 15,354          |
| Shares redeemed                        | + (15,327)     | (155,475)         | (33,889)       | (345,056)       |
| <b>Net transactions in fund shares</b> | <b>(1,073)</b> | <b>(\$10,638)</b> | <b>7,488</b>   | <b>\$77,210</b> |

**Shares Outstanding and Net Assets**

|                            | 9/1/04-2/28/05 |                  | 9/1/03-8/31/04 |                  |
|----------------------------|----------------|------------------|----------------|------------------|
|                            | SHARES         | NET ASSETS       | SHARES         | NET ASSETS       |
| Beginning of period        | 71,349         | \$728,355        | 63,861         | \$647,520        |
| Total increase or decrease | + (1,073)      | (22,127)         | 7,488          | 80,835           |
| <b>End of period</b>       | <b>70,276</b>  | <b>\$706,228</b> | <b>71,349</b>  | <b>\$728,355</b> |

Unless stated, all numbers are x 1,000.

The tax-basis components of distributions for the period ended 08/31/04 are:

|                         |          |
|-------------------------|----------|
| Ordinary income         | \$19,204 |
| Long-term capital gains | \$—      |

Figures for shares represent shares sold plus shares reinvested, minus shares redeemed. Figures for net assets represent the changes in net assets from operations plus the changes in value from transactions in fund shares, minus distributions paid.

Includes distributions in excess of net investment income in the amount of \$250 at the end of the current period and net investment income not yet distributed in the amount of \$6 at the end of the prior period.

# Schwab Total Bond Market Fund™

## Financial Statements

### Financial Highlights

|   | 9/1/04–<br>2/28/05* | 9/1/03–<br>8/31/04 | 9/1/02–<br>8/31/03 | 9/1/01–<br>8/31/02 | 9/1/00–<br>8/31/01 | 9/1/99–<br>8/31/00 |
|---|---------------------|--------------------|--------------------|--------------------|--------------------|--------------------|
| <b>Per-Share Data (\$)</b>                  |                     |                    |                    |                    |                    |                    |
| Net asset value at beginning of period      | 10.15               | 10.20              | 10.22              | 10.24              | 9.65               | 9.58               |
| Income from investment operations:          |                     |                    |                    |                    |                    |                    |
| Net investment income                       | 0.16                | 0.31               | 0.34               | 0.47               | 0.60               | 0.61               |
| Net realized and unrealized gains or losses | (0.02)              | 0.32               | 0.10               | 0.13               | 0.59               | 0.07               |
| Total income from investment operations     | 0.14                | 0.63               | 0.44               | 0.60               | 1.19               | 0.68               |
| Less distributions:                         |                     |                    |                    |                    |                    |                    |
| Dividends from net investment income        | (0.16)              | (0.33)             | (0.37)             | (0.46)             | (0.60)             | (0.61)             |
| Distributions from net realized gains       | (0.12)              | (0.35)             | (0.09)             | (0.16)             | —                  | —                  |
| Total distributions                         | (0.28)              | (0.68)             | (0.46)             | (0.62)             | (0.60)             | (0.61)             |
| Net asset value at end of period            | 10.01               | 10.15              | 10.20              | 10.22              | 10.24              | 9.65               |
| Total return (%)                            | 1.40 <sup>1</sup>   | 6.37               | 4.37               | 6.18               | 12.68              | 7.36               |
| <b>Ratios/Supplemental Data (%)</b>         |                     |                    |                    |                    |                    |                    |
| Ratios to average net assets:               |                     |                    |                    |                    |                    |                    |
| Net operating expenses                      | 0.54 <sup>2</sup>   | 0.52               | 0.43               | 0.35               | 0.35               | 0.36 <sup>3</sup>  |
| Gross operating expenses                    | 0.54 <sup>2</sup>   | 0.54               | 0.54               | 0.57               | 0.58               | 0.63               |
| Net investment income                       | 3.18 <sup>2</sup>   | 3.08               | 3.36               | 4.66               | 6.00               | 6.42               |
| Portfolio turnover rate                     | 111 <sup>1</sup>    | 223                | 121                | 74                 | 153                | 135                |
| Net assets, end of period (\$ x 1,000,000)  | 1,119               | 1,042              | 1,025              | 1,053              | 926                | 647                |

\* Unaudited.

<sup>1</sup> Not annualized.

<sup>2</sup> Annualized.

<sup>3</sup> The ratio of net operating expenses would have been 0.35% if certain non-routine expenses (proxy fees) had not been included.

**Portfolio Holdings** as of February 28, 2005, unaudited

This section shows all the securities in the fund's portfolio and their value, as of the report date.

The fund files its complete schedule of portfolio holdings with the SEC for the first and third quarters of each fiscal year on Form N-Q. The fund's Forms N-Q is available on the SEC's website at <http://www.sec.gov> and may be reviewed and copied at the SEC's Public Reference Room in Washington, D.C. Call 1-800-SEC-0330 for information on the operation of the Public Reference Room. The schedule of portfolio holdings filed on a fund's most recent Form N-Q is available by visiting Schwab's website at [www.schwab.com/schwabfunds](http://www.schwab.com/schwabfunds).

We use the symbols below to designate certain characteristics of the securities.

- ▲ Delayed-delivery security
- ▷ Variable-rate security
- Callable security
- All or a portion of this security is held as collateral for futures contracts and delayed-delivery security
- ◆ All or a portion of the security is on loan

For fixed-rate obligations, the rate shown is the interest rate (the rate established when the obligation was issued) and the maturity date shown is the stated legal maturity. For variable-rate obligations, the rate shown is the rate as of the report date, and the maturity

shown is the later of the next interest rate change date or demand date.

| <b>Holdings by Category</b>                                     | <b>Cost</b><br>(\$x1,000) | <b>Value</b><br>(\$x1,000) |
|---|---------------------------|----------------------------|
| <b>40.8% Mortgage-Backed Securities</b>                         | 457,927                   | 456,547                    |
| <b>26.1% U.S. Government Securities</b>                         | 289,561                   | 292,637                    |
| <b>22.6% Corporate Bonds</b>                                    | 251,794                   | 253,125                    |
| <b>21.5% Asset-Backed Obligations</b>                           | 239,593                   | 240,026                    |
| <b>10.1% Commercial Paper &amp; Other Corporate Obligations</b> | 112,454                   | 112,454                    |
| <b>2.7% Preferred Stock</b>                                     | 29,742                    | 30,286                     |
| <b>0.1% Other Investment Companies</b>                          | 961                       | 961                        |
| <b>123.9% Total Investments</b>                                 | <b>1,382,032</b>          | <b>1,386,036</b>           |
| <b>(0.9)% Short Sales</b>                                       | (9,691)                   | (9,600)                    |
| <b>14.0% Collateral Invested for Securities on Loan</b>         | 156,336                   | 156,336                    |
| <b>(37.0)% Other Assets and Liabilities</b>                     |                           | (413,762)                  |
| <b>100.0% Net Assets</b>  |                           | <b>1,119,010</b>           |

| <b>Security Series</b><br>Rate, Maturity Date | <b>Face Amount</b><br>(\$ x 1,000) | <b>Value</b><br>(\$ x 1,000) |
|---|------------------------------------|------------------------------|
|---|------------------------------------|------------------------------|

**Mortgage-Backed Securities** 40.8% of net assets**Collateralized Mortgage Obligations** 2.7%■ **Freddie Mac**

|                      |       |       |
|----------------------|-------|-------|
| Series 2574 Class JM |       |       |
| 5.00%, 03/31/33      | 5,742 | 5,788 |

■ **Freddie Mac Structured Pass Through Securities**

|                      |        |               |
|----------------------|--------|---------------|
| Series H010 Class A3 |        |               |
| 2.72%, 04/15/10      | 25,000 | 24,205        |
|                      |        | <b>29,993</b> |

| <b>Security Series</b><br>Rate, Maturity Date | <b>Face Amount</b><br>(\$ x 1,000) | <b>Value</b><br>(\$ x 1,000) |
|---|------------------------------------|------------------------------|
|---|------------------------------------|------------------------------|

**U.S. Government Agency Mortgages** 38.1%**Fannie Mae**

|                               |        |        |
|-------------------------------|--------|--------|
| 5.00%, 07/01/19               | 1,842  | 1,857  |
| ▲ 5.00%, 02/01/35 to 03/01/35 | 31,235 | 31,167 |
| ■ 5.50%, 07/27/12 to 08/01/17 | 9,893  | 10,149 |
| ■ 5.50%, 04/01/33 to 03/01/35 | 54,213 | 54,743 |
| ■ 6.00%, 09/02/25 to 11/01/34 | 26,830 | 27,552 |
| ■ 6.50%, 09/01/22 to 09/01/33 | 17,662 | 18,434 |
| ■ 7.00%, 04/16/06 to 04/09/16 | 5,745  | 6,058  |

## Portfolio Holdings continued

| Security Series    | Rate, Maturity Date            | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|--------------------|--------------------------------|-----------------------------|-----------------------|
| ■                  | 7.50%, 12/28/24                | 3,930                       | 4,208                 |
| TBA                |                                |                             |                       |
| ▲                  | 4.50%, 03/01/20                | 20,000                      | 19,738                |
| ▲                  | 5.00%, 03/01/20                | 15,000                      | 15,103                |
| ▲                  | 5.00%, 03/01/35 to<br>04/01/35 | 73,000                      | 71,923                |
| ▲                  | 5.50%, 03/01/35                | 30,000                      | 30,253                |
| ▲                  | 6.50%, 03/01/35                | 14,000                      | 14,582                |
| <b>Freddie Mac</b> |                                |                             |                       |
| ■                  | 6.00%, 10/23/24                | 5,817                       | 5,977                 |
| ■                  | 6.50%, 08/25/24                | 5,984                       | 6,236                 |
| TBA                |                                |                             |                       |
| ▲                  | 6.00%, 03/01/20                | 28,000                      | 29,094                |
| <b>Ginnie Mae</b>  |                                |                             |                       |
|                    | 6.00%, 06/15/33 to<br>12/15/33 | 7,823                       | 8,086                 |
|                    | 7.50%, 03/15/32                | 1,949                       | 2,092                 |
| TBA                |                                |                             |                       |
| ▲                  | 6.50%, 03/01/34                | 10,000                      | 10,494                |
| ▲                  | 6.00%, 03/01/35                | 27,000                      | 27,861                |
| ▲                  | 7.00%, 03/01/35                | 19,000                      | 20,116                |
| ▲                  | 8.00%, 03/01/35                | 10,000                      | 10,831                |
|                    |                                |                             | <b>426,554</b>        |

**U.S. Government Securities 26.1% of net assets****U.S. Government Agency Securities 6.1%**

|                    |                 |        |               |
|--------------------|-----------------|--------|---------------|
| <b>Fannie Mae</b>  |                 |        |               |
| ■◆                 | 2.50%, 06/15/08 | 3,000  | 2,860         |
| ■◆                 | 6.63%, 09/15/09 | 32,500 | 35,653        |
| ■                  | 4.63%, 10/15/14 | 12,500 | 12,490        |
| ■                  | 6.63%, 11/15/30 | 4,000  | 4,865         |
| <b>Freddie Mac</b> |                 |        |               |
|                    | 2.75%, 10/15/06 | 12,500 | 12,337        |
|                    |                 |        | <b>68,205</b> |

**U.S. Treasury Obligations 20.0%****Treasury Inflation Protection Security**

|  |                 |        |        |
|--|-----------------|--------|--------|
|  | 1.88%, 07/15/13 | 18,500 | 19,628 |
|  | 2.00%, 07/15/14 | 10,000 | 10,391 |

**U.S. Treasury Bills**

|   |                 |     |     |
|---|-----------------|-----|-----|
| ■ | 2.19%, 03/10/05 | 265 | 265 |
| ■ | 2.44%, 05/05/05 | 115 | 115 |
| ■ | 2.55%, 05/19/05 | 210 | 209 |

| Security Series            | Rate, Maturity Date | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|----------------------------|---------------------|-----------------------------|-----------------------|
| <b>U.S. Treasury Bonds</b> |                     |                             |                       |
| ■                          | 9.88%, 11/15/15     | 3,000                       | 4,382                 |
| ■                          | 7.25%, 05/15/16     | 2,500                       | 3,104                 |
| ■                          | 9.00%, 11/15/18     | 7,000                       | 10,095                |
| ■                          | 8.00%, 11/15/21     | 7,000                       | 9,626                 |
| ■◆                         | 7.25%, 08/15/22     | 6,500                       | 8,411                 |
| ■◆                         | 6.25%, 08/15/23     | 12,700                      | 14,970                |
| ■                          | 6.13%, 11/15/27     | 7,500                       | 8,874                 |
| ■                          | 5.25%, 02/15/29     | 5,000                       | 5,332                 |
| ■◆                         | 6.13%, 08/15/29     | 1,000                       | 1,193                 |
| ■◆                         | 6.25%, 05/15/30     | 7,000                       | 8,506                 |
| ■◆                         | 5.38%, 02/15/31     | 18,010                      | 19,808                |

**U.S. Treasury Notes**

|    |                 |        |        |
|----|-----------------|--------|--------|
| ◆  | 1.63%, 02/28/06 | 4,000  | 3,937  |
| ◆  | 2.00%, 05/15/06 | 3,000  | 2,953  |
| ■◆ | 2.50%, 05/31/06 | 7,000  | 6,927  |
| ◆  | 2.75%, 07/31/06 | 3,000  | 2,972  |
|    | 2.38%, 08/15/06 | 2,500  | 2,463  |
| ◆  | 6.50%, 10/15/06 | 12,900 | 13,509 |
| ■◆ | 2.63%, 11/15/06 | 6,000  | 5,913  |
| ◆  | 6.63%, 05/15/07 | 2,000  | 2,127  |
| ◆  | 3.25%, 08/15/07 | 1,500  | 1,486  |
| ◆  | 6.13%, 08/15/07 | 2,000  | 2,115  |
| ◆  | 3.00%, 11/15/07 | 1,100  | 1,081  |
| ◆  | 3.13%, 09/15/08 | 2,000  | 1,954  |
| ◆  | 3.13%, 10/15/08 | 2,000  | 1,952  |
| ◆  | 3.38%, 12/15/08 | 1,000  | 983    |
|    | 4.00%, 06/15/09 | 2,000  | 2,006  |
| ■◆ | 3.50%, 12/15/09 | 12,000 | 11,745 |
| ◆  | 3.63%, 01/15/10 | 11,000 | 10,819 |
|    | 6.50%, 02/15/10 | 600    | 667    |
| ◆  | 5.75%, 08/15/10 | 2,100  | 2,274  |
| ◆  | 5.00%, 02/15/11 | 9,620  | 10,079 |
| ◆  | 4.25%, 11/15/14 | 5,000  | 4,954  |
| ◆  | 4.00%, 02/15/15 | 6,800  | 6,607  |

**224,432****Corporate Bonds 22.6% of net assets****Finance 6.1%****Banking 3.6%****Bumiputra-Commerce Bank**

|  |                 |       |       |
|--|-----------------|-------|-------|
|  | 5.13%, 10/16/13 | 3,000 | 3,041 |
|--|-----------------|-------|-------|

**Citigroup, Inc.**

|  |                 |       |       |
|--|-----------------|-------|-------|
|  | 5.00%, 09/15/14 | 5,000 | 5,023 |
|--|-----------------|-------|-------|



| Security Series<br>Rate, Maturity Date                            | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|---|-----------------------------|-----------------------|
| ■ Deutsche Bank Capital Trust, 144A<br>Class B<br>4.35%, 03/30/05 | 10,000                      | 10,050                |
| ■ Doral Financial Corp.<br>3.50%, 04/20/05                        | 3,000                       | 3,000                 |
| ■ Emigrant Bancorp., 144A<br>6.25%, 06/15/14                      | 2,000                       | 2,074                 |
| ■ Emigrant Capital Trust I, 144A<br>4.95%, 03/10/05               | 1,000                       | 997                   |
| HSBC Finance Corp.<br>3.08%, 05/16/05                             | 7,000                       | 7,032                 |
| ■ Industrial Bank of Korea, 144A<br>4.00%, 05/19/14               | 1,000                       | 969                   |
| ■ JP Morgan Chase & Co.<br>5.13%, 09/15/14                        | 5,000                       | 5,041                 |
| ■ RBS Capital Trust IV<br>3.35%, 03/31/05                         | 3,000                       | 3,057                 |
|   |                             | <b>40,284</b>         |
| <b>Brokerage 1.5%</b>   |                             |                       |
| ■ Credit Suisse Financial Products<br>3.19%, 03/07/05             | 4,000                       | 4,008                 |
| ■ Goldman Sachs Capital I<br>6.35%, 02/15/34                      | 3,000                       | 3,190                 |
| Merrill Lynch & Co.<br>3.12%, 03/02/05                            | 5,000                       | 5,022                 |
| ■ Morgan Stanley<br>4.75%, 04/01/14                               | 5,000                       | 4,877                 |
|   |                             | <b>17,097</b>         |
| <b>Finance Companies 0.6%</b>                                     |                             |                       |
| ■ General Electric Capital Corp.<br>2.75%, 03/08/05               | 5,000                       | 5,034                 |
| ■ International Lease Finance Corp.<br>3.06%, 04/15/05            | 2,000                       | 2,010                 |
|   |                             | <b>7,044</b>          |
| <b>Insurance 0.2%</b>   |                             |                       |
| ■ Twin Reefs Pass-Through, Section 3C7, 144A<br>3.59%, 03/10/05   | 2,200                       | 2,213                 |
| <b>Real Estate Investment Trust 0.2%</b>                          |                             |                       |
| ▲ Istar Financial, Inc.<br>3.26%, 03/01/05                        | 2,000                       | 2,005                 |

| Security Series<br>Rate, Maturity Date   | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|--|-----------------------------|-----------------------|
| <b>Industrial 13.0%</b>  |                             |                       |
| <b>Basic Industry 0.2%</b>   |                             |                       |
| FMC Corp.<br>10.25%, 11/01/09  | 2,000                       | 2,275                 |
| <b>Capital Goods 1.7%</b>  |                             |                       |
| ■ BAE Asset Systems 2001 Asset Trust, 144A<br>Series 2001 Class G<br>6.66%, 09/15/13 | 12,929                      | 14,099                |
| Georgia Pacific<br>7.70%, 06/15/15   | 2,000                       | 2,335                 |
| Temple - Inland, Inc.<br>5.00%, 05/17/07   | 3,000                       | 3,032                 |
|  |                             | <b>19,466</b>         |
| <b>Communications 3.0%</b>   |                             |                       |
| ■ America Movil SA de CV, 144A<br>3.33%, 04/27/05                                    | 4,000                       | 4,022                 |
| ■ Directv Holdings/Finance<br>8.38%, 03/15/13  | 5,000                       | 5,675                 |
| News America, Inc. 144A<br>6.20%, 12/15/34   | 3,000                       | 3,105                 |
| ■ Panamsat Corp.<br>9.00%, 08/15/14  | 2,000                       | 2,210                 |
| Sprint Capital Corp.<br>8.38%, 03/15/12  | 3,000                       | 3,595                 |
| ■ TCI Communications Financing III<br>9.65%, 03/31/27                                | 3,000                       | 3,429                 |
| ■ TCI Communications, Inc.<br>9.80%, 02/01/12  | 4,000                       | 5,112                 |
| ■ Telefonos de Mexico SA, 144A<br>4.50%, 11/19/08                                    | 3,000                       | 3,003                 |
| ■ Verizon New England, Inc.<br>6.50%, 09/15/11                                       | 3,000                       | 3,268                 |
|  |                             | <b>33,419</b>         |
| <b>Consumer Cyclical 4.6%</b>  |                             |                       |
| ■ Autonation, Inc.<br>9.00%, 08/01/08  | 3,000                       | 3,405                 |
| CVS Corp.<br>5.30%, 01/11/27   | 9,972                       | 9,915                 |
| ■ D.R. Horton, Inc.<br>5.63%, 09/15/14   | 3,000                       | 3,034                 |
| ■ Daimler-Chrysler, NA Holdings<br>8.50%, 01/18/31                                   | 2,000                       | 2,556                 |

## Portfolio Holdings continued

| Security Series                        | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) | Security Series                  | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|--|-----------------------------|-----------------------|----------------------------------|-----------------------------|-----------------------|
| Rate, Maturity Date                    |                             |                       | Rate, Maturity Date              |                             |                       |
| <b>Ford Motor Credit Co.</b>           |                             |                       | <b>■ XTO Energy, Inc.</b>        |                             |                       |
| 5.70%, 01/15/10                        | 3,000                       | 2,945                 | 5.00%, 01/31/15                  | 3,000                       | 2,980                 |
| ■ 7.38%, 02/01/11                      | 3,000                       | 3,143                 |                                  |                             | <b>15,925</b>         |
| <b>General Motors Acceptance Corp.</b> |                             |                       | <b>Transportation 0.8%</b>       |                             |                       |
| 5.85%, 01/14/09                        | 5,000                       | 4,959                 | ■ Burlington North Santa Fe      |                             |                       |
| ■ International Speedway Corp.         |                             |                       | 4.88%, 01/15/15                  | 3,000                       | 2,974                 |
| 4.20%, 04/15/09                        | 3,000                       | 2,946                 | ■ Hertz Corp.                    |                             |                       |
| ■ Mandalay Resort Group                |                             |                       | 3.97%, 05/05/05                  | 3,000                       | 3,007                 |
| 6.50%, 07/31/09                        | 4,500                       | 4,747                 | ■ Union Pacific Corp.            |                             |                       |
| <b>Mohegan Tribal Gaming, 144A</b>     |                             |                       | 6.25%, 05/01/34                  | 3,000                       | 3,249                 |
| 6.13%, 02/15/13                        | 500                         | 512                   |                                  |                             | <b>9,230</b>          |
| ■ Ryland Group, Inc.                   |                             |                       | <b>Utilities 3.5%</b>            |                             |                       |
| 9.13%, 06/15/11                        | 2,500                       | 2,751                 | ■ Appalachian Power Co.          |                             |                       |
| <b>Station Casinos, Inc.</b>           |                             |                       | Series H                         |                             |                       |
| 6.00%, 04/01/12                        | 2,000                       | 2,082                 | 5.95%, 05/15/33                  | 3,000                       | 3,090                 |
| ■ Standard Pacific Corp.               |                             |                       | ■ Atmos Energy Corp.             |                             |                       |
| 9.50%, 09/15/10                        | 2,000                       | 2,153                 | 4.00%, 04/15/05                  | 3,000                       | 2,923                 |
| ■ Time Warner Entertainment Co.        |                             |                       | ■ Centerpoint Energy Resources   |                             |                       |
| 8.88%, 10/01/12                        | 2,000                       | 2,472                 | Series B                         |                             |                       |
| <b>Toll Corp.</b>                      |                             |                       | 7.88%, 04/01/13                  | 3,000                       | 3,547                 |
| ■ 8.00%, 05/01/09                      | 1,000                       | 1,040                 | ■ Columbia Energy Group          |                             |                       |
| ■ 8.25%, 02/01/11                      | 2,000                       | 2,163                 | Series F                         |                             |                       |
|  |                             | <b>50,823</b>         | 7.42%, 11/28/15                  | 5,000                       | 5,216                 |
| <b>Consumer Non-Cyclical 1.3%</b>      |                             |                       | <b>Energy Transfer Partners</b>  |                             |                       |
| ■ Anheuser Busch Cos, Inc.             |                             |                       | 5.95%, 02/01/15                  | 3,000                       | 3,071                 |
| 5.75%, 01/15/11                        | 3,500                       | 3,546                 | <b>Entergy Gulf States</b>       |                             |                       |
| <b>Highmark, Inc., 144A</b>            |                             |                       | 2.48%, 12/01/09                  | 2,400                       | 2,402                 |
| 6.80%, 08/15/13                        | 2,000                       | 2,197                 | ■ 4.88%, 11/01/11                | 3,000                       | 2,960                 |
| ■ Manor Care, Inc.                     |                             |                       | ■ Magellan Midstream Partners    |                             |                       |
| 8.00%, 03/01/08                        | 1,333                       | 1,462                 | 5.65%, 10/15/16                  | 3,000                       | 3,047                 |
| ■ Miller Brewing Co. 144A              |                             |                       | ■ Ohio Edison Co.                |                             |                       |
| 5.50%, 08/15/13                        | 5,000                       | 5,169                 | 5.45%, 05/01/15                  | 4,000                       | 4,061                 |
| ■ Stater Brothers Holdings             |                             |                       | ■ Pacific Gas and Electric Co.   |                             |                       |
| 5.99%, 03/15/05                        | 2,000                       | 2,065                 | 6.05%, 03/01/34                  | 2,000                       | 2,116                 |
|  |                             | <b>14,439</b>         | ■ Public Services Electric & Gas |                             |                       |
| <b>Energy 1.4%</b>                     |                             |                       | Series C                         |                             |                       |
| ■ Husky Oil Ltd.                       |                             |                       | 4.00%, 11/01/08                  | 3,000                       | 2,970                 |
| 8.90%, 08/15/28                        | 6,000                       | 6,738                 | <b>Westar Energy, Inc.</b>       |                             |                       |
| ■ Phillips Petroleum Co.               |                             |                       | 6.00%, 07/01/14                  | 3,258                       | 3,502                 |
| 9.38%, 02/15/11                        | 5,000                       | 6,207                 |                                  |                             | <b>38,905</b>         |

| Security Series<br>Rate, Maturity Date                          | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|---|-----------------------------|-----------------------|
| <b>Asset-Backed Obligations</b> 21.5% of net assets             |                             |                       |
| ■ <b>Aegis Asset Backed Securities Trust</b>                    |                             |                       |
| Series 2003-1 Class A1<br>3.05%, 03/28/05                       | 6,260                       | 6,292                 |
| <b>Ameriquest Finance NIM Trust</b>                             |                             |                       |
| Series 2001-RN4 Class A<br>4.60%, 07/25/34                      | 1,108                       | 1,104                 |
| <b>Ameriquest Mortgage Securities, Inc.</b>                     |                             |                       |
| Series 2003-13 Class AV2<br>3.01%, 03/28/05                     | 15,205                      | 15,266                |
| ■ <b>Amortizing Residential Collateral Trust</b>                |                             |                       |
| Series 2002-BC6 Class A2<br>3.00%, 03/28/05                     | 10,781                      | 10,807                |
| ■ <b>Aria CDO I (Jersey) Ltd.</b>                               |                             |                       |
| Series 1A-3 Class B1U5<br>3.13%, 04/07/05                       | 6,000                       | 6,035                 |
| ■ <b>Asset Backed Securities Corp. Home Equity Loan Trust</b>   |                             |                       |
| Series 2003-HE1 Class A2<br>3.09%, 03/15/05                     | 1,779                       | 1,789                 |
| ▶ <b>Capital One Master Trust</b>                               |                             |                       |
| Series 2001-2 Class C<br>3.69%, 03/15/05                        | 6,000                       | 6,030                 |
| ■ <b>CDC Mortgage Capital Trust</b>                             |                             |                       |
| Series 2003-HE2 Class M2<br>4.55%, 03/28/05                     | 5,410                       | 5,596                 |
| ■ <b>Centex Home Equity Loan Trust</b>                          |                             |                       |
| Series 2003-B Class M1<br>3.35%, 03/28/05                       | 19,000                      | 19,155                |
| ■ <b>Chase Funding Mortgage Loan Asset-Backed</b>               |                             |                       |
| Series 2003-2 Class 2A2<br>2.93%, 03/28/05                      | 11,180                      | 11,211                |
| <b>Countrywide Asset-Backed Certificates</b>                    |                             |                       |
| ■ Series 2001-3 Class M1<br>3.15%, 03/28/05                     | 2,193                       | 2,195                 |
| ■ Series 2001-BC3 Class M1<br>3.20%, 03/28/05                   | 2,959                       | 2,963                 |
| ■ Series 2002-3 Class M1<br>3.40%, 03/28/05                     | 4,000                       | 4,020                 |
| ■ <b>First Franklin Mortgage Loan Asset-Backed Certificates</b> |                             |                       |
| Series 2002-FF3 Class A2<br>3.11%, 03/28/05                     | 2,923                       | 2,936                 |

| Security Series<br>Rate, Maturity Date           | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|--|-----------------------------|-----------------------|
| ■ <b>Impac CMB Trust</b>                         |                             |                       |
| Series 2003-10 Class 1A1<br>3.00%, 03/28/05      | 22,226                      | 22,242                |
| ■ <b>Long Beach Mortgage Loan Trust</b>          |                             |                       |
| Series 2003-4 Class M3<br>4.80%, 03/28/05        | 5,500                       | 5,630                 |
| ■ <b>Main Street Warehouse Funding Trust</b>     |                             |                       |
| Series 2004-MSD<br>4.95%, 03/28/05               | 8,000                       | 8,013                 |
| ■ <b>Master Asset Backed Securities Trust</b>    |                             |                       |
| Series 2003-OPT1 Class A2<br>3.07%, 03/28/05     | 5,331                       | 5,350                 |
| <b>MBNA Credit Card Master Note Trust</b>        |                             |                       |
| ■ Series 2003-B3 Class B3<br>2.97%, 03/15/05     | 10,000                      | 10,061                |
| ■ Series 2003-C3 Class C3<br>3.94%, 03/15/05     | 4,500                       | 4,605                 |
| ▶ <b>Merrill Lynch Mortgage Investors, Inc.</b>  |                             |                       |
| Series 2004-WMC1 Class A2<br>2.95%, 03/28/05     | 3,855                       | 3,866                 |
| <b>Morgan Stanley ABS Capital I</b>              |                             |                       |
| Series 2004-NC3N<br>6.00%, 03/25/34              | 659                         | 658                   |
| <b>Morgan Stanley Mortgage Loan Trust</b>        |                             |                       |
| Series 2004-9 Class 4A<br>5.65%, 11/25/19        | 13,978                      | 14,372                |
| ■ <b>New Century Home Equity Loan Trust</b>      |                             |                       |
| Series 2004-2 Class A3<br>2.90%, 03/28/05        | 19,144                      | 19,156                |
| <b>Novastar NIM Trust</b>                        |                             |                       |
| Series 2004-N1<br>4.46%, 02/25/34                | 1,302                       | 1,304                 |
| ▶ <b>Option One Mortgage Loan Trust</b>          |                             |                       |
| Series 2003-6 Class A2<br>2.98%, 03/25/05        | 10,484                      | 10,518                |
| ■ <b>Provident Bank Home Equity Loan Trust</b>   |                             |                       |
| Series 1997-2 Class A5<br>2.88%, 03/28/05        | 1,610                       | 1,611                 |
| <b>Residential Asset Mortgage Products, Inc.</b> |                             |                       |
| ■ Series 2003-RS1 Class All<br>3.04%, 03/28/05   | 4,656                       | 4,674                 |
| ■ Series 2003-RZ4 Class A4<br>4.04%, 03/28/05    | 11,700                      | 11,653                |

**Portfolio Holdings** continued

| Security Series                                 | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|---|-----------------------------|-----------------------|
| Rate, Maturity Date                             |                             |                       |
| <b>Securitized Asset Backed NIM Trust</b>       |                             |                       |
| Series 2004-OP2 Class N                         |                             |                       |
| 5.50%, 08/25/34                                 | 2,065                       | 2,053                 |
| <b>Sequoia Mortgage Trust</b>                   |                             |                       |
| ▶ Series 2004-4 Class B2                        |                             |                       |
| 3.50%, 03/21/05                                 | 4,000                       | 3,934                 |
| ▶ Series 2004-4 Class-B1                        |                             |                       |
| 3.10%, 03/21/05                                 | 5,000                       | 4,939                 |
| <b>■ Structured Asset Investment Loan Trust</b> |                             |                       |
| Series 2003-BC1 Class A2                        |                             |                       |
| 2.99%, 03/28/05                                 | 9,963                       | 9,988                 |
|   |                             | <b>240,026</b>        |

**Commercial Paper & Other Corporate Obligations**  
 10.1% of net assets

|  |        |                |
|--|--------|----------------|
| <b>Viacom, Inc.</b>                                |        |                |
| 2.59%, 03/01/05                                    | 37,000 | 37,000         |
| <b>Cox Communications, Inc., Section 4(2)</b>      |        |                |
| 2.75%, 03/01/05                                    | 1,310  | 1,310          |
| <b>Daimlerchrysler N.A. Holdings</b>               |        |                |
| 2.65%, 03/14/05                                    | 20,950 | 20,930         |
| <b>General Motors Acceptance Corp.</b>             |        |                |
| 2.65%, 03/03/05                                    | 20,682 | 20,679         |
| <b>Kinder Morgan Energy Partners, Section 4(2)</b> |        |                |
| 2.60%, 03/07/05                                    | 25,000 | 24,989         |
| <b>Atlantis Two Funding Corp.</b>                  |        |                |
| 2.60%, 03/08/05                                    | 7,550  | 7,546          |
|  |        | <b>112,454</b> |

| Security and Number of Shares                   | Value<br>(\$ x 1,000) |
|---|-----------------------|
| <b>Preferred Stock</b> 2.7% of net assets       |                       |
| <b>Cobank, ACB, 144A</b>                        |                       |
| 115,000   | 6,302                 |
| ■ <b>Fannie Mae, Series J</b>                   |                       |
| 200,000   | 9,953                 |
| ■ <b>Fannie Mae, Series O</b>                   |                       |
| 50,000  | 2,777                 |
| ■ <b>Shell Frontier Oil &amp; Gas, Series D</b> |                       |
| 35,000  | 3,500                 |
| <b>Zurich Regcaps Funding Trust VI, 144A</b>    |                       |
| 80,000  | 7,754                 |
|   | <b>30,286</b>         |

**Other Investment Companies** 0.1% of net assets

|   |         |            |
|---|---------|------------|
| <b>Provident Institutional Funds—<br/>Fed Funds Portfolio</b> | 961,307 | <b>961</b> |
|---|---------|------------|

End of investments.

| Security Series     | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|---------------------|-----------------------------|-----------------------|
| Rate, Maturity Date |                             |                       |

**Short Sales** 0.9% of net assets

**U.S. Government Agency Mortgages** 0.9%

|                   |        |              |
|-------------------|--------|--------------|
| <b>Fannie Mae</b> |        |              |
| 4.50%, 04/01/35   | 10,000 | <b>9,600</b> |

End of short sale position.

| Security Series     | Face Amount  | Value        |
|---------------------|--------------|--------------|
| Rate, Maturity Date | (\$ x 1,000) | (\$ x 1,000) |

**Collateral Invested for Securities on Loan**

14.0% of net assets

**Short-Term Investments 13.8%**

|  |         |                |
|--|---------|----------------|
| <b>UBS Financial Services, Inc.</b>      |         |                |
| 2.59%, 03/01/05                          | 26,693  | 26,693         |
| <b>West LB Time Deposit</b>              |         |                |
| 2.61%, 03/01/05                          | 105,894 | 105,894        |
| <b>Chase Manhattan Bank Time Deposit</b> |         |                |
| 2.50%, 03/01/05                          | 21,330  | 21,330         |
|  |         | <b>153,917</b> |

| Security and Number of Shares | Value        |
|-------------------------------|--------------|
|                               | (\$ x 1,000) |

**Other Investment Companies 0.2%**

|                                   |           |              |
|-----------------------------------|-----------|--------------|
| <b>Institutional Money Market</b> |           |              |
| <b>Trust</b>                      | 2,419,338 | <b>2,419</b> |

End of collateral invested for securities on loan.

In addition to the above, the fund held the following at 2/28/05. All numbers are x 1,000 except number of futures contracts.

**Futures Contracts**

|   | Number of Contracts | Contract Value | Unrealized Gains/(Losses) |
|---|---------------------|----------------|---------------------------|
| 2 Year, Long U.S. Treasury Note, expires 06/30/05   | 165                 | 34,219         | (116)                     |
| 5 Year, Long U.S. Treasury Note, expires 06/21/05   | 700                 | 75,305         | (678)                     |
| 10 Year, Short U.S. Treasury Note, expires 06/21/05 | 250                 | 27,469         | 308                       |
|   |                     |                | <b>(486)</b>              |

## Statement of

**Assets and Liabilities**

As of February 28, 2005; unaudited. All numbers are x 1,000 except NAV.

**Assets**

|   |                  |
|---|------------------|
| Investments, at value (including \$151,280 of securities on loan) | \$1,386,036      |
| Collateral invested for securities on loan                        | 156,336          |
| Receivables:  |                  |
| Fund shares sold  | 1,188            |
| Investments sold  | 13,895           |
| Investments sold short  | 9,706            |
| Interest  | 8,075            |
| Dividends   | 415              |
| Prepaid expenses  | + 30             |
| <b>Total assets</b>   | <b>1,575,681</b> |

**Liabilities**

|   |                |
|---|----------------|
| Securities sold short, at value             | 9,600          |
| Collateral held for securities on loan      | 156,336        |
| Payables:                                   |                |
| Fund shares redeemed                        | 427            |
| Dividends to shareholders                   | 226            |
| Investments bought                          | 289,750        |
| Due to brokers for futures                  | 180            |
| Investment adviser and administration fees  | 23             |
| Transfer agent and shareholder service fees | 23             |
| Accrued expenses                            | + 106          |
| <b>Total liabilities</b>                    | <b>456,671</b> |

**Net Assets**

|                          |                    |
|--------------------------|--------------------|
| <b>Total assets</b>      | 1,575,681          |
| <b>Total liabilities</b> | - 456,671          |
| <b>Net assets</b>        | <b>\$1,119,010</b> |

**Net Assets by Source**

|  |           |
|--|-----------|
| Capital received from investors                  | 1,111,076 |
| Distributions in excess of net investment income | (446)     |
| Net realized capital gains                       | 4,771     |
| Net unrealized capital gains                     | 3,609     |

**Net Asset Value (NAV)**

| <b>Net Assets</b> | <b>÷</b> | <b>Shares Outstanding</b> | <b>=</b> | <b>NAV</b> |
|-------------------|----------|---------------------------|----------|------------|
| \$1,119,010       |          | 111,820                   |          | \$10.01    |

Unless stated, all numbers are x 1,000.

The amortized cost of the fund's securities was \$1,382,032.

Includes certain restricted but deemed liquid 144A and Section 4(2) securities worth \$88,765, or 7.9% of the fund's total net assets.

Not counting short-term obligations and government securities, the fund's security transactions during the period were:

|                  |           |
|------------------|-----------|
| Purchases        | \$198,322 |
| Sales/maturities | \$267,440 |

The fund's long-term government security transactions were:

|                  |           |
|------------------|-----------|
| Purchases        | \$930,055 |
| Sales/maturities | \$814,410 |

The fund's total security transactions with other Schwab Funds during the period were \$21,671.

The proceeds for securities sold short is \$9,691.

These derive from investments, futures, swap agreements and short sales.

**Federal Tax Data**

|   |                |
|---|----------------|
| <b>Portfolio cost</b>                   | \$1,382,510    |
| <b>Net unrealized gains and losses:</b> |                |
| Gains                                   | \$11,988       |
| Losses                                  | + (8,462)      |
|   | <b>\$3,526</b> |

**As of August 31, 2004:****Undistributed earnings:**

|                         |         |
|-------------------------|---------|
| Ordinary income         | \$3,004 |
| Long-term capital gains | \$2,969 |

## Statement of

**Operations**

For September 1, 2004 through February 28, 2005; unaudited. All numbers are x 1,000.

Unless stated, all numbers are x 1,000.

**Investment Income**

|                                |               |
|--------------------------------|---------------|
| Interest                       | \$19,361      |
| Securities on loan             | 125           |
| Dividends                      | + 454         |
| <b>Total investment income</b> | <b>19,940</b> |

**Net Realized Gains and Losses**

|  |               |
|--|---------------|
| Net realized gains on investments sold   | 13,285        |
| Net realized losses on futures contracts | (296)         |
| Net realized gains on short sales        | + 3           |
| <b>Net realized gains</b>                | <b>12,992</b> |

**Net Unrealized Gains and Losses**

|                                      |                 |
|--------------------------------------|-----------------|
| Net unrealized losses on investments | (14,349)        |
| Net unrealized losses on futures     | (759)           |
| Net unrealized gains on short sales  | + 91            |
| <b>Net unrealized losses</b>         | <b>(15,017)</b> |

**Expenses**

|   |              |
|---|--------------|
| Investment adviser and administrator fees   | 1,378        |
| Transfer agent and shareholder service fees | 1,340        |
| Trustees' fees                              | 6            |
| Custodian and portfolio accounting fees     | 66           |
| Professional fees                           | 17           |
| Registration fees                           | 27           |
| Shareholder reports                         | 44           |
| Other expenses                              | + 21         |
| <b>Total expenses</b>                       | <b>2,899</b> |

**Increase in Net Assets from Operations**

|   |                 |
|---|-----------------|
| <b>Total investment income</b>                | 19,940          |
| <b>Net expenses</b>                           | - 2,899         |
| <b>Net investment income</b>                  | <b>17,041</b>   |
| <b>Net realized gains</b>                     | 12,992          |
| <b>Net unrealized losses</b>                  | + (15,017)      |
| <b>Increase in net assets from operations</b> | <b>\$15,016</b> |

Calculated as a percentage of average daily net assets: 0.30% of the first \$500 million and 0.22% of assets beyond that. These fees are paid to Charles Schwab Investment Management, Inc. (CSIM).

Calculated as a percentage of average daily net assets: for transfer agent services, 0.05% of the fund's assets; for shareholder services, 0.20% of the fund's assets. These fund's are paid to Charles Schwab & Co., Inc. (Schwab).

For the fund's independent trustees only.

CSIM and Schwab have guaranteed that the annual operating expenses (excluding interest, taxes and certain non-routine expenses) will not exceed 0.55% of the fund's average daily net assets through November 15, 2005.

These add up to a net loss on investments of \$2,025.

## Statements of

**Changes in Net Assets**

For the current and prior report periods. All numbers are x 1,000.  
Figures for current period are unaudited.

**Operations**

|   | 9/1/04-2/28/05 | 9/1/03-8/31/04 |
|---|----------------|----------------|
| Net investment income                         | \$17,041       | \$32,491       |
| Net realized gains                            | 12,992         | 10,994         |
| Net unrealized gains or losses                | + (15,017)     | 19,933         |
| <b>Increase in net assets from operations</b> | <b>15,016</b>  | <b>63,418</b>  |

**Distributions Paid**

|                                       |                 |                 |
|---------------------------------------|-----------------|-----------------|
| Dividends from net investment income  | 17,496          | 34,327          |
| Distributions from net realized gains | + 12,616        | 35,223          |
| <b>Total distributions</b>            | <b>\$30,112</b> | <b>\$69,550</b> |

**Transactions in Fund Shares**

|  | 9/1/04-2/28/05 |                 | 9/1/03-8/31/04 |                 |
|--|----------------|-----------------|----------------|-----------------|
|  | SHARES         | VALUE           | SHARES         | VALUE           |
| Shares sold                            | 15,428         | \$155,886       | 20,689         | \$209,609       |
| Shares reinvested                      | 2,848          | 28,707          | 6,912          | 69,703          |
| Shares redeemed                        | + (9,130)      | (92,279)        | (25,382)       | (256,531)       |
| <b>Net transactions in fund shares</b> | <b>9,146</b>   | <b>\$92,314</b> | <b>2,219</b>   | <b>\$22,781</b> |

**Shares Outstanding and Net Assets**

|                      | 9/1/04-2/28/05 |                    | 9/1/03-8/31/04 |                    |
|----------------------|----------------|--------------------|----------------|--------------------|
|                      | SHARES         | NET ASSETS         | SHARES         | NET ASSETS         |
| Beginning of period  | 102,674        | \$1,041,792        | 100,455        | \$1,025,143        |
| Total increase       | + 9,146        | 77,218             | 2,219          | 16,649             |
| <b>End of period</b> | <b>111,820</b> | <b>\$1,119,010</b> | <b>102,674</b> | <b>\$1,041,792</b> |

Unless stated, all numbers are x 1,000.

The tax-basis components of distributions for the period ended 08/31/04 are:

|                         |          |
|-------------------------|----------|
| Ordinary income         | \$50,360 |
| Long-term capital gains | \$19,190 |

Figures for shares represent shares sold plus shares reinvested, minus shares redeemed. Figures for net assets represent the changes in net assets from operations plus the changes in value from transactions in fund shares, minus distributions paid.

Includes distributions in excess of net investment income in the amount of \$446 for the current period and net investment income not yet distributed in the amount of \$9 for the prior period.

Percent of fund shares owned by other Schwab Funds as of the end of the current period:

**Schwab MarketTrack Portfolios**

|                        |       |
|------------------------|-------|
| Growth Portfolio       | 7.9%  |
| Balanced Portfolio     | 16.4% |
| Conservative Portfolio | 13.9% |

**Schwab Annuity Portfolios**

|                     |      |
|---------------------|------|
| Growth Portfolio II | 0.4% |
|---------------------|------|



# Schwab GNMA Fund™

## Financial Statements

### Financial Highlights

| Investor Shares                                 | 9/1/04–<br>2/28/05* | 9/1/03–<br>8/31/04 | 3/3/03¹–<br>8/31/03 |
|---|---------------------|--------------------|---------------------|
| <b>Per-Share Data (\$)</b>                      |                     |                    |                     |
| Net asset value at beginning of period          | 9.78                | 9.69               | 10.00               |
| Income from investment operations:              |                     |                    |                     |
| Net investment income                           | 0.17                | 0.16               | 0.06                |
| Net realized and unrealized gains or losses     | (0.04)              | 0.26               | (0.17)              |
| Total income or loss from investment operations | 0.13                | 0.42               | (0.11)              |
| Less distributions:                             |                     |                    |                     |
| Dividends from net investment income            | (0.19)              | (0.33)             | (0.20)              |
| Net asset value at end of period                | 9.72                | 9.78               | 9.69                |
| Total return (%)                                | 1.34²               | 4.39               | (1.11)²             |
| <b>Ratios/Supplemental Data (%)</b>             |                     |                    |                     |
| Ratios to average net assets:                   |                     |                    |                     |
| Net operating expenses                          | 0.74³               | 0.51               | —                   |
| Gross operating expenses                        | 1.04³               | 1.11               | 0.99³               |
| Net investment income                           | 3.41³               | 1.89               | 1.37³               |
| Portfolio turnover rate                         | 73²                 | 199                | 105²                |
| Net assets, end of period (\$ x 1,000,000)      | 18                  | 18                 | 21                  |

\* Unaudited.

¹ Commencement of operations.

² Not annualized.

³ Annualized.

| Select Shares                                   | 9/1/04–<br>2/28/05* | 9/1/03–<br>8/31/04 | 3/3/03–<br>8/31/03  |
|---|---------------------|--------------------|---------------------|
| <b>Per-Share Data (\$)</b>                      |                     |                    |                     |
| Net asset value at beginning of period          | 9.78                | 9.69               | 10.00               |
| Income from investment operations:              |                     |                    |                     |
| Net investment income                           | 0.18                | 0.17               | 0.06                |
| Net realized and unrealized gains or losses     | (0.04)              | 0.26               | (0.17)              |
| Total income or loss from investment operations | 0.14                | 0.43               | (0.11)              |
| Less distributions:                             |                     |                    |                     |
| Dividends from net investment income            | (0.20)              | (0.34)             | (0.20)              |
| Net asset value at end of period                | 9.72                | 9.78               | 9.69                |
| Total return (%)                                | 1.44 <sup>2</sup>   | 4.53               | (1.11) <sup>2</sup> |
| <b>Ratios/Supplemental Data (%)</b>             |                     |                    |                     |
| Ratios to average net assets:                   |                     |                    |                     |
| Net operating expenses                          | 0.55 <sup>3</sup>   | 0.37               | —                   |
| Gross operating expenses                        | 0.89 <sup>3</sup>   | 0.96               | 0.83 <sup>3</sup>   |
| Net investment income                           | 3.61 <sup>3</sup>   | 2.03               | 1.37 <sup>3</sup>   |
| Portfolio turnover rate                         | 73 <sup>2</sup>     | 199                | 105 <sup>2</sup>    |
| Net assets, end of period (\$ x 1,000,000)      | 20                  | 19                 | 28                  |

\* Unaudited.

<sup>1</sup> Commencement of operations.

<sup>2</sup> Not annualized.

<sup>3</sup> Annualized.

**Portfolio Holdings** as of February 28, 2005, unaudited

This section shows all the securities in the fund's portfolio and their value, as of the report date.

The fund files its complete schedule of portfolio holdings with the SEC for the first and third quarters of each fiscal year on Form N-Q. The fund's Forms N-Q is available on the SEC's website at <http://www.sec.gov> and may be reviewed and copied at the SEC's Public Reference Room in Washington, D.C. Call 1-800-SEC-0330 for information on the operation of the Public Reference Room. The schedule of portfolio holdings filed on a fund's most recent Form N-Q is available by visiting Schwab's website at [www.schwab.com/schwabfunds](http://www.schwab.com/schwabfunds).

We use the symbols below to designate certain characteristics of the securities.

- ▲ Delayed-delivery security
- Variable-rate security
- All or a portion of this security is held as collateral for delayed-delivery security

For fixed-rate obligations, the rate shown is the interest rate (the rate established when the obligation was issued) and the maturity date shown is the stated legal maturity. For variable-rate obligations, the rate shown is the rate as of the report date, and the maturity shown is the later of the next interest rate change date or demand date.

| Holdings by Category |   | Cost<br>(\$x1,000) | Value<br>(\$x1,000) |
|----------------------|---|--------------------|---------------------|
| 96.7%                | <b>Mortgage-Backed Securities</b>                         | 35,787             | 36,146              |
| 4.5%                 | <b>Asset-Backed Obligations</b>                           | 1,665              | 1,666               |
| 3.3%                 | <b>U.S. Government Securities</b>                         | 1,261              | 1,251               |
| 1.9%                 | <b>Commercial Paper &amp; Other Corporate Obligations</b> | 700                | 700                 |
| 1.0%                 | <b>Other Investment Companies</b>                         | 390                | 390                 |
| 107.4%               | <b>Total Investments</b>                                  | <b>39,803</b>      | <b>40,153</b>       |
| (2.6)%               | <b>Short Sales</b>  | (978)              | (969)               |
| (4.8)%               | <b>Other Assets and Liabilities</b>                       |                    | (1,798)             |
| 100.0%               | <b>Net Assets</b>   |                    | <b>37,386</b>       |

| Security Series<br>Rate, Maturity Date | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|--|-----------------------------|-----------------------|
|--|-----------------------------|-----------------------|

**Mortgage-Backed Securities** 96.7% of net assets**U.S. Government Agency Mortgages** 96.7%

|                               |        |               |
|-------------------------------|--------|---------------|
| <b>Fannie Mae</b>             |        |               |
| 6.00%, 11/1/34                | 484    | 497           |
| 6.50%, 03/1/32                | 958    | 998           |
| <b>Ginnie Mae</b>             |        |               |
| ■ 5.00%, 02/15/18 to 12/15/34 | 7,413  | 7,418         |
| ■ 5.50%, 11/15/18 to 12/15/34 | 12,167 | 12,408        |
| ■ 6.00%, 04/15/28 to 03/15/34 | 5,827  | 6,024         |
| ■ 6.50%, 05/15/24 to 10/15/32 | 3,079  | 3,234         |
| ■ 7.00%, 11/15/23 to 08/15/31 | 1,526  | 1,621         |
| ■ 7.50%, 07/15/23 to 03/15/28 | 608    | 656           |
| ■ 8.00%, 06/15/05 to 08/15/09 | 301    | 312           |
| 8.50%, 08/15/27 to 12/15/29   | 84     | 91            |
| 9.00%, 01/15/30 to 06/15/30   | 44     | 48            |
| TBA                           |        |               |
| ▲ 5.00%, 04/01/35             | 1,300  | 1,291         |
| ▲ 6.00%, 03/01/35             | 1,500  | 1,548         |
|                               |        | <b>36,146</b> |

**Asset-Backed Obligations** 4.5% of net assets

|  |     |     |
|--|-----|-----|
| <b>■ Ameriquest Finance NIM Trust</b>          |     |     |
| Series 2001-RN4 Class A                        |     |     |
| 4.60%, 03/25/05                                | 101 | 100 |
| <b>▸ Countrywide Asset Backed Certificates</b> |     |     |
| Series 2003-2 Class M2                         |     |     |
| 4.32%, 03/28/05                                | 125 | 128 |
| <b>Fremont NIM Trust</b>                       |     |     |
| Series 2004-D Class N1                         |     |     |
| 4.50%, 06/25/06                                | 363 | 363 |

**Portfolio Holdings** continued

| Security Series                                     | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|---|-----------------------------|-----------------------|
| Rate, Maturity Date                                 |                             |                       |
| <b>Morgan Stanley ABS Capital I</b>                 |                             |                       |
| Series 2004-NC1N                                    |                             |                       |
| 7.00%, 12/25/33                                     | 53                          | 53                    |
| Series 2004-NC3N                                    |                             |                       |
| 6.00%, 03/25/34                                     | 56                          | 56                    |
| <b>Novastar NIM Trust</b>                           |                             |                       |
| Series 2004-N1                                      |                             |                       |
| 4.46%, 02/25/34                                     | 195                         | 196                   |
| <b>Novastar NIM Trust, 144A</b>                     |                             |                       |
| Series 2004-N3                                      |                             |                       |
| 3.97%, 03/25/35                                     | 623                         | 623                   |
| <b>► Option One Mortgage Loan Trust</b>             |                             |                       |
| Series 2003-3 Class M2                              |                             |                       |
| 4.25%, 03/28/05                                     | 100                         | 102                   |
| <b>Sharps SP I L.L.C. Net Interest Margin Trust</b> |                             |                       |
| Series 2004-HE2N Class NA                           |                             |                       |
| 5.43%, 10/25/34                                     | 45                          | 45                    |
|   |                             | <b>1,666</b>          |

**U.S. Government Securities** 3.3% of net assets

|                            |     |              |
|----------------------------|-----|--------------|
| <b>U.S. Treasury Bills</b> |     |              |
| 2.19%, 03/10/05            | 15  | 15           |
| <b>U.S. Treasury Notes</b> |     |              |
| 3.13%, 01/31/07            | 750 | 744          |
| 3.63%, 01/15/10            | 500 | 492          |
|                            |     | <b>1,251</b> |

**Commercial Paper & Other Corporate Obligations**  
1.9% of net assets

|   |     |     |
|---|-----|-----|
| <b>Cox Communications, Inc., Section 4(2)</b> |     |     |
| 2.75%, 03/01/05                               | 700 | 700 |

| Security and Number of Shares | Value<br>(\$ x 1,000) |
|-------------------------------|-----------------------|
|-------------------------------|-----------------------|

**Other Investment Companies** 1.0% of net assets

|                                       |         |            |
|---------------------------------------|---------|------------|
| <b>Provident Institutional Funds—</b> |         |            |
| <b>Fed Funds Portfolio</b>            | 389,950 | <b>390</b> |

End of investments.

| Security Series     | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|---------------------|-----------------------------|-----------------------|
| Rate, Maturity Date |                             |                       |

**Short Sales** 2.6% of net assets**U.S. Government Agency Mortgages** 2.6%

|                       |       |            |
|-----------------------|-------|------------|
| <b>Ginnie Mae TBA</b> |       |            |
| 4.50%, 04/01/35       | 1,000 | <b>969</b> |

End of short sale position.

## Statement of

**Assets and Liabilities**

As of February 28, 2005; unaudited. All numbers are x 1,000 except NAV.

**Assets**

|                        |               |
|------------------------|---------------|
| Investments, at value  | \$40,153      |
| Receivables:           |               |
| Fund shares sold       | 109           |
| Interest               | 168           |
| Investments sold short | + 980         |
| <b>Total assets</b>    | <b>41,410</b> |

**Liabilities**

|                                 |              |
|---------------------------------|--------------|
| Securities sold short, at value | 969          |
| Payables:                       |              |
| Fund shares redeemed            | 116          |
| Dividends to shareholders       | 28           |
| Investments bought              | 2,865        |
| Accrued expenses                | + 46         |
| <b>Total liabilities</b>        | <b>4,024</b> |

**Net Assets**

|                          |                 |
|--------------------------|-----------------|
| <b>Total assets</b>      | 41,410          |
| <b>Total liabilities</b> | - 4,024         |
| <b>Net assets</b>        | <b>\$37,386</b> |

**Net Assets by Source**

|  |         |
|--|---------|
| Capital received from investors                  | 38,986  |
| Distributions in excess of net investment income | (88)    |
| Net realized capital losses                      | (1,871) |
| Net unrealized capital gains                     | 359     |

**Net Asset Value (NAV) by Share Class**

| Share Class     | Net Assets | ÷ | Shares Outstanding | = | NAV    |
|-----------------|------------|---|--------------------|---|--------|
| Investor Shares | \$17,823   |   | 1,834              |   | \$9.72 |
| Select Shares   | \$19,563   |   | 2,013              |   | \$9.72 |

Unless stated, all numbers are x 1,000.

The fund's amortized cost for these securities was \$39,803.

Includes certain restricted but deemed liquid 144A and Section 4(2) securities worth \$1,323, or 3.5% of the fund's total net assets.

Not counting short-term obligations and government securities, the fund's security transactions during the period were:

|                  |         |
|------------------|---------|
| Purchases        | \$1,158 |
| Sales/maturities | \$693   |

The fund's long-term government security transactions were:

|                  |          |
|------------------|----------|
| Purchases        | \$27,887 |
| Sales/maturities | \$26,761 |

The proceeds for securities sold short is \$978.

These derive from investments, futures, and short sales.

**Federal Tax Data**

|   |              |
|---|--------------|
| <b>Portfolio cost</b>                   | \$39,803     |
| <b>Net unrealized gains and losses:</b> |              |
| Gains                                   | \$449        |
| Losses                                  | + (99)       |
|   | <b>\$350</b> |

**As of August 31, 2004:****Undistributed earnings:**

|                         |      |
|-------------------------|------|
| Ordinary income         | \$32 |
| Long-term capital gains | \$—  |

**Unused capital losses:**

|                   |         |
|-------------------|---------|
| Expires 08/31 of: |         |
| 2012              | \$1,405 |

|                                |              |
|--------------------------------|--------------|
| <b>Deferred capital losses</b> | <b>\$535</b> |
|--------------------------------|--------------|

## Statement of

**Operations**

For September 1, 2004 through February 28, 2005; unaudited. All numbers are x 1,000.

**Investment Income**

|                                |   |            |
|--------------------------------|---|------------|
| Interest                       |   | \$748      |
| Dividends                      | + | 3          |
| <b>Total investment income</b> |   | <u>751</u> |

**Net Realized Gains and Losses**

|   |   |           |
|---|---|-----------|
| Net realized gains on investments sold  |   | 51        |
| Net realized gains on futures contracts | + | 22        |
| <b>Net realized gains</b>               |   | <b>73</b> |

**Net Unrealized Gains and Losses**

|                                      |              |
|--------------------------------------|--------------|
| Net unrealized losses on investments | (232)        |
| Net unrealized losses on futures     | (5)          |
| Net unrealized gains on short sales  | + 9          |
| <b>Net unrealized losses</b>         | <b>(228)</b> |

**Expenses**

|  |            |
|--|------------|
| Investment adviser and administrator fees    | 81         |
| Transfer agent and shareholder service fees: |            |
| Investor Shares                              | 22         |
| Select Shares                                | 9          |
| Trustees' fees                               | 4          |
| Custodian and portfolio accounting fees      | 22         |
| Professional fees                            | 17         |
| Registration fees                            | 13         |
| Shareholder reports                          | 2          |
| Other expenses                               | + 4        |
| Total expenses                               | 174        |
| Expense reduction                            | - 58       |
| <b>Net expenses</b>                          | <b>116</b> |

**Increase in Net Assets from Operations**

|  |   |              |
|--|---|--------------|
| Total investment income                |   | 751          |
| Net expenses                           | — | 116          |
| Net investment income                  |   | <u>635</u>   |
| Net realized gains                     |   | 73           |
| Net unrealized losses                  | + | (228)        |
| Increase in net assets from operations |   | <u>\$480</u> |

Unless stated, all numbers are x 1,000.

Calculated as a percentage of average daily net assets: 0.45% of the first \$500 million, 0.40% of the next \$500 million and 0.375% over \$1 billion. These fees are paid to Charles Schwab Investment Management, Inc. (CSIM). Prior to November 15, 2004, these fees were calculated as 0.45% of average daily net assets.

Calculated as a percentage of average daily net assets: for transfer agent services, 0.05% of the fund's assets; for shareholder services, 0.20% and 0.05% of the assets of each respective share class. These fees are paid to Charles Schwab & Co., (Schwab).

For the fund's independent trustees only.

Includes \$54 from the investment adviser (CSIM) and \$4 from the transfer agent and shareholder service agent (Schwab). CSIM and Schwab has guaranteed through November 15, 2005 to limit the annual operating expenses.

| <b>Share Class</b> | <b>% of Average Daily Net Assets</b> |
|--------------------|--------------------------------------|
| Investor Shares    | 0.74%                                |
| Select Shares      | 0.55%                                |

This limit excludes interest, taxes and certain non-routine expenses.

These add up to a net loss on investments of \$155.

## Statements of

**Changes in Net Assets**

For the current and prior report periods. All numbers are x 1,000.  
Figures for current period are unaudited.

**Operations**

|   | 9/1/04–2/28/05 | 9/1/03–8/31/04 |
|---|----------------|----------------|
| Net investment income                         | \$635          | \$826          |
| Net realized gains or losses                  | 73             | (345)          |
| Net unrealized gains or losses                | + (228)        | 1,303          |
| <b>Increase in net assets from operations</b> | <b>480</b>     | <b>1,784</b>   |

**Distributions Paid****Dividends from Net Investment Income**

|   |              |                |
|---|--------------|----------------|
| Investor Shares                                   | 348          | 653            |
| Select Shares                                     | + 381        | 797            |
| <b>Total dividends from net investment income</b> | <b>\$729</b> | <b>\$1,450</b> |

**Transactions in Fund Shares**

|  | 9/1/04–2/28/05 |                  | 9/1/03–8/31/04 |                   |
|--|----------------|------------------|----------------|-------------------|
|  | SHARES         | VALUE            | SHARES         | VALUE             |
| <b>Shares Sold</b>                     |                |                  |                |                   |
| Investor Shares                        | 260            | \$2,541          | 619            | \$6,060           |
| Select Shares                          | + 409          | 3,997            | 810            | 7,918             |
| <b>Total shares sold</b>               | <b>669</b>     | <b>\$6,538</b>   | <b>1,429</b>   | <b>\$13,978</b>   |
| <b>Shares Reinvested</b>               |                |                  |                |                   |
| Investor Shares                        | 28             | \$276            | 58             | \$560             |
| Select Shares                          | + 30           | 291              | 65             | 640               |
| <b>Total shares reinvested</b>         | <b>58</b>      | <b>\$567</b>     | <b>123</b>     | <b>\$1,200</b>    |
| <b>Shares Redeemed</b>                 |                |                  |                |                   |
| Investor Shares                        | (254)          | (\$2,486)        | (1,022)        | (\$9,955)         |
| Select Shares                          | + (357)        | (3,491)          | (1,872)        | (18,228)          |
| <b>Total shares redeemed</b>           | <b>(611)</b>   | <b>(\$5,977)</b> | <b>(2,894)</b> | <b>(\$28,183)</b> |
| <b>Net transactions in fund shares</b> | <b>116</b>     | <b>\$1,128</b>   | <b>(1,342)</b> | <b>(\$13,005)</b> |

**Shares Outstanding and Net Assets**

|                            | 9/1/04–2/28/05 |                 | 9/1/03–8/31/04 |                 |
|----------------------------|----------------|-----------------|----------------|-----------------|
|                            | SHARES         | NET ASSETS      | SHARES         | NET ASSETS      |
| Beginning of period        | 3,731          | \$36,507        | 5,073          | \$49,178        |
| Total increase or decrease | + 116          | 879             | (1,342)        | (12,671)        |
| <b>End of period</b>       | <b>3,847</b>   | <b>\$37,386</b> | <b>3,731</b>   | <b>\$36,507</b> |

Unless stated, all numbers are x 1,000.

The tax-basis components of distributions for the period ended 08/31/04 are:

|                         |         |
|-------------------------|---------|
| Ordinary income         | \$1,450 |
| Long-term capital gains | \$–     |

The difference of net investment income between financial statement and tax purposes for the period ended 08/31/04 is:

|                |       |
|----------------|-------|
| Paydown losses | \$630 |
|----------------|-------|

Figures for shares represent shares sold plus shares reinvested, minus shares redeemed. Figures for net assets represent the changes in net assets from operations plus the changes in value of transactions in fund shares, minus distributions paid.

Includes distributions in excess of net investment income in the amount of \$88 for the current period and net investment income not yet distributed in the amount of \$6 for the prior period.

# Financial Notes unaudited

## Business Structure of the Funds

**Each of the funds discussed in this report is a series of Schwab Investments, a no-load, open-end management investment company.** The company is organized as a Massachusetts business trust and is registered under the Investment Company Act of 1940, as amended. The sidebar shows the funds in this report and their trust.

**Both Schwab YieldPlus Fund® and Schwab GNMA Fund™ offer two share classes:** Investor Shares and Select Shares®. Shares of each class represent interest in the same portfolio, but each class has different expenses and investment minimums. Schwab Short-Term Bond Market Fund™ and Schwab Total Bond Market Fund™ each offers one share class.

Shares are bought and sold at net asset value, or NAV, which is the price for all outstanding shares. Each share has a par value of 1/1,000 of a cent, and the trustees may issue as many shares as necessary.

## The Trust and Its Funds

This list shows all of the funds included in Schwab Investments. The funds discussed in this report are highlighted.

**Schwab Investments** organized October 26, 1990

Schwab 1000 Fund

Schwab YieldPlus Fund

Schwab Short-Term Bond Market Fund

Schwab Total Bond Market Fund

Schwab GNMA Fund

Schwab Tax-Free YieldPlus Fund

Schwab Short/Intermediate Tax-Free Bond Fund

Schwab Long-Term Tax-Free Bond Fund

Schwab California Tax-Free YieldPlus Fund

Schwab California Short/Intermediate Tax-Free Bond Fund

Schwab California Long-Term Tax-Free Bond Fund

## Fund Operations

Most of the funds' investments are described in the fund-by-fund sections earlier in this report. However, there are certain other investments and policies that may affect a fund's financials, as described below. Other policies concerning the funds' business operations also are described here.

**The funds declare dividends every day they are open for business.** These dividends, which are substantially equal to a fund's net investment income for that day, are paid out to shareholders once a month. The funds may make distributions from any net realized capital gains once a year.

**The funds may enter into swap agreements.** In these transactions, a fund and a counterparty agree to swap payments that are based on two different rates. The counterparty is typically a large financial institution, and the term of the swap is specified in advance. For example, a fund may agree that for six months it will pay the counterparty the equivalent of the interest on a given amount invested at LIBOR (the London Interbank Offered Rate). In exchange, the counterparty might agree to pay a fund the equivalent of the same amount invested in a certain bond index during this same six months.

Swap agreements carry certain risks. Because the net gains or losses stemming from a swap agreement depend on the movements of one rate relative to another, a fund could experience unanticipated losses if one or both rates failed to behave as expected. A fund also could lose money if a counterparty failed to honor the terms of a swap agreement.

**The funds may loan securities to certain brokers, dealers and other financial institutions who pay the funds negotiated fees.** The funds receive cash, letters of credit or U.S. Government securities as collateral on these loans. All of the cash collateral received is reinvested in high quality, short-term investments. The value of the collateral must be at least 102% of the market



value of the loaned securities as of the first day of the loan, and at least 100% each day thereafter.

**The funds may buy securities on a delayed-delivery basis.** In these transactions, a fund agrees to buy a security for a stated price, with settlement generally occurring within two weeks. If the security's value falls before settlement occurs, a fund could end up paying more for the security than its market value at the time of settlement. The funds have set aside sufficient securities as collateral for those securities bought on a delayed-delivery basis.

**The funds may also sell securities short (sell securities they do not own).** When they do so, the funds also place assets worth at least 100% of the value of the short securities into segregated accounts, as collateral. If the market value of the short securities subsequently falls, the funds can realize a gain by closing the position. However, if the value rises, the funds typically would have to add to their collateral or close out their short position at a loss. The potential for losses associated with short positions is much greater than the original value of the securities sold short and may exceed amounts recorded in the Statements of Assets and Liabilities.

**The funds may invest in futures contracts.** Futures contracts involve certain risks because they can be very sensitive to market movements.

One risk is that the price of a futures contract may not move in perfect correlation with the price of the underlying securities. Another risk is that, at certain times, it may be impossible for a fund to close out a position in a futures contract, due to a difference in trading hours or to market conditions that may reduce the liquidity for a futures contract or its underlying securities.

Because futures carry inherent risks, a fund must give the broker a deposit of cash and/or securities (the "initial margin") whenever it enters into the futures contract. The amount of the deposit may vary from

one contract to another, but it is generally a percentage of the contract amount.

Futures are traded publicly on exchanges, and their market value changes daily. A fund records the change in market value of futures, and also the change in the amount of margin deposit required ("variation margin").

**The funds may enter into "TBA" (to be announced) purchase commitments to purchase securities for a fixed price at a future date, typically not exceeding 45 days.** TBAs may be considered securities in themselves, and involve a risk of loss if the value of the security to be purchased declines prior to settlement date. This risk is in addition to the risk of decline in a fund's other assets.

**The funds may enter into mortgage dollar roll transactions.** In these transactions, a fund sells mortgage-backed securities for delivery in the current month and simultaneously agrees to buy back, on a given date in the future, securities of a similar type, coupon rate and maturity. Dollar roll transactions involve the risk that the market value of the security sold short by the fund may decline below the repurchase price of similar securities.

**The funds pay fees to affiliates of the investment adviser for various services.** Through their trust, the funds have agreements with Charles Schwab Investment Management, Inc. (CSIM) to provide investment advisory and administrative services and with Charles Schwab & Co., Inc. (Schwab) to provide transfer agent and shareholder services.

Although these agreements specify certain fees for these services, CSIM and Schwab have made additional agreements with the funds that may limit the total expenses charged. The rates and limitations for these fees vary from fund to fund, and are described in each fund's Statement of Operations.

**The funds may engage in certain transactions involving affiliates.** For instance, a fund may let other Schwab Funds® buy and sell fund shares, particularly Schwab MarketTrack Portfolios.

The funds may make direct transactions with certain other Schwab Funds when practical. When one fund is seeking to sell a security that another is seeking to buy, an interfund transaction can allow both funds to benefit by reducing transaction costs. This practice is limited to funds that share the same investment adviser, trustees and officers.

Pursuant to an exemptive order issued by the SEC, the funds may enter into interfund borrowing and lending transactions within the Schwab Funds. All loans are for temporary or emergency purposes only. The interest rate charged on the loan is the average of the overnight repurchase agreement rate and the short-term bank loan rate. The interfund lending facility is subject to the oversight and periodic review of the Board of Trustees of the Schwab Funds.

**Trustees may include people who are officers and/or directors of the investment adviser or Schwab.** Federal securities law limits the percentage of such “interested persons” who may serve on a trust’s board, and the trust was in compliance with these limitations throughout the report period. The trust did not pay any of these persons for their service as trustees, but it did pay non-interested persons (independent trustees), as noted in each fund’s Statement of Operations.

**The funds may borrow money from banks and custodians.** The funds may obtain temporary bank loans through the trusts to which they belong, to use for meeting shareholder redemptions or for extraordinary or emergency purposes. The trusts have custodian overdraft facilities and line of credit arrangements of \$150 million and \$100 million with PNC Bank, N.A., and Bank of America, N.A., respectively. The funds pay interest on the amounts they

borrow at rates that are negotiated periodically. There was no borrowing for any funds during the period.

**The funds intend to meet federal income and excise tax requirements for regulated investment companies.** Accordingly, the funds distribute substantially all of their net investment income and realized net capital gains (if any) to their respective shareholders each year. The net investment income and realized capital gains and losses may differ for financial statement and tax purposes primarily due to differing treatments of paydown gains and losses and amortization of bond discounts and premiums. As long as a fund meets the tax requirements, it is not required to pay federal income tax.

**Under the funds’ organizational documents, the officers and trustees are indemnified against certain liability arising out of the performance of their duties to the funds.** In addition, in the normal course of business the funds enter into contracts with their vendors and others that provide general indemnifications. The funds’ maximum exposure under these arrangements is unknown as this would involve future claims that may be made against the funds. However, based on experience, the funds expect the risk of loss to be remote.

## Accounting Policies

The following are the main policies the funds use in preparing their financial statements.

**The funds value the securities in their portfolios every business day.** The funds use the following policies to value various types of securities:

**Bonds and notes:** valued at halfway between the most recent bid and asked quotes or, if such quotes are unavailable, at prices for securities of comparable maturity, credit quality and type. Valuations for bonds and notes are provided by an independent bond-pricing service.

**Securities for which no quoted value is available:** valued at fair value, as determined in good faith by the fund's investment adviser using guidelines adopted by the fund's Board of Trustees. In the determination of a fair valuation the guidelines include but are not limited to the use of analytical data, business conditions, recent trades, general and/or specific market trends and any emergency or significant events that would have a material impact on the value of the security.

**Swap agreements:** swaps may be valued based on a model that constructs curves, such as swap yield curves, based on market data, and that uses the curves to calculate prices. Or swaps may be valued based on dealer quotes.

**Futures and forwards:** open contracts are valued at their settlement prices as of the close of their exchanges (for futures) or at a market value based on that day's exchange rates (for forwards). When a fund closes out a futures or forwards position, it calculates the difference between the value of the position at the beginning and at the end, and records a realized gain or loss accordingly.

**Short-term securities (60 days or less to maturity):** valued at amortized cost.

**If a fund sells securities short,** it records the proceeds received as an asset and the obligation to buy back the securities as a liability. At the time a short sale is initiated, the asset and the liability are of equal value and effectively cancel each other out. Subsequently, the fund values the liability side of the transaction according to the market price of the securities sold short, and values the asset side according to the value of the proceeds. When the fund closes out a short position (buys the security), it records the outcome as a realized gain or loss. Interest accrued on securities sold short is recorded as an expense on the fund's records.

**Security transactions** are recorded as of the date the order to buy or sell the security is executed.

**Interest income** is recorded as it accrues. If a fund buys a debt security at a discount (that is, for less than its face value) or a premium (more than face value), it amortizes the discount or premium from the current date up to maturity. The fund then increases (in the case of discounts) or reduces (in the case of premiums) the income it records from the security. If the security is callable (meaning that the issuer has the option to pay it off before its maturity date), then the fund amortizes the premium to the security's call date and price, rather than the maturity date and price.

**Realized gains and losses** from security transactions are based on the identified costs of the securities involved. Gains and losses from paydowns on mortgage and asset backed securities are recorded as adjustments to interest income.

**Expenses** that are specific to a fund or a class are charged directly to that fund or class. Expenses that are common to all funds within the trust generally are allocated among the funds in proportion to their net assets.

**For funds offering multiple share classes,** all of the realized and unrealized gains or losses and net investment income, other than class specific expenses, are allocated daily to each class in proportion to its net assets.

**Each fund maintains its own account for purposes of holding assets and accounting,** and is considered a separate entity for tax purposes. Within its account, each fund also may keep certain assets in segregated accounts, required by securities law.

**The accounting policies described above conform with accounting principles generally accepted in the United States of America.** Notwithstanding this, shareholders should understand that in order to follow these principles, fund management has to make estimates and assumptions that affect the information reported in the financial statements. It's possible that once the results are known, they may turn out to be different from these estimates.

# Fund Trustees

A fund’s Board of Trustees is responsible for protecting the interests of that fund’s shareholders. The tables below give information about the people who serve as trustees and officers for the Schwab Funds®, including the funds covered in this report. Trustees remain in office until they resign, retire or are removed by shareholder vote.<sup>1</sup>

Under the Investment Company Act of 1940, any officer, director, or employee of Schwab or CSIM is considered an “interested person,” meaning that he or she is considered to have a business interest in Schwab or CSIM. These individuals are listed as “interested trustees.” The “independent trustees” are individuals who, under the 1940 Act, are not considered to have a business interest in Schwab or CSIM.

Each of the Schwab Funds (of which there were 52 as of 2/28/05) belongs to one of these trusts: The Charles Schwab Family of Funds, Schwab Investments, Schwab Capital Trust or Schwab Annuity Portfolios. Currently all these trusts have the same trustees and officers. The address for all trustees and officers is 101 Montgomery Street, San Francisco, CA 94104. You can find more information about the trustees and officers in the Statement of Additional Information, which is available free by calling 1-800-435-4000.

| Individuals Who Are Interested Trustees and Officers of the Trust |   |   |
|---|---|---|
| Name and Birthdate  | Trust Position(s);<br>Trustee Since   | Main Occupations and Other Directorships and Affiliations   |
| <b>Charles R. Schwab</b> <sup>2</sup><br>7/29/37                  | Chairman, Trustee:<br>Family of Funds, 1989;<br>Investments, 1991;<br>Capital Trust, 1993;<br>Annuity Portfolios, 1994. | Chair, CEO, Director, The Charles Schwab Corp., Charles Schwab & Co., Inc.; Chair, Director, Charles Schwab Investment Management, Inc.; Chair, Charles Schwab Holdings (UK); CEO, Director, Charles Schwab Holdings, Inc.; Chair, CEO Schwab (SIS) Holdings, Inc. I, Schwab International Holdings, Inc.; Director, Charles Schwab Bank, N.A., U.S. Trust, United States Trust Co. of New York, Siebel Systems (software), Xsign, Inc. (electronic payment systems), TrustMark, Inc., All Kinds of Minds (education); Trustee, Stanford University. <i>Until 5/04:</i> Director, The Gap, Inc. (clothing retailer). <i>Until 5/03:</i> Co-CEO, The Charles Schwab Corp. <i>Until 3/02:</i> Director, Audiobase, Inc. (Internet audio solutions). <i>Until 5/02:</i> Director, Vodaphone AirTouch PLC (telecommunications). <i>Until 7/01:</i> Director, The Charles Schwab Trust Co. |

<sup>1</sup> The Schwab Funds retirement policy requires that independent trustees elected after January 1, 2000 retire at age 72 or after twenty years of service as a trustee, whichever comes first. Independent trustees elected prior to January 1, 2000 will retire on the following schedule: Messrs. Holmes and Dorward will retire on December 31, 2007, and Messrs. Stephens and Wilsey will retire on December 31, 2010.

<sup>2</sup> In addition to his position with the investment adviser and the distributor, Mr. Schwab also owns stock of The Charles Schwab Corporation.

## Individuals Who Are Officers of the Trust but Not Trustees

| Name and Birthdate                  | Trust Office(s) Held                                       | Main Occupations and Other Directorships and Affiliations   |
|-------------------------------------|--|---|
| <b>Evelyn Dilsaver</b><br>5/4/55    | President, CEO<br>(all trusts).                            | EVP, President, Director, Charles Schwab Investment Management, Inc. <i>Until 7/04</i> : SVP for Development and Distribution, Asset Management Products and Services Enterprise. <i>Until 6/03</i> : EVP, CFO, Chief Administrative Officer, U.S. Trust.   |
| <b>Stephen B. Ward</b><br>4/5/55    | SVP, Chief Investment<br>Officer (all trusts).             | SVP, Chief Investment Officer, Director, Charles Schwab Investment Management, Inc.; Chief Investment Officer, The Charles Schwab Trust Co.   |
| <b>Kimon Daifotis</b><br>7/10/59    | SVP, Chief Investment<br>Officer (all trusts).             | <i>Since 9/04</i> : Chief Investment Officer, Fixed Income, Charles Schwab Investment Management, Inc. <i>Since 6/04</i> : SVP, Charles Schwab Investment Management, Inc. <i>Until 6/04</i> : VP, Charles Schwab Investment Management, Inc.   |
| <b>Jeffrey Mortimer</b><br>9/29/63  | SVP, Chief Investment<br>Officer (all trusts).             | <i>Since 5/04</i> : SVP, Chief Investment Officer, Equities, Charles Schwab Investment Management, Inc. <i>Since 6/04</i> : VP, Chief Investment Officer, Laudus Trust, Laudus Variable Insurance Trust. <i>Until 5/04</i> : VP, Charles Schwab Investment Management, Inc.   |
| <b>Randall Fillmore</b><br>11/11/60 | Chief Compliance<br>Officer (all trusts).                  | <i>Since 9/04</i> : SVP, Institutional Compliance and Chief Compliance Officer, Charles Schwab Investment Management, Inc. <i>Until 9/04</i> : VP, Charles Schwab & Co., Charles Schwab Investment Management, Inc. <i>Until 2002</i> : VP of Internal Audit, Charles Schwab & Co., Inc.; Chief Compliance Officer, Laudus Trust, Laudus Variable Insurance Trust. <i>Prior to 2000</i> : PricewaterhouseCoopers. |
| <b>Koji E. Felton</b><br>3/13/61    | Secretary (all trusts).                                    | SVP, Chief Counsel, Assistant Corporate Secretary, Charles Schwab Investment Management, Inc. <i>Until 6/98</i> : Branch Chief in Enforcement, U.S. Securities and Exchange Commission, San Francisco.  |
| <b>George Pereira</b><br>6/9/64     | Treasurer, Principal<br>Financial Officer<br>(all trusts). | <i>Since 11/04</i> : SVP, CFO, Charles Schwab Investment Management, Inc. <i>Until 11/04</i> : SVP, Financial Reporting, Charles Schwab & Co., Inc. <i>Until 12/99</i> : Chief Financial Officer, Commerzbank Capital Markets. <i>Until 9/99</i> : Managing Director at the New York Stock Exchange.  |

## Individuals Who Are Independent Trustees

| Name and Birthdate                   | Trustee Since  | Main Occupations and Other Directorships and Affiliations  |
|--------------------------------------|--|--|
| <b>Mariann Byerwalter</b><br>8/13/60 | 2000 (all trusts).   | Chair, JDN Corp. Advisory LLC; Trustee, Stanford University, America First Cos., Omaha, NE (venture capital/fund management), Redwood Trust, Inc. (mortgage finance), Stanford Hospitals and Clinics, SRI International (research), PMI Group, Inc. (mortgage insurance), Lucile Packard Children's Hospital. <i>Since 2/05:</i> Director, Pacific Life Insurance Company. <i>Since 2004:</i> Laudus Trust, Laudus Variable Insurance Trust. <i>2001:</i> Special Assistant to the President, Stanford University.         |
| <b>Donald F. Dorward</b><br>9/23/31  | Family of Funds, 1989; Investments, 1991; Capital Trust, 1993; Annuity Portfolios, 1994. | CEO, Dorward & Associates (corporate management, marketing and communications consulting). <i>Until 1999:</i> EVP, Managing Director, Grey Advertising. <i>Until 1996:</i> President, CEO, Allen & Dorward Advertising.  |
| <b>William A. Hasler</b><br>11/22/41 | 2000 (all trusts).   | Dean Emeritus, Haas School of Business, University of California, Berkeley; Director, Aphton Corp. (bio-pharmaceuticals); Non-Executive Chair, Solelectron Corp. (manufacturing), Mission West Properties (commercial real estate), Stratex Networks (network equipment), TOUSA (home building); Public Governor, Member, executive committee, Pacific Stock & Options Exchange. <i>Since 2004:</i> Trustee, Laudus Trust, Laudus Variable Insurance Trust. <i>Until 2/04:</i> Co-CEO, Aphton Corp. (bio-pharmaceuticals). |
| <b>Robert G. Holmes</b><br>5/15/31   | Family of Funds, 1989; Investments, 1991; Capital Trust, 1993; Annuity Portfolios, 1994. | Chair, CEO, Director, Semloh Financial, Inc. (international financial services and investment advisory firm).  |
| <b>Gerald B. Smith</b><br>9/28/50    | 2000 (all trusts).   | Chair, CEO, Founder, Smith Graham & Co. (investment advisors); Trustee, Cooper Industries (electrical products, tools and hardware); Chairman, audit committee, Northern Border Partners, L.P. (energy).   |
| <b>Donald R. Stephens</b><br>6/28/38 | Family of Funds, 1989; Investments, 1991; Capital Trust, 1993; Annuity Portfolios, 1994. | Managing Partner, D.R. Stephens & Co. (investments). <i>Until 1996:</i> Chair, CEO, North American Trust (real estate investment trust).   |
| <b>Michael W. Wilsey</b><br>8/18/43  | Family of Funds, 1989; Investments, 1991; Capital Trust, 1993; Annuity Portfolios, 1994. | Chair, CEO, Wilsey Bennett, Inc. (real estate investment and management, and other investments).   |

# Glossary

**Alternative Minimum Tax (AMT)** A federal income tax designed to limit the extent to which high-income taxpayers (including individuals, estates, trusts and corporations) can benefit from certain deductions and exemptions. For example, some types of income that are exempt from regular federal income tax are not exempt from the AMT.

**asset allocation** The practice of dividing a portfolio among different asset classes, with each asset class assigned a particular percentage.

**asset-backed securities** Bond or other debt securities that represent ownership in a pool of debt obligations such as credit card debt.

**asset class** A group of securities with similar structure and basic characteristics. Stocks, bonds and cash are the three main examples of asset classes.

**average rate** The average rate of interest paid annually by the fixed-income securities in a fund or portfolio.

**bond** A security representing a loan from the investor to the issuer. A bond typically pays interest at a fixed rate (the “coupon rate”) until a specified date (the “maturity date”), at which time the issuer returns the money borrowed (“principal” or “face value”) to the bondholder. Because of their structure, bonds are sometimes called “fixed income securities” or “debt securities.”

An individual bond is subject to the credit risk of the issuer. Changes in interest rates can affect a bond’s market value prior to call or maturity. There is no guarantee that a bond’s yield to call or maturity will provide a positive return over the rate of inflation.

**bond fund** A bond fund is subject to the same credit, interest rate, and inflation risks as bonds. In addition, a bond fund incurs ongoing fees and expenses. A bond fund’s net asset value will fluctuate with the price of the underlying bonds and the portfolio turnover activity; return of principal is not guaranteed.

**call** An early repayment of a bond’s principal by the issuer, usually done because the issuer is able to refinance its bond debt at a lower rate.

**call protection** A term used in reference to a bond that cannot be called by the issuer before maturity, or at least for many years from the present date. A bond that offers call protection can more reliably be expected to provide a given yield over a given number of years than a bond that could be called (assuming both bonds are of the same credit quality).

**capital gain, capital loss** The difference between the amount paid for an investment and its value at a later time. If the investment has been sold, the capital gain or loss is considered a realized gain or loss. If the investment is still held, the gain or loss is still “on paper” and is considered unrealized.

**certificate of participation** A municipal bond that is repaid from an annual budget appropriation rather than being backed by the full faith and credit of the issuer.

**coupon, coupon rate** The annual rate of interest paid until maturity by the issuer of a debt security.

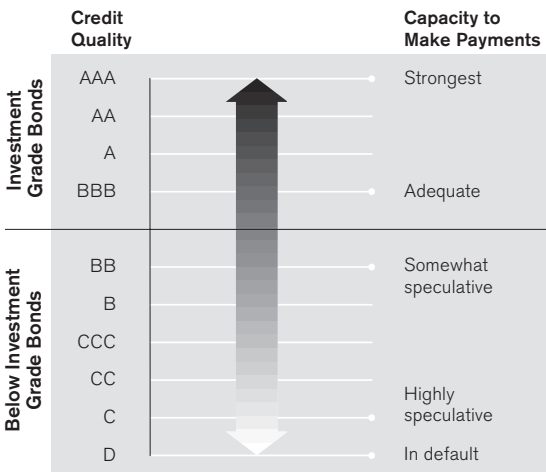
**credit quality** The capacity of an issuer to make its interest and principal payments. See chart below.

**credit risk** The risk that a bond issuer may be unable to pay interest or principal to its bondholders.

**discount rate** The implied rate on a debt security that does not pay interest but is bought at a discount and redeemed at face value when it matures.

## Credit Ratings

Most major bond issuers arrange with a recognized independent rating organization, such as Standard & Poor’s (S&P) or Moody’s Investors Service, to rate the credit-worthiness of their bonds. The spectrum of these ratings is divided into two major categories: investment grade and below investment grade (sometimes called “junk bonds”). Bonds rated below investment grade range from those that are considered to have some vulnerability to default to those that appear on the brink of default or are in default.





**dividend** Money from earnings that is distributed to shareholders as a given amount per share.

**duration** A measure of a bond's sensitivity to interest rates. Calculations of duration generally take into account the investment's yield, interest payments, maturity date and call features. Like maturity, duration is expressed in years, but is more accurate than maturity in determining the effect of interest rate movements on a bond investment's price. The duration of a portfolio equals the market value weighted average of the duration of the bonds held in the portfolio.

**expense ratio** The amount that is taken from a mutual fund's assets each year to cover the fund's operating expenses. An expense ratio of 0.50% means that a fund's expenses amount to half of one percent of its average net assets a year.

**general obligation bonds** Municipal bonds that are secured by the issuer's full faith and credit, which typically is backed by the power of the issuer to levy taxes.

**interest** Payments to bondholders (usually made twice a year) as compensation for loaning the bond principal to the issuer.

**interest rate risk** The risk that a bond's value will fluctuate if market interest rates change or are expected to change. Bond prices tend to move in the opposite direction of interest rates: when interest rates rise, bond prices tend to fall.

**market risk** Those elements of risk that are common to all securities in an asset class, and therefore cannot be significantly reduced by diversification within the asset class. Also known as "systematic risk."

**maturity** The date a bond is scheduled to be "retired" and its principal amount returned to the bondholder.

**mortgage-backed securities** Bond or other debt securities that represent ownership in a pool of mortgage loans.

**muni, municipal bonds, municipal securities** Debt securities issued by a state, its counties, municipalities, authorities and other subdivisions, or the territories and possessions of the United States and the District of Columbia, including their subdivisions, agencies and instrumentalities and corporations. These securities may be issued to obtain money for various public purposes, including the construction of a wide range of public facilities such as airports, bridges, highways, housing, hospitals, mass transportation, public utilities, schools, streets, and water and sewer works.

**net asset value (NAV)** The value of one share of a mutual fund. NAV is calculated by taking the fund's total assets, subtracting liabilities, and dividing by the number of shares outstanding.

**outstanding shares, shares outstanding** When speaking of a company or mutual fund, indicates all shares currently held by investors.

**prepayment risk** The risk that a mortgage-backed security may be paid off early, typically because interest rates have fallen and the homeowners who hold the underlying mortgages have refinanced those mortgages at lower rates. In this type of situation, the investor who held the mortgage-backed security will usually have to settle for a lower rate when reinvesting the principal.

**restricted securities** Securities that are subject to contractual restrictions on resale and may be sold only to "qualified institutional buyers" under Securities Act Rule 144A. These securities are often purchased in private placement transactions.

**revenue bonds** Municipal bonds that are issued to finance public works projects and are secured by revenue generated by the project (such as water and sewer fees) rather than the full faith and credit of the issuer.

**section 4(2)/144A securities** Securities exempt from registration under Section 4(2) of the Securities Act of 1933. These securities may be sold only to qualified institutional buyers under Securities Act Rule 144A.

**taxable-equivalent yield** The yield an investor would need to get from a taxable investment in order to match the yield paid by a given tax-exempt investment, once the effect of all applicable taxes is taken into account. For example, if your tax rate were 25%, a tax-exempt investment paying 4.5% would have a taxable-equivalent yield for you of 6.0% ( $4.5\% \div [1 - 0.25\%] = 6.0\%$ ).

**total return** The percentage that an investor would have earned or lost on an investment in the fund assuming dividends and distributions were reinvested.

**weighted average** For mutual funds, an average that gives the same weight to each security as the security represents in the fund's portfolio.

**weighted average maturity** For mutual funds, the maturity of all the bonds in its portfolio, calculated as a weighted average. As a rule, the longer a fund's weighted average maturity, the greater its interest rate risk.

**yield** The income paid out by an investment, expressed as a percentage of the investment's market value.

**yield to maturity** The annualized rate of return a bondholder could expect if the bond were held to maturity. In addition to interest payments, yield to maturity also factors in any difference between a bond's current price and its principal amount, or face value.



## Notes

## Notes

Schwab Funds® offers you a complete family of mutual funds, each one based on a clearly defined investment approach and using disciplined management strategies. The list at right shows all currently available Schwab Funds.

Whether you're an experienced investor or just starting out, Schwab Funds can help you achieve your financial goals. An investor should consider a fund's investment objectives, risks, and charges and expenses carefully before investing or sending money. This and other important information can be found in the fund's prospectus. Please call 1-800-435-4000 for a prospectus and brochure for any Schwab Fund. Please read the prospectus carefully before you invest. This report must be preceded or accompanied by a current prospectus.

### Methods for Placing Orders

The following information outlines how Schwab investors can place orders. If you are investing through a third-party investment provider, methods for placing orders may be different.

#### Internet<sup>1</sup>

[www.schwab.com](http://www.schwab.com)

#### Schwab by Phone™<sup>2</sup>

Use our automated voice service or speak to a representative. Call **1-800-435-4000**, day or night (for TDD service, call **1-800-345-2550**).

#### TeleBroker®

Use our automated touch-tone phone service at **1-800-272-4922**.

#### Mail

Write to Schwab Funds at:  
P.O. Box 3812  
Englewood, CO  
80155-3812

When selling or exchanging shares, be sure to include the signatures of at least one of the persons whose name is on the account.

### Proxy Voting Policies, Procedures and Results

A description of the proxy voting policies and procedures used to determine how to vote proxies on behalf of the funds is available without charge, upon request, by visiting Schwab's web site at [www.schwab.com/schwabfunds](http://www.schwab.com/schwabfunds), the SEC's web site at <http://www.sec.gov>, or by contacting Schwab Funds at 1-800-435-4000.

Information regarding how a fund voted proxies relating to portfolio securities during the most recent twelve-month period ended June 30 is available, without charge, by visiting Schwab's web site at [www.schwab.com/schwabfunds](http://www.schwab.com/schwabfunds) or the SEC's website at <http://www.sec.gov>.

## The Schwab Funds Family®

### Stock Funds

Schwab S&P 500 Index Fund  
Schwab 1000 Index Fund®  
Schwab Small-Cap Index Fund®  
Schwab Total Stock Market Index Fund®  
Schwab International Index Fund®  
Schwab Core Equity Fund™  
Schwab Dividend Equity Fund™  
Schwab Small-Cap Equity Fund™  
Schwab Hedged Equity Fund™  
Schwab Financial Services Fund  
Schwab Health Care Fund  
Schwab Technology Fund  
Schwab® Institutional Select® Funds  
    Schwab® Institutional Select® S&P 500 Fund  
    Schwab® Institutional Select® Large-Cap Value Index Fund  
    Schwab® Institutional Select® Small-Cap Value Index Fund

### Asset Allocation Funds

Schwab MarketTrack Portfolios®  
    Schwab MarketTrack All Equity Portfolio™  
    Schwab MarketTrack Growth Portfolio™  
    Schwab MarketTrack Balanced Portfolio™  
    Schwab MarketTrack Conservative Portfolio™

### Bond Funds

Schwab YieldPlus Fund®  
Schwab Short-Term Bond Market Fund™  
Schwab Total Bond Market Fund™  
Schwab GNMA Fund™  
Schwab Tax-Free YieldPlus Fund™  
Schwab Short/Intermediate Tax-Free Bond Fund™  
Schwab Long-Term Tax-Free Bond Fund™  
Schwab California Tax-Free YieldPlus Fund™  
Schwab California Short/Intermediate Tax-Free Bond Fund™  
Schwab California Long-Term Tax-Free Bond Fund™

### Schwab Money Funds

Schwab offers an array of money market funds that seek high current income consistent with safety and liquidity.<sup>3</sup> Choose from taxable or tax-advantaged alternatives. Many can be linked to your eligible Schwab account to "sweep" cash balances automatically, subject to availability, when you're between investments. Or, for your larger cash reserves, choose one of our Value Advantage Investments®.

<sup>1</sup> Shares of Sweep Investments™ may not be purchased directly over the Internet.

<sup>2</sup> Orders placed in person or through a telephone representative may be subject to a service fee payable to Schwab.

<sup>3</sup> Investments in money market funds are neither insured nor guaranteed by the Federal Deposit Insurance Corporation (FDIC) or any other government agency and, although they seek to preserve the value of your investment at \$1 per share, it is possible to lose money.

**Investment Adviser**

Charles Schwab Investment Management, Inc.  
101 Montgomery Street, San Francisco, CA 94104

**Distributor**

Charles Schwab & Co., Inc. (Schwab)

**Funds**

Schwab Funds®  
P.O. Box 3812, Englewood, CO 80155-3812

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# Schwab Tax-Free Bond Funds

## **Semiannual Report**

February 28, 2005

Schwab Tax-Free  
YieldPlus Fund™

Schwab Short/Intermediate  
Tax-Free Bond Fund™

Schwab Long-Term  
Tax-Free Bond Fund™

Schwab California Tax-Free  
YieldPlus Fund™

Schwab California  
Short/Intermediate  
Tax-Free Bond Fund™

Schwab California Long-Term  
Tax-Free Bond Fund™

*charles* SCHWAB

# *Six funds designed to offer tax-free income.<sup>1</sup>*

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The president of Schwab Funds® and the funds' managers take a look at the factors that shaped fund performance during the report period.

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### Schwab Tax-Free YieldPlus Fund™

Investor Shares: **SWYIX** Select Shares®: **SWYTX**

The fund seeks high current income that is exempt from federal income tax, consistent with minimal changes in share price.<sup>1</sup>

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### Schwab Short/Intermediate

#### Tax-Free Bond Fund™

Ticker Symbol: **SWITX**

The fund seeks high current income that is exempt from federal income tax, consistent with capital preservation.<sup>1</sup>

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### Schwab Long-Term Tax-Free Bond Fund™

Ticker symbol: **SWNTX**

The fund seeks high current income that is exempt from federal income tax, consistent with capital preservation.<sup>1</sup>

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### Schwab California Tax-Free YieldPlus Fund™

Investor Shares: **SWYKX** Select Shares: **SWYCX**

The fund seeks high current income that is exempt from federal and California personal income tax, consistent with minimal changes in share price.<sup>1</sup>

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### Schwab California Short/Intermediate Tax-Free Bond Fund™

Ticker symbol: **SWCSX**

The fund seeks high current income exempt from federal and California personal income tax that is consistent with capital preservation.<sup>1</sup>

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### Schwab California Long-Term Tax-Free Bond Fund™

Ticker symbol: **SWCAX**

The fund seeks high current income exempt from federal and California personal income tax that is consistent with capital preservation.<sup>1</sup>

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Fund investment adviser: Charles Schwab Investment Management, Inc. (CSIM).

Distributor and transfer agent: Charles Schwab & Co., Inc. (Schwab).

<sup>1</sup> A portion of income may be subject to the alternative minimum tax (AMT) and, for the national funds, state and local income taxes as well.

# From the Chairman



Charles Schwab  
Chairman

Dear Shareholder,

I am a big fan of mutual funds and have been throughout my 40-year career. During this time, the mutual fund market has grown, with investors today having nearly 17,000 funds from which to choose.

I also have advocated the need to take a long-term view of investing, as well as the importance of developing and maintaining an asset allocation plan. I continue to believe that mutual funds are excellent vehicles to help you build a diversified portfolio in keeping with your goals. More specifically, bond funds can fill the fixed income portion of your asset allocation plan while helping to cushion the impact of more volatile asset classes.

We have developed Schwab bond funds that are designed to deliver both performance and value. Our range of tax-free bond funds is designed to help investors in higher tax brackets retain more of what they earn. We recently introduced two new bond funds that can help you meet your long-term cash management needs: Schwab Tax-Free YieldPlus Fund™ and Schwab California Tax-Free YieldPlus Fund™. These funds generally do not invest in securities that generate income subject to the Alternative Minimum Tax (AMT).

As to value, I'd like to remind you that many of the Schwab Funds®, including the two new funds mentioned above, offer Select Shares®, a share class that carries lower expenses in exchange for higher investment minimums.

In closing, I want to remind you that our commitment to our shareholders will not change. Thank you for investing with us.

Sincerely,

A handwritten signature in black ink that reads "Charles Schwab". The signature is written in a cursive, flowing style.

# Management's Discussion

for the six months ended February 28, 2005



**Evelyn Dilsaver** is President and CEO of Charles Schwab Investment Management, Inc. and is president of each of the funds covered in this report. She joined the firm in 1992 and has held a variety of executive positions at Schwab.

Dear Shareholder,

When I assumed my new role as President and CEO of Schwab Funds® last year, I pledged that I would be committed to offering you more relevant choices and better value. I am pleased to report that we already have done both.

In terms of new products, we recently introduced two new tax-free bond funds: Schwab Tax-Free YieldPlus Fund™ and Schwab California Tax-Free YieldPlus Fund™. These funds are designed to help you get more from your long-term cash investments. Further, in response to growing investor concern over the federal alternative minimum tax (AMT), neither of these two funds has invested in securities that generate income subject to AMT.

I'm also happy to announce that Schwab Funds has launched another equity fund. The Schwab Premier Equity Fund™ is the newest addition to the actively managed Schwab Funds that use Schwab Equity Ratings®.

To reiterate what Chuck Schwab said about providing great value to our shareholders, our two new funds—the Schwab Tax-Free YieldPlus Fund and the Schwab California Tax-Free YieldPlus Fund—as well as the Schwab YieldPlus Fund® and the Schwab GNMA Fund™ offer Select Shares®.

I speak for all of Schwab Funds, when I say we want Schwab to be a place where investors can find useful, quality financial products and services to help them succeed. Regardless of the size of their portfolios, Schwab should be the place investors can always trust to watch out for their best interests.

I continue to look for more ways to offer you relevant choices and value. Your trust is very important to us, and I will do all I can to maintain that trust. Thank you for investing in Schwab Funds.

Sincerely,

A handwritten signature in dark ink that reads "Evelyn Dilsaver". The signature is fluid and cursive, with a large, stylized "E" and "D".

*Investors should consider carefully information contained in the prospectus, including investment objectives, risks, charges and expenses. You can request a prospectus by calling Schwab at 1-800-435-4000. Please read the prospectus carefully before investing.*





**Joanne Larkin**, at right, a vice president of the investment adviser, has had overall management responsibility for the funds since their inception. She joined the firm in 1992, and has worked in fixed-income asset management and research since 1984.

**Kim Daifotis, CFA**, at left, a senior vice president and chief investment officer, fixed income, of the investment adviser, co-manages the tax-free YieldPlus funds. He joined the firm in 1997, and has worked in fixed-income asset management and research since 1982.

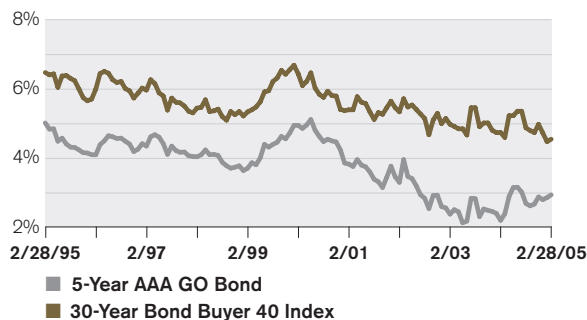
## The Investment Environment and the Funds

Oil prices hit highs never seen before, the Federal Reserve raised short-term interest rates to curb inflationary pressures, and GDP showed impressive growth. As expected in this type of economic environment, short/intermediate bonds went up in yield and down in price. What wasn't expected was how little these events affected long-term bonds, which traded in a narrow range throughout the six-month report period.

Early in the period, investors were heartened when oil prices dipped and major summer events—both political conventions and the Olympics in Greece—went off without any terrorism. Unfortunately, the brief respite in oil prices was short-lived. Strengthening global demand for oil, particularly in the Pacific Rim, and supply constraints in the wake of the Florida hurricanes, drove crude prices to record highs, above \$50 per barrel in late October. After that crude prices backed off to the mid-\$40 range, as supply concerns dissipated, but then spiked upwards again in mid-February.

The firming labor market, as well as steady gains in capital spending, kept the economic expansion on a self-sustaining path. The caution surrounding the economic outlook and geopolitical environment began to dissipate just prior to the beginning of the report period and firms, unable to continue boosting productivity by restraining hiring, added more than two million new jobs during 2004. Moreover, many leading indicators, such as the Institute for Supply Management's business

**Yields of Municipal Securities: Effective Yields of Five-Year and 30-Year Municipal Bonds**



**As the Fed raised short-term interest rates, the spread tightened.**

Yields, or interest rates, represent the cost of borrowing money. Rapid economic growth, waning investor interest in bonds, an increase in the issuance of bonds, or the expectation of higher inflation can drive rates up, while the opposite conditions can push rates down.

Data source: Bloomberg L.P.

**Performance at a Glance**

Total return for the six months ended 2/28/05, except where noted.

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**Schwab Tax-Free YieldPlus Fund™**

Total return for 12/16/04 – 2/28/05  
Investor Shares . . . . . **0.33%**  
Select Shares® . . . . . **0.33%**  
Benchmark . . . . . **0.08%**  
Fund Category¹ . . . . . **-0.08%**

*Performance Details . . . . . page 7-8*

**Schwab Short/Intermediate Tax-Free Bond Fund™ . . . . . -0.10%**  
Benchmark . . . . . **-0.13%**  
Fund Category¹ . . . . . **0.22%**

*Performance Details . . . . . page 10*

**Schwab Long-Term Tax-Free Bond Fund™ . . . . . 1.61%**  
Benchmark . . . . . **2.40%**  
Fund Category¹ . . . . . **2.29%**

*Performance Details . . . . . page 12*

activity surveys suggested further improvement, while continuing claims for unemployment benefits remained near cyclical lows.

Consumer sentiment rebounded, the labor market continued to sustain consumer spending, and corporate liquidity remained positive. Though some adverse effects of high oil and commodity prices earlier in the year may have hampered growth and stirred inflationary pressures, strong productivity growth and slack in the economy have thus far kept a lid on inflation.

Amid signs of solidly expanding output and improved hiring, the Fed began to take the Fed funds rate higher. The rate was raised in June and August, as well as another four times since then, ending the report period at a still-moderate 2.50%. The moves have had a limited impact on overall economic growth, due primarily to the record-low level of rates from which the increases began.

The Fed's action led investors to expect that rates would continue to rise, causing the yield curve to flatten considerably at the front end: the 2-year Treasury Note increased about 1.20% during the period, while the 10-year Treasury Note declined about 0.26%. Fed chief Alan Greenspan called it a conundrum as to why in this type of economy longer rates on bond yields haven't gone up more. Other experts suggested that the slight inflation we're seeing remains contained, and the Fed won't let it get out of control.

**Muni yields traded in a relatively narrow range, with short rates trending upwards.** The muni yield curve continued to flatten, with rates rising at the short end on the likelihood that there will be more interest rate hikes. Generally speaking, a flattening trend in the yield curve suggests that investors believe economic activity will slow, though the curve is still steep enough to suggest modest growth.

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A portion of income may be subject to the alternative minimum tax (AMT) and, for the national funds, state and local income tax as well.  
¹ Source for category information: Morningstar, Inc.

## Performance at a Glance

Total return for the six months ended 2/28/05, except where noted.

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### Schwab California Tax-Free YieldPlus Fund™

Total return for 12/16/04 – 2/28/05  
Investor Shares . . . . . **0.22%**  
Select Shares . . . . . **0.22%**  
Benchmark . . . . . **0.08%**  
Fund Category¹ . . . . . **0.07%**

*Performance Details . . . . . page 14-15*

### Schwab California Short/Intermediate Tax-Free Bond Fund™

. . . . . **0.29%**  
Benchmark . . . . . **-0.13%**  
Fund Category¹ . . . . . **1.21%**

*Performance Details . . . . . page 17*

### Schwab California Long-Term Tax-Free Bond Fund™

. . . . . **2.60%**  
Benchmark . . . . . **2.40%**  
Fund Category¹ . . . . . **2.82%**

*Performance Details . . . . . page 19*

Within this economic scenario, there were several unknowns, including the escalating price of oil, variable monthly employment numbers, and the direction that interest rates would take. We were of the opinion that interest rates would move higher and we managed our portfolios accordingly.

*The Schwab Tax-Free YieldPlus Fund and the Schwab California Tax-Free YieldPlus Fund were launched on December 16, 2004. Performance numbers are since inception, not for the full six-month report period.*

**The Schwab Tax-Free YieldPlus Fund and the Schwab California Tax-Free YieldPlus Fund** beat their benchmark, the Lehman Brothers 1-Year Municipal Bond Index, for the period since inception. All the bonds purchased by the funds were investment grade. Our credit-research group, however, was able to find opportunities in the lower-rated end of the investment-grade spectrum and selected names that performed well in this economic environment. Furthermore, neither fund invested in securities that generate income subject to the AMT.

**Schwab Short/Intermediate Tax-Free Bond Fund and Schwab Long-Term Tax-Free Bond Fund** had mixed results relative to their respective benchmarks. The long-term fund had positive returns, but fell short of its benchmark and the category average. The short/intermediate fund slightly beat its benchmark, lagged the category and was slightly down for the six-month period. We managed the funds conservatively, buying high-quality AA or better paper, including essential services such as water and sewer bonds. (Approximately 70% of the holdings in the funds were AA or higher.) We also kept the duration short-to-neutral relative to our peers.

**The Schwab California Short/Intermediate Tax-Free Bond Fund and Schwab California Long-Term Tax-Free Bond Fund** beat their respective benchmarks, but fell short of the category averages. The positive performance relative to their benchmarks was partially due to the three major

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¹ Source for category information: Morningstar, Inc.

*The muni yield curve continued to flatten, with rates rising at the short end on the likelihood that there will be more interest rate hikes.*

credit-rating agencies upgrading their California ratings. The upgrades served to tighten the credit-quality spreads, which contributed to California's general obligation bonds outperforming their national counterparts. Similar to how we managed the national funds, these funds also were managed conservatively, and we kept the duration short-to-neutral relative to our peers. This approach also led us to buy essential services, such as water and sewer bonds.

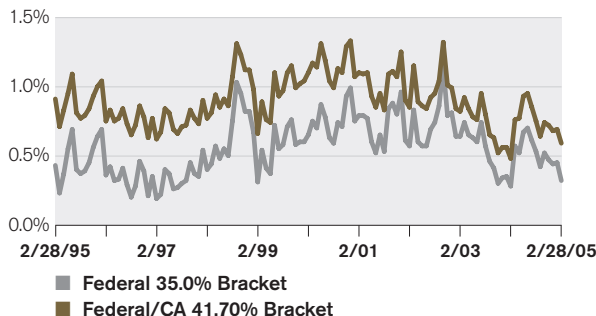
Nothing in this report represents a recommendation of a security by the investment adviser. Manager views and portfolio holdings may have changed since the report date.

#### Yield Advantage of Munis over Treasuries: For Five-Year Bonds; Tax Brackets Shown are the Highest Applicable

**Demand was strong throughout the period, with munis outperforming Treasuries. By the end of the period, the spread relationship between munis and Treasuries was at a historic low.**

This chart shows how much more the average five-year muni yielded than the average five-year Treasury after federal (or combined California and federal) income tax.

Data source: Bloomberg L.P.



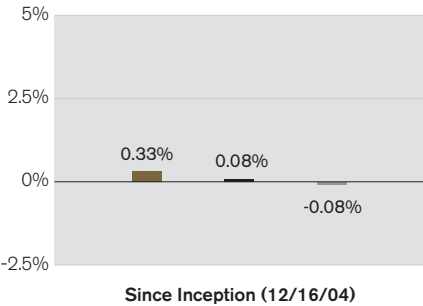
# Schwab Tax-Free YieldPlus Fund™

## Investor Shares Performance as of 2/28/05

### Total Returns<sup>1, 2</sup>

This bar chart compares performance of the fund's Investor Shares with its benchmark and Morningstar category.

- Fund: **Investor Shares**
- Benchmark: **Lehman Brothers 1-Year Municipal Bond Index**
- Fund Category: **Morningstar Municipal National Intermediate/Short Bond**

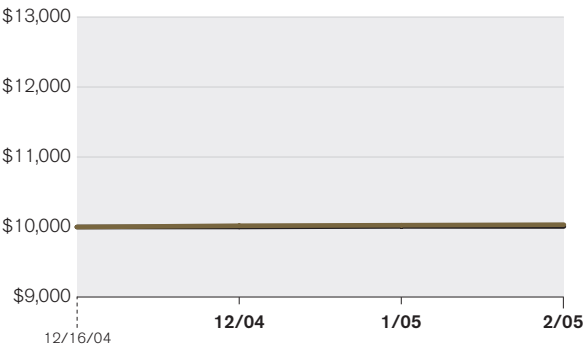


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### Performance of a Hypothetical \$10,000 Investment<sup>1</sup>

This graph shows performance since inception of a hypothetical \$10,000 investment in the fund's Investor Shares compared with a similar investment in its benchmark.

- \$10,033 **Investor Shares**
- \$10,008 **Lehman Brothers 1-Year Municipal Bond Index**



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<sup>1</sup> Fund expenses have been absorbed by CSIM and Schwab. Without these reductions, the fund's total return would have been lower. Performance does not reflect the deduction of taxes that a shareholder would pay on fund distributions or on the redemption of fund shares.

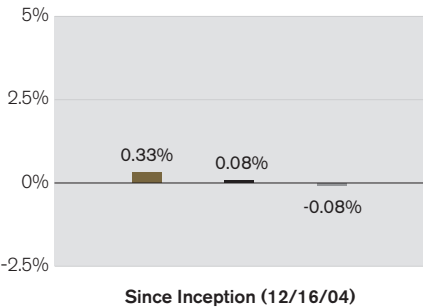
<sup>2</sup> Source for category information: Morningstar, Inc.

Select Shares® Performance as of 2/28/05

Total Returns<sup>1, 2</sup>

This bar chart compares performance of the fund's Select Shares with its benchmark and Morningstar category.

- Fund: **Select Shares**
- Benchmark: **Lehman Brothers 1-Year Municipal Bond Index**
- Fund Category: **Morningstar Municipal National Intermediate/Short Bond**

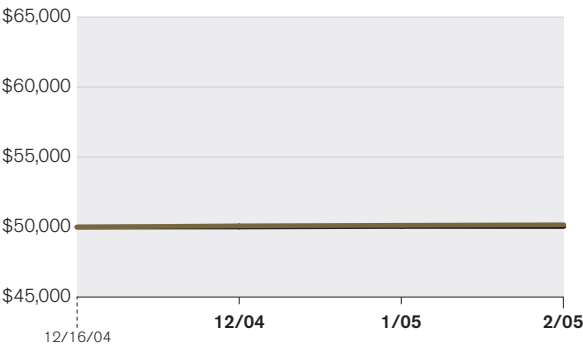


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Performance of a Hypothetical \$50,000 Investment<sup>1</sup>

This graph shows performance since inception of a hypothetical \$50,000 investment (the minimum investment for this share class) in the fund's Select Shares, compared with a similar investment in its benchmark.

- \$50,167 **Select Shares**
- \$50,038 **Lehman Brothers 1-Year Municipal Bond Index**



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<sup>1</sup> Fund expenses have been absorbed by CSIM and Schwab. Without these reductions, the fund's total return would have been lower. Performance does not reflect the deduction of taxes that a shareholder would pay on fund distributions or on the redemption of fund shares.

<sup>2</sup> Source for category information: Morningstar, Inc.

Fund Facts as of 2/28/05

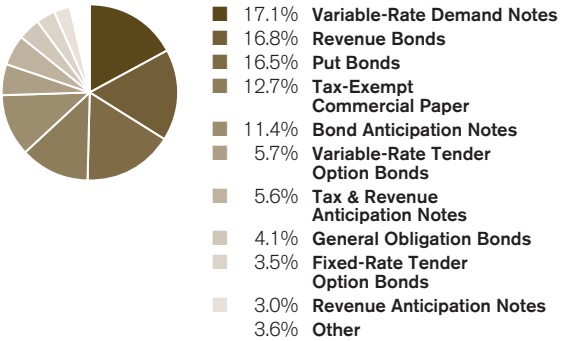
| Statistics  |          |
|---|----------|
| Number of Holdings  | 75       |
| Style Assessment <sup>1</sup>                                   |          |
| Interest Rate Sensitivity                                       | Short    |
| Credit Quality  | High     |
| 30-Day SEC Yield <sup>2</sup>                                   |          |
| Investor Shares   | 2.24%    |
| Select Shares   | 2.24%    |
| 30-Day SEC Yield—No Waiver <sup>3</sup>                         |          |
| Investor Shares   | 1.56%    |
| Select Shares   | 1.71%    |
| Taxable-Equivalent Yield <sup>4</sup>                           |          |
| Investor Shares   | 3.45%    |
| Select Shares   | 3.45%    |
| Weighted Average Maturity                                       | 0.9 yrs  |
| Weighted Average Duration                                       | 0.8 yrs  |
| Weighted Average Credit Quality                                 | AA       |
| Portfolio Turnover Rate <sup>5</sup>                            | 0%       |
| Minimum Initial Investment                                      |          |
| Investor Shares (\$1,000 for retirement and custodial accounts) | \$2,500  |
| Select Shares   | \$50,000 |

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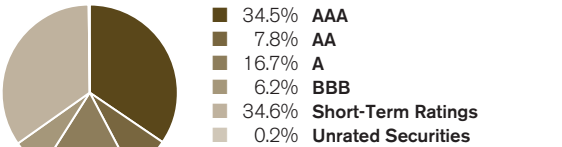
Portfolio Composition % of Investments

These charts show three different views of the fund's portfolio: by type of security, credit quality of the security and remaining maturity.

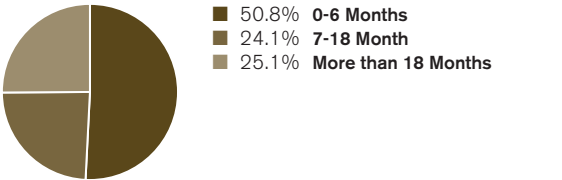
By Security Type



By Credit Quality<sup>6</sup>



By Maturity



Portfolio holdings may have changed since the report date.

<sup>1</sup> Source: Morningstar, Inc. Interest rate sensitivity and credit quality are two main components of bond performance. The assessment reflects the fund's portfolio as of 2/28/05, and is not a precise indication of risk or performance—past, present or future. Definitions of style assessments: Sensitivity (measured as duration): Short, up to 3.5 years; Medium, more than 3.5 years to less than six years; Long, six years or greater. Credit quality: High, AA or better; Medium, A or BBB; Low, BB or lower.

<sup>2</sup> Fund expenses have been waived by CSIM and Schwab and are guaranteed to be 0.00% from 12/16/04 (commencement of operations) through 5/01/05. The yields do not reflect the deduction of taxes that a shareholder would pay on fund distributions or on the redemption of fund shares.

<sup>3</sup> Yield if fund expenses had not been absorbed by CSIM and Schwab.

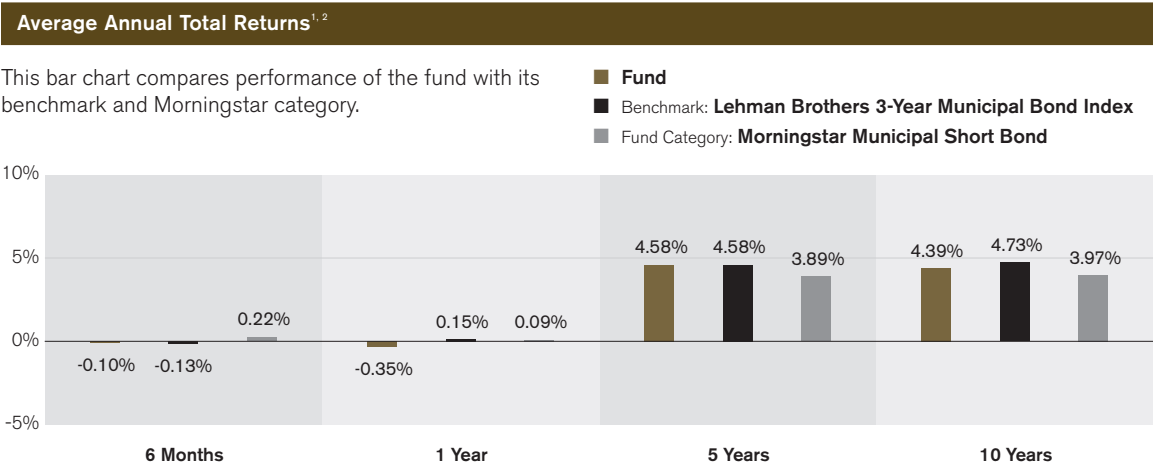
<sup>4</sup> This is the taxable-equivalent 30-day SEC yield for a hypothetical investor in the highest federal tax bracket (35.00%). Your tax rate may be different.

<sup>5</sup> Not annualized.

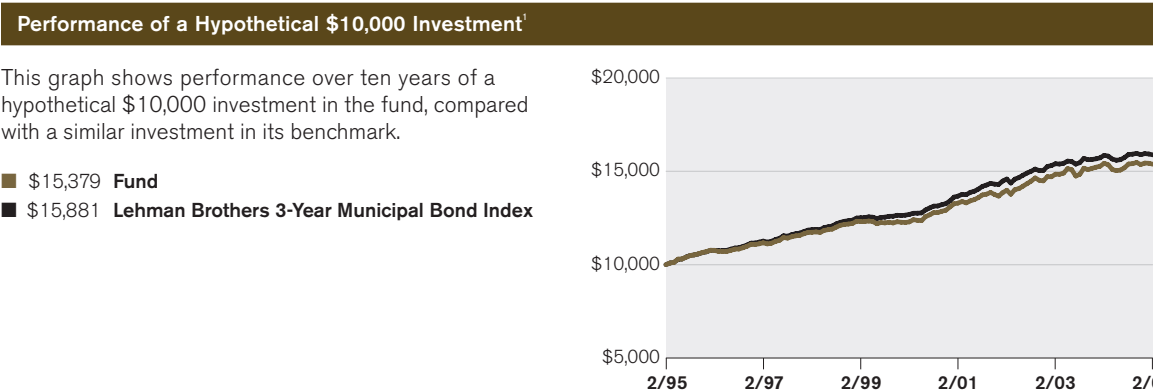
<sup>6</sup> Based on ratings from Moody's. Where Moody's ratings are not available, Standard & Poor's ratings are used. The fund may use different ratings provided by other ratings agencies for purposes of determining compliance with the fund's investment policies.

# Schwab Short/Intermediate Tax-Free Bond Fund™

Performance as of 2/28/05



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<sup>2</sup> Source for category information: Morningstar, Inc.



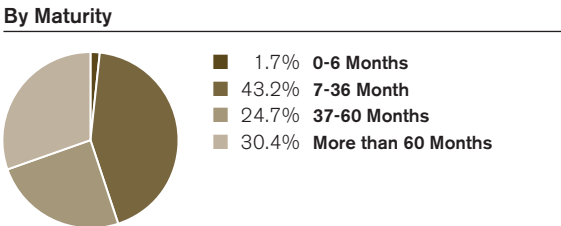
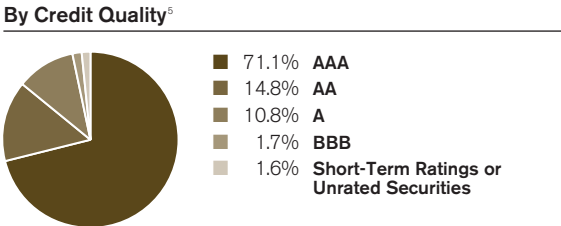
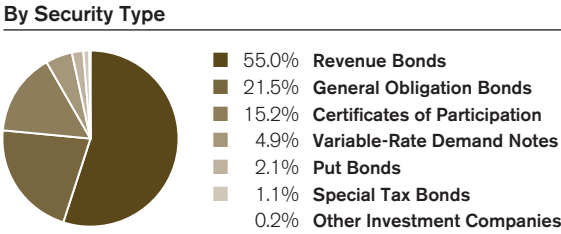
Fund Facts as of 2/28/05

| Statistics                               |         |
|--|---------|
| Number of Holdings                       | 61      |
| Style Assessment <sup>1</sup>            |         |
| Interest Rate Sensitivity                | Short   |
| Credit Quality                           | High    |
| 30-Day SEC Yield <sup>2</sup>            | 2.31%   |
| Taxable-Equivalent Yield <sup>3</sup>    | 3.55%   |
| 12-Month Distribution Yield <sup>2</sup> | 2.67%   |
| Weighted Average Maturity                | 4.6 yrs |
| Weighted Average Duration                | 3.2 yrs |
| Weighted Average Credit Quality          | AAA     |
| Portfolio Turnover Rate <sup>4</sup>     | 0%      |
| Minimum Initial Investment               | \$2,500 |
| (\$1,000 for custodial accounts)         |         |

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Portfolio Composition % of Investments

These charts show three different views of the fund's portfolio: by type of security, credit quality of the security and remaining maturity.



Portfolio holdings may have changed since the report date.

<sup>1</sup> Source: Morningstar, Inc. Interest rate sensitivity and credit quality are two main components of bond performance. The assessment reflects the fund's portfolio as of 2/28/05 and is not a precise indication of risk or performance—past, present or future. Definitions of style assessments: Sensitivity (measured as duration): Short, up to 4.5 years; Medium, more than 4.5 years to less than seven years; Long, seven years or greater. Credit quality: High, AA or better; Medium, A or BBB; Low, BB or lower.

<sup>2</sup> The yield does not reflect the deduction of taxes that a shareholder would pay on fund distributions or on the redemption of fund shares.

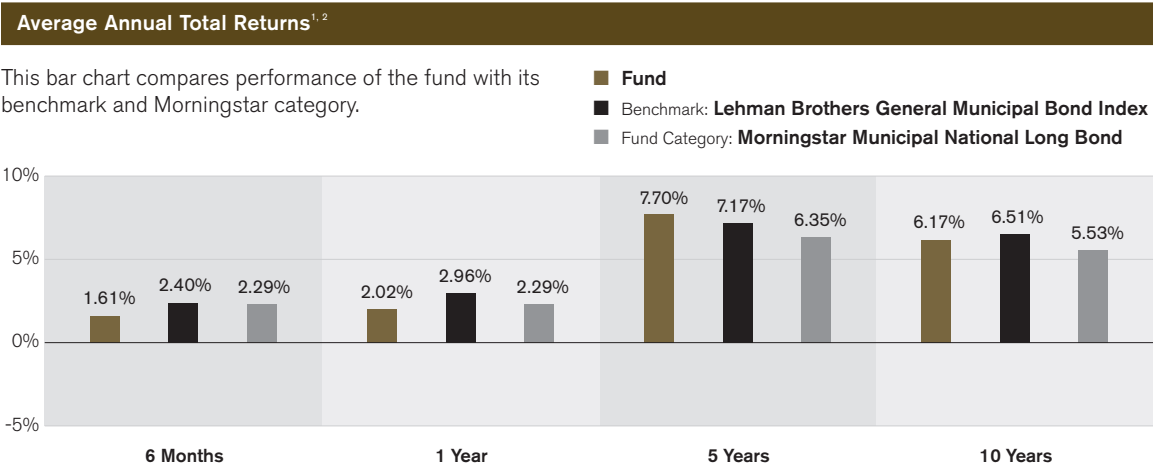
<sup>3</sup> This is the taxable-equivalent 30-day SEC yield for a hypothetical investor in the highest federal tax bracket (35.00%). Your tax rate may be different.

<sup>4</sup> Not annualized.

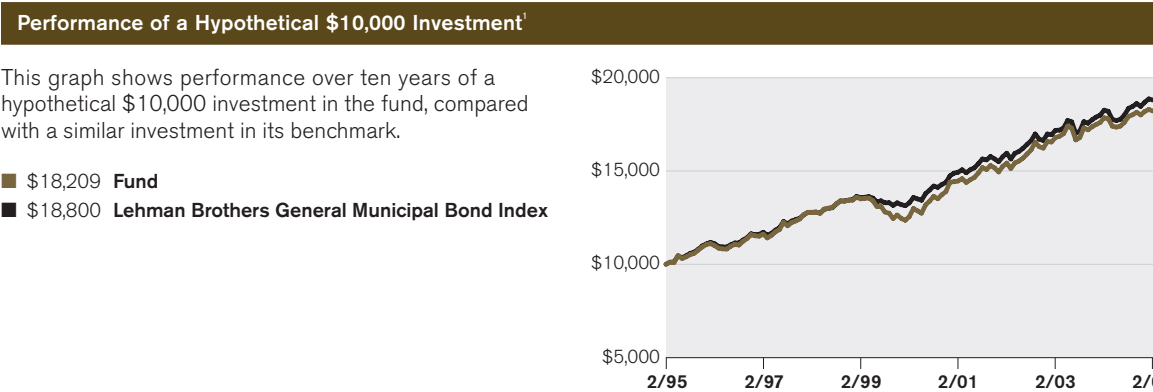
<sup>5</sup> Based on ratings from Moody's. Where Moody's ratings are not available, Standard & Poor's ratings are used. The fund may use different ratings provided by other ratings agencies for purposes of determining compliance with the fund's investment policies.

# Schwab Long-Term Tax-Free Bond Fund<sup>TM</sup>

Performance as of 2/28/05



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<sup>1</sup> Fund expenses have been partially absorbed by CSIM and Schwab. Without these reductions, the fund's total return would have been lower. Performance does not reflect the deduction of taxes that a shareholder would pay on fund distributions or on the redemption of fund shares.

<sup>2</sup> Source for category information: Morningstar, Inc.

Fund Facts as of 2/28/05

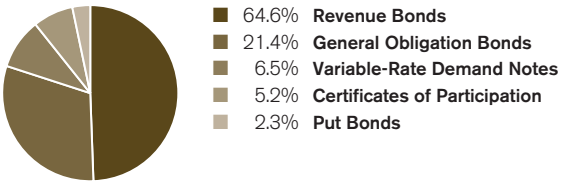
| Statistics                               |          |
|--|----------|
| Number of Holdings                       | 53       |
| Style Assessment <sup>1</sup>            |          |
| Interest Rate Sensitivity                | Long     |
| Credit Quality                           | High     |
| 30-Day SEC Yield <sup>2</sup>            | 3.78%    |
| 30-Day SEC Yield—No Waiver <sup>3</sup>  | 3.77%    |
| Taxable-Equivalent Yield <sup>4</sup>    | 5.82%    |
| 12-Month Distribution Yield <sup>2</sup> | 3.93%    |
| Weighted Average Maturity                | 11.9 yrs |
| Weighted Average Duration                | 5.3 yrs  |
| Weighted Average Credit Quality          | AAA      |
| Portfolio Turnover Rate <sup>5</sup>     | 0%       |
| Minimum Initial Investment               | \$2,500  |
| (\$1,000 for custodial accounts)         |          |

The performance data quoted represents past performance. Past performance does not guarantee future results. Investment returns and principal value will fluctuate so that an investor's shares may be worth more or less than their original cost. Current performance may be lower or higher than performance data quoted. To obtain performance information current to the most recent month end, please visit [www.schwab.com/schwabfunds](http://www.schwab.com/schwabfunds).

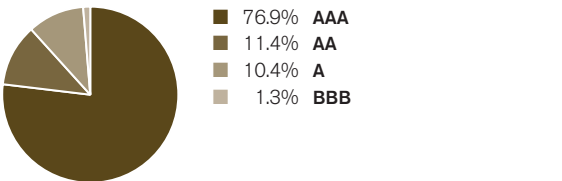
Portfolio Composition % of Investments

These charts show three different views of the fund's portfolio: by type of security, credit quality of the security and remaining maturity.

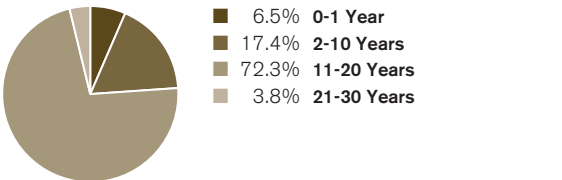
By Security Type



By Credit Quality<sup>6</sup>



By Maturity



Portfolio holdings may have changed since the report date.

<sup>1</sup> Source: Morningstar, Inc. Interest rate sensitivity and credit quality are two main components of bond performance. The assessment reflects the fund's portfolio as of 2/28/05 and is not a precise indication of risk or performance—past, present or future. Definitions of style assessments: Sensitivity (measured as duration): Short, up to 4.5 years; Medium, more than 4.5 years to less than seven years; Long, seven years or greater. Credit quality: High, AA or better; Medium, A or BBB; Low, BB or lower.

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<sup>3</sup> Yield if fund expenses had not been partially absorbed by CSIM and Schwab.

<sup>4</sup> This is the taxable-equivalent 30-day SEC yield for a hypothetical investor in the highest federal tax bracket (35.00%). Your tax rate may be different.

<sup>5</sup> Not annualized.

<sup>6</sup> Based on ratings from Moody's. Where Moody's ratings are not available, Standard & Poor's ratings are used. The fund may use different ratings provided by other ratings agencies for purposes of determining compliance with the fund's investment policies.

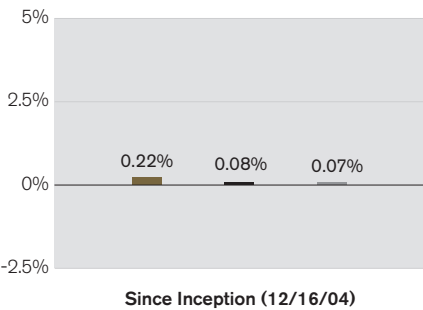
# Schwab California Tax-Free YieldPlus Fund™

## Investor Shares Performance as of 2/28/05

### Total Returns<sup>1, 2</sup>

This bar chart compares performance of the fund's Investor Shares with its benchmark and Morningstar category.

- Fund: **Investor Shares**
- Benchmark: **Lehman Brothers 1-Year Municipal Bond Index**
- Fund Category: **Morningstar Municipal California Intermediate/Short Bond**

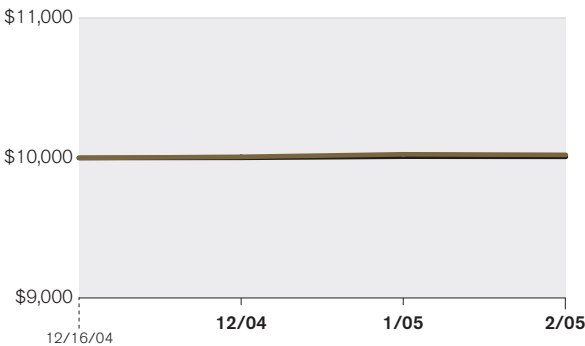


The performance data quoted represents past performance. Past performance does not guarantee future results. Investment returns and principal value will fluctuate so that an investor's shares may be worth more or less than their original cost. Current performance may be lower or higher than performance data quoted. To obtain performance information current to the most recent month end, please visit [www.schwab.com/schwabfunds](http://www.schwab.com/schwabfunds).

### Performance of a Hypothetical \$10,000 Investment<sup>1</sup>

This graph shows performance since inception of a hypothetical \$10,000 investment in the fund's Investor Shares compared with a similar investment in its benchmark.

- \$10,022 **Investor Shares**
- \$10,008 **Lehman Brothers 1-Year Municipal Bond Index**



All figures on this page assume dividends and distributions were reinvested. Index figures do not include trading and management costs, which would lower performance. Indices are unmanaged, and you cannot invest in them directly. Performance results less than one year are not annualized.

<sup>1</sup> Fund expenses have been absorbed by CSIM and Schwab. Without these reductions, the fund's total return would have been lower. Performance does not reflect the deduction of taxes that a shareholder would pay on fund distributions or on the redemption of fund shares.

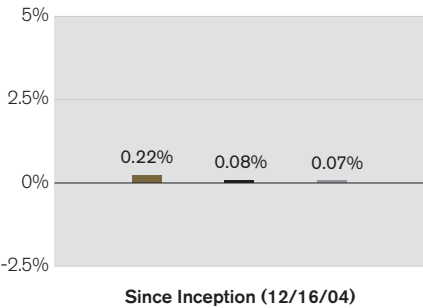
<sup>2</sup> Source for category information: Morningstar, Inc.

Select Shares® Performance as of 2/28/05

Total Returns<sup>1, 2</sup>

This bar chart compares performance of the fund's Select Shares with its benchmark and Morningstar category.

- Fund: **Select Shares**
- Benchmark: **Lehman Brothers 1-Year Municipal Bond Index**
- Fund Category: **Morningstar Municipal California Intermediate/Short Bond**

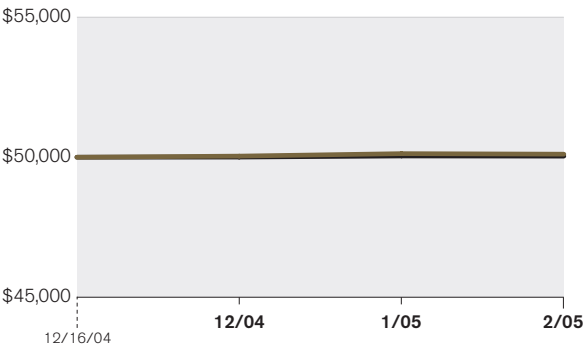


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Performance of a Hypothetical \$50,000 Investment<sup>1</sup>

This graph shows performance since inception of a hypothetical \$50,000 investment (the minimum investment for this share class) in the fund's Select Shares, compared with a similar investment in its benchmark.

- \$50,109 **Select Shares**
- \$50,038 **Lehman Brothers 1-Year Municipal Bond Index**

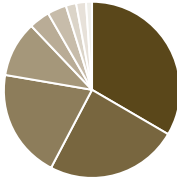
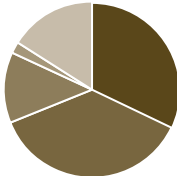
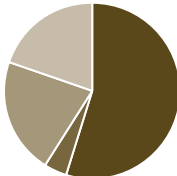


All figures on this page assume dividends and distributions were reinvested. Index figures do not include trading and management costs, which would lower performance. Indices are unmanaged, and you cannot invest in them directly. Performance results less than one year are not annualized.

<sup>1</sup> Fund expenses have been absorbed by CSIM and Schwab. Without these reductions, the fund's total return would have been lower. Performance does not reflect the deduction of taxes that a shareholder would pay on fund distributions or on the redemption of fund shares.

<sup>2</sup> Source for category information: Morningstar, Inc.

Fund Facts as of 2/28/05

| Statistics   |                                  | Portfolio Composition % of Investments |                                   |
|--|----------------------------------|--|-----------------------------------|
| <b>Number of Holdings</b>  |                                  | 75                                     |                                   |
| <b>Style Assessment<sup>1</sup></b>  |                                  |  |                                   |
| Interest Rate Sensitivity  |                                  | Short                                  |                                   |
| Credit Quality   |                                  | High                                   |                                   |
| <b>30-Day SEC Yield<sup>2</sup></b>  |                                  |  |                                   |
| Investor Shares  |                                  | 2.22%                                  |                                   |
| Select Shares  |                                  | 2.22%                                  |                                   |
| <b>30-Day SEC Yield—No Waiver<sup>3</sup></b>  |                                  |  |                                   |
| Investor Shares  |                                  | 1.57%                                  |                                   |
| Select Shares  |                                  | 1.72%                                  |                                   |
| <b>Taxable-Equivalent Yield<sup>4</sup></b>  |                                  |  |                                   |
| Investor Shares  |                                  | 3.81%                                  |                                   |
| Select Shares  |                                  | 3.81%                                  |                                   |
| <b>Weighted Average Maturity</b>   |                                  | 1.2 yrs                                |                                   |
| <b>Weighted Average Duration</b>   |                                  | 0.9 yrs                                |                                   |
| <b>Weighted Average Credit Quality</b>   |                                  | AA                                     |                                   |
| <b>Portfolio Turnover Rate<sup>5</sup></b>   |                                  | 3%                                     |                                   |
| <b>Minimum Initial Investment</b>  |                                  |  |                                   |
| Investor Shares (\$1,000 for retirement and custodial accounts)  |                                  | \$2,500                                |                                   |
| Select Shares  |                                  | \$50,000                               |                                   |
| <b>The performance data quoted represents past performance. Past performance does not guarantee future results. Investment returns and principal value will fluctuate so that an investor's shares may be worth more or less than their original cost. Current performance may be lower or higher than performance data quoted. To obtain performance information current to the most recent month end, please visit <a href="http://www.schwab.com/schwabfunds">www.schwab.com/schwabfunds</a>.</b> |                                  |  |                                   |
| <b>By Security Type</b>  |                                  |  |                                   |
|   |                                  |  |                                   |
| 33.4%  | Variable-Rate Demand Notes       | 24.3%                                  | Revenue Bonds                     |
| 20.0%  | Put Bonds                        | 10.2%                                  | Tax-Exempt Commercial Paper       |
| 3.8%   | Tax & Revenue Anticipation Notes | 3.5%                                   | Certificates of Participation     |
| 1.9%   | Revenue Anticipation Notes       | 1.8%                                   | Variable-Rate Tender Option Bonds |
| 1.1%   | General Obligation Bonds         |  |                                   |
| <b>By Credit Quality<sup>6</sup></b>   |                                  |  |                                   |
|    |                                  |  |                                   |
| 32.1%  | AAA                              | 36.8%                                  | AA                                |
| 13.0%  | A                                | 2.1%                                   | BBB                               |
| 16.0%  | Short-Term Ratings               |  |                                   |
| <b>By Maturity</b>   |                                  |  |                                   |
|   |                                  |  |                                   |
| 54.8%  | 0-6 Months                       | 4.2%                                   | 7-18 Month                        |
| 21.3%  | 19-30 Months                     | 19.7%                                  | More than 30 Months               |

Portfolio holdings may have changed since the report date.

<sup>1</sup> Source: Morningstar, Inc. Interest rate sensitivity and credit quality are two main components of bond performance. The assessment reflects the fund's portfolio as of 2/28/05, and is not a precise indication of risk or performance—past, present or future. Definitions of style assessments: Sensitivity (measured as duration): Short, up to 3.5 years; Medium, more than 3.5 years to less than six years; Long, six years or greater. Credit quality: High, AA or better; Medium, A or BBB; Low, BB or lower.

<sup>2</sup> Fund expenses have been waived by CSIM and Schwab and are guaranteed to be 0.00% from 12/16/04 (commencement of operations) through 5/01/05. The yields do not reflect the deduction of taxes that a shareholder would pay on fund distributions or on the redemption of fund shares.

<sup>3</sup> Yield if fund expenses had not been absorbed by CSIM and Schwab.

<sup>4</sup> This is the taxable-equivalent 30-day SEC yield for a hypothetical investor in the highest combined federal and California tax bracket (41.70%). Your tax rate may be different.

<sup>5</sup> Not annualized.

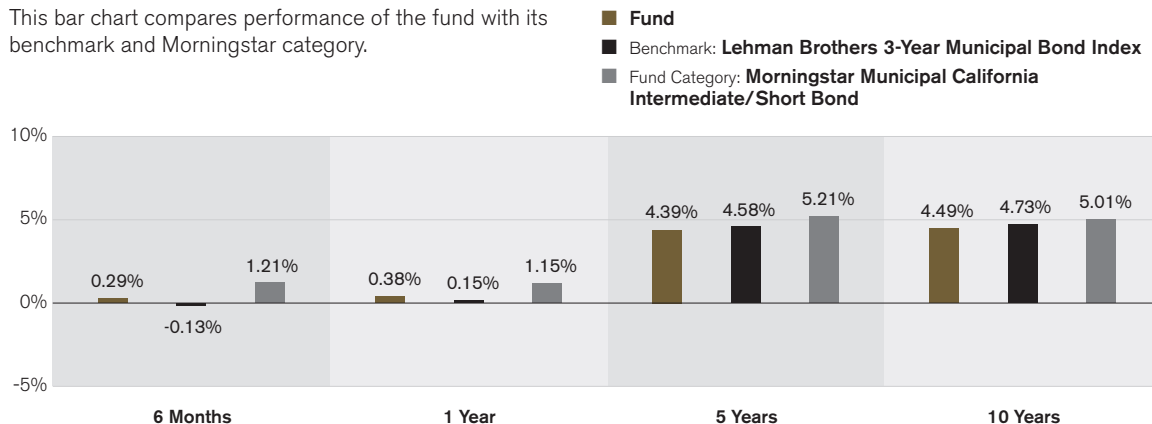
<sup>6</sup> Based on ratings from Moody's. Where Moody's ratings are not available, Standard & Poor's ratings are used. The fund may use different ratings provided by other ratings agencies for purposes of determining compliance with the fund's investment policies.

# Schwab California Short/Intermediate Tax-Free Bond Fund™

Performance as of 2/28/05

## Average Annual Total Returns<sup>1,2</sup>

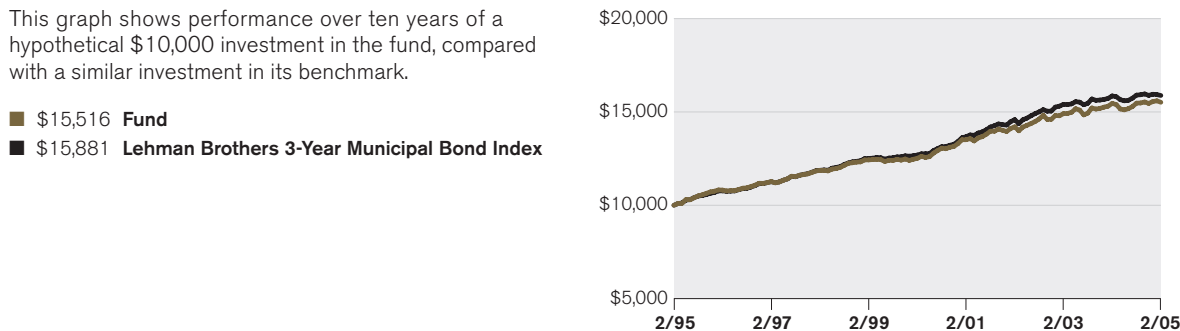
This bar chart compares performance of the fund with its benchmark and Morningstar category.



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## Performance of a Hypothetical \$10,000 Investment<sup>1</sup>

This graph shows performance over ten years of a hypothetical \$10,000 investment in the fund, compared with a similar investment in its benchmark.



All figures on this page assume dividends and distributions were reinvested. Index figures do not include trading and management costs, which would lower performance. Indices are unmanaged, and you cannot invest in them directly. Performance results less than one year are not annualized.

<sup>1</sup> Performance does not reflect the deduction of taxes that a shareholder would pay on fund distributions or on the redemption of fund shares.

<sup>2</sup> Source for category information: Morningstar, Inc.

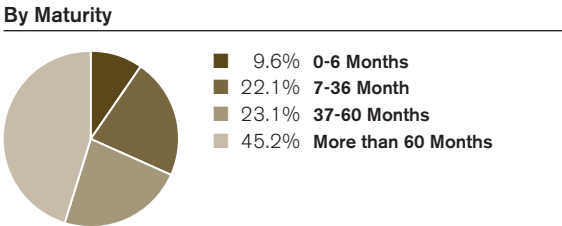
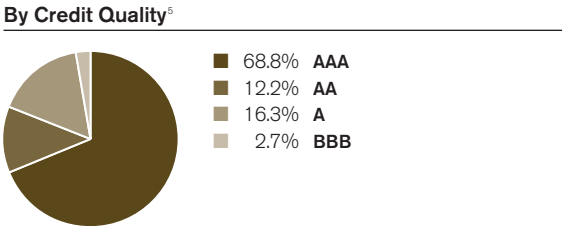
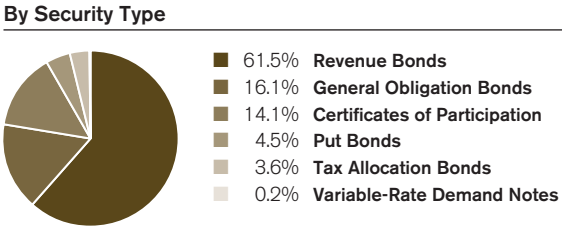
Fund Facts as of 2/28/05

| Statistics                               |         |
|--|---------|
| Number of Holdings                       | 62      |
| Style Assessment <sup>1</sup>            |         |
| Interest Rate Sensitivity                | Short   |
| Credit Quality                           | High    |
| 30-Day SEC Yield <sup>2</sup>            | 2.44%   |
| Taxable-Equivalent Yield <sup>3</sup>    | 4.19%   |
| 12-Month Distribution Yield <sup>2</sup> | 3.03%   |
| Weighted Average Maturity                | 4.3 yrs |
| Weighted Average Duration                | 3.1 yrs |
| Weighted Average Credit Quality          | AA      |
| Portfolio Turnover Rate <sup>4</sup>     | 0%      |
| Minimum Initial Investment               | \$2,500 |
| (\$1,000 for custodial accounts)         |         |

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Portfolio Composition % of Investments

These charts show three different views of the fund's portfolio: by type of security, credit quality of the security and remaining maturity.



Portfolio holdings may have changed since the report date.

<sup>1</sup> Source: Morningstar, Inc. Interest rate sensitivity and credit quality are two main components of bond performance. The assessment reflects the fund's portfolio as of 2/28/05 and is not a precise indication of risk or performance—past, present or future. Definitions of style assessments: Sensitivity (measured as duration): Short, up to 4.5 years; Medium, more than 4.5 years to less than seven years; Long, seven years or greater. Credit quality: High, AA or better; Medium, A or BBB; Low, BB or lower.

<sup>2</sup> The yield does not reflect the deduction of taxes that a shareholder would pay on fund distributions or on the redemption of fund shares.

<sup>3</sup> This is the taxable-equivalent 30-day SEC yield for a hypothetical investor in the highest combined federal and California tax bracket (41.70%). Your tax rate may be different.

<sup>4</sup> Not annualized.

<sup>5</sup> Based on ratings from Moody's. Where Moody's ratings are not available, Standard & Poor's ratings are used. The fund may use different ratings provided by other ratings agencies for purposes of determining compliance with the fund's investment policies.

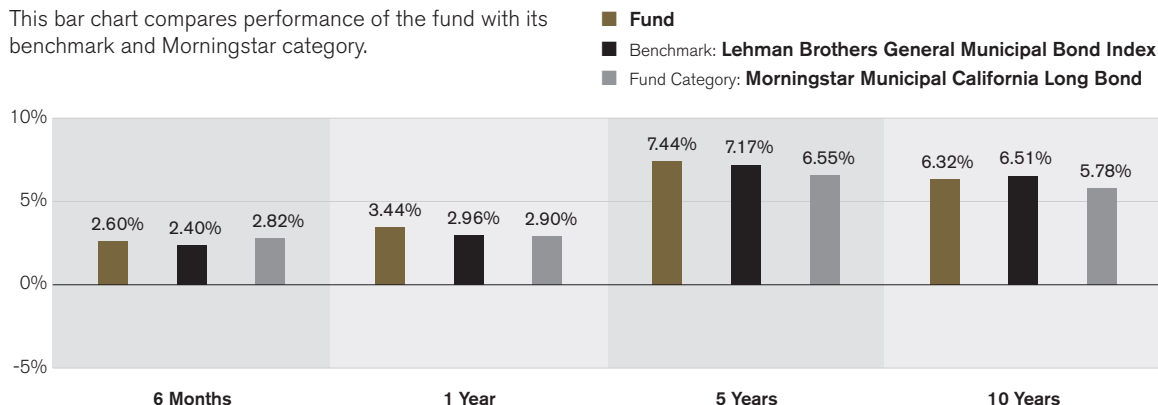


# Schwab California Long-Term Tax-Free Bond Fund<sup>TM</sup>

Performance as of 2/28/05

## Average Annual Total Returns<sup>1,2</sup>

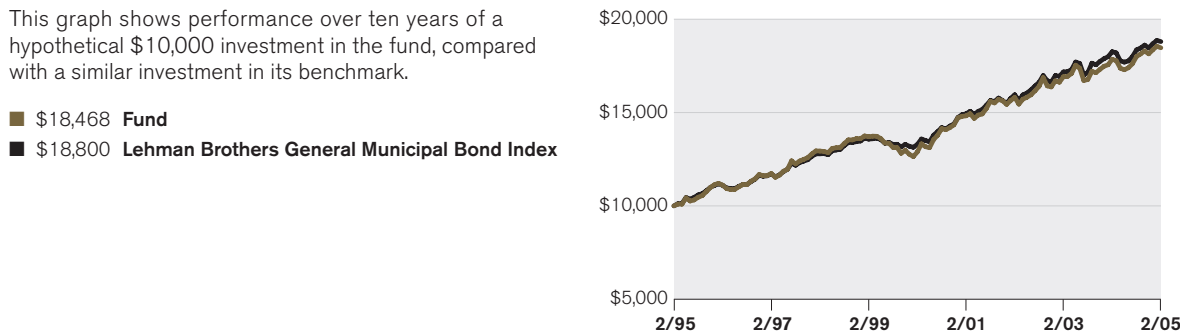
This bar chart compares performance of the fund with its benchmark and Morningstar category.



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## Performance of a Hypothetical \$10,000 Investment<sup>1</sup>

This graph shows performance over ten years of a hypothetical \$10,000 investment in the fund, compared with a similar investment in its benchmark.



All figures on this page assume dividends and distributions were reinvested. Index figures do not include trading and management costs, which would lower performance. Indices are unmanaged, and you cannot invest in them directly. Performance results less than one year are not annualized.

<sup>1</sup> Performance does not reflect the deduction of taxes that a shareholder would pay on fund distributions or on the redemption of fund shares.

<sup>2</sup> Source for category information: Morningstar, Inc.

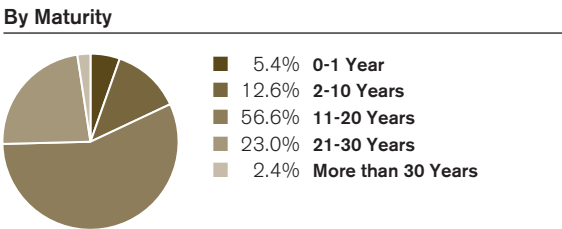
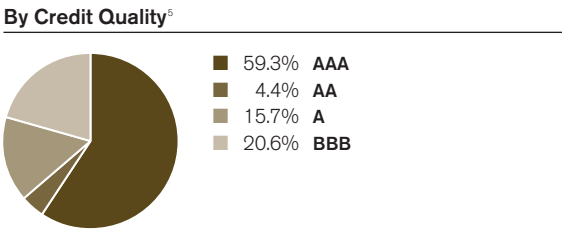
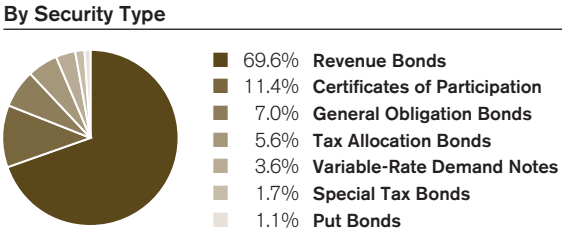
Fund Facts as of 2/28/05

| Statistics                               |          |
|--|----------|
| Number of Holdings                       | 78       |
| Style Assessment <sup>1</sup>            |          |
| Interest Rate Sensitivity                | Long     |
| Credit Quality                           | High     |
| 30-Day SEC Yield <sup>2</sup>            | 4.16%    |
| Taxable-Equivalent Yield <sup>3</sup>    | 7.14%    |
| 12-Month Distribution Yield <sup>2</sup> | 4.24%    |
| Weighted Average Maturity                | 15.7 yrs |
| Weighted Average Duration                | 6.2 yrs  |
| Weighted Average Credit Quality          | AA       |
| Portfolio Turnover Rate <sup>4</sup>     | 0%       |
| Minimum Initial Investment               | \$2,500  |
| (\$1,000 for custodial accounts)         |          |

The performance data quoted represents past performance. Past performance does not guarantee future results. Investment returns and principal value will fluctuate so that an investor's shares may be worth more or less than their original cost. Current performance may be lower or higher than performance data quoted. To obtain performance information current to the most recent month end, please visit [www.schwab.com/schwabfunds](http://www.schwab.com/schwabfunds).

Portfolio Composition % of Investments

These charts show three different views of the fund's portfolio: by type of security, credit quality of the security and remaining maturity.



Portfolio holdings may have changed since the report date.

<sup>1</sup> Source: Morningstar, Inc. Interest rate sensitivity and credit quality are two main components of bond performance. The assessment reflects the fund's portfolio as of 2/28/05 and is not a precise indication of risk or performance—past, present or future. Definitions of style assessments: Sensitivity (measured as duration): Short, up to 4.5 years; Medium, more than 4.5 years to less than seven years; Long, seven years or greater. Credit quality: High, AA or better; Medium, A or BBB; Low, BB or lower.

<sup>2</sup> The yield does not reflect the deduction of taxes that a shareholder would pay on fund distributions or on the redemption of fund shares.

<sup>3</sup> This is the taxable-equivalent 30-day SEC yield for a hypothetical investor in the highest combined federal and California tax bracket (41.70%). Your tax rate may be different.

<sup>4</sup> Portfolio turnover rate is less than 1.00%. Not annualized.

<sup>5</sup> Based on ratings from Moody's. Where Moody's ratings are not available, Standard & Poor's ratings are used. The fund may use different ratings provided by other ratings agencies for purposes of determining compliance with the fund's investment policies.

# Fund Expenses

## Examples for a \$1,000 Investment

As a fund shareholder, you incur two types of costs: transaction costs, such as redemption fees; and, ongoing costs, such as management fees, transfer agent and shareholder services fees, and other fund expenses.

The expense examples below are intended to help you understand your ongoing cost (in dollars) of investing in a fund and to compare this cost with the ongoing cost of investing in other mutual funds. These examples are based on an investment of \$1,000 invested for six-months beginning September 1, 2004 and held through February 28, 2005, unless noted otherwise.

**Actual Return** lines in the table below provide information about actual account values and actual expenses. You may use this information, together with the amount you invested, to estimate the expenses that you paid over the period. To do so, simply divide your account value by \$1,000 (for example, an \$8,600 account value  $\div$  \$1,000 = 8.6), then multiply the result by the number given for your fund or share class under the heading entitled "Expenses Paid

During Period."

**Hypothetical Return** lines in the table below provide information about hypothetical account values and hypothetical expenses based on a fund's or share class' actual expense ratio and an assumed return of 5% per year before expenses. Because the return used is not an actual return, it may not be used to estimate the actual ending account value or expenses you paid for the period.

You may use this information to compare the ongoing costs of investing in the fund and other funds. To do so, compare this 5% hypothetical example with the 5% hypothetical examples that appear in the shareholder reports of the other funds.

Please note that the expenses shown in the table are meant to highlight your ongoing costs only, and do not reflect any transactional costs, such as redemption fees. If these transactional costs were included, your costs would have been higher.

|  | Expense Ratio <sup>1</sup><br>(Annualized) | Beginning<br>Account Value<br>at 9/1/04 | Ending<br>Account Value<br>(Net of Expenses)<br>at 2/28/05 | Expenses<br>Paid During Period<br>9/1/04–2/28/05 |
|--|--|---|--|--|
| <b>Schwab Tax-Free YieldPlus Fund™</b>                   |  |   |  |  |
| <i>Investor Shares</i>                                   |  |   |  |  |
| Actual Return  | 0.00%                                      | \$1,000                                 | \$1,003.30   | \$0.00 <sup>2</sup>                              |
| Hypothetical 5% Return                                   | 0.00%                                      | \$1,000                                 | \$1,010.27   | \$0.00 <sup>2</sup>                              |
| <i>Select Shares®</i>                                    |  |   |  |  |
| Actual Return  | 0.00%                                      | \$1,000                                 | \$1,003.30   | \$0.00 <sup>2</sup>                              |
| Hypothetical 5% Return                                   | 0.00%                                      | \$1,000                                 | \$1,010.27   | \$0.00 <sup>2</sup>                              |
| <b>Schwab Short/Intermediate<br/>Tax-Free Bond Fund™</b> |  |   |  |  |
| Actual Return  | 0.63%                                      | \$1,000                                 | \$999.00   | \$3.12 <sup>3</sup>                              |
| Hypothetical 5% Return                                   | 0.63%                                      | \$1,000                                 | \$1,021.67   | \$3.16 <sup>3</sup>                              |
| <b>Schwab Long-Term<br/>Tax-Free Bond Fund™</b>          |  |   |  |  |
| Actual Return  | 0.65%                                      | \$1,000                                 | \$1,016.10   | \$3.25 <sup>3</sup>                              |
| Hypothetical 5% Return                                   | 0.65%                                      | \$1,000                                 | \$1,021.57   | \$3.26 <sup>3</sup>                              |

<sup>1</sup> Based on the most recent six-month expense ratio; may differ from the expense ratio provided in Financial Highlights.

<sup>2</sup> Schwab and the investment adviser have guaranteed that "annual operating expenses" (excluding interest, taxes, and certain non-routine expense) of Investor Shares and Select Shares will equal 0.00% from 12/16/04 (commencement of operations) through 5/01/05.

<sup>3</sup> Expenses for each fund are equal to its annualized expense ratio, multiplied by the average account value over the period, multiplied by 181 days of the period, and divided by 365 days of the fiscal year.

|  | Expense Ratio <sup>1</sup><br>(Annualized) | Beginning<br>Account Value<br>at 9/1/04 | Ending<br>Account Value<br>(Net of Expenses)<br>at 2/28/05 | Expenses<br>Paid During Period<br>9/1/04–2/28/05 |
|--|--|---|--|--|
| <b>Schwab California Tax-Free<br/>YieldPlus Fund™</b>                |  |   |  |  |
| <i>Investor Shares</i>   |  |   |  |  |
| Actual Return  | 0.00%                                      | \$1,000                                 | \$1,002.20   | \$0.00 <sup>2</sup>                              |
| Hypothetical 5% Return   | 0.00%                                      | \$1,000                                 | \$1,010.27   | \$0.00 <sup>2</sup>                              |
| <i>Select Shares®</i>  |  |   |  |  |
| Actual Return  | 0.00%                                      | \$1,000                                 | \$1,002.20   | \$0.00 <sup>2</sup>                              |
| Hypothetical 5% Return   | 0.00%                                      | \$1,000                                 | \$1,010.27   | \$0.00 <sup>2</sup>                              |
| <b>Schwab California Short/<br/>Intermediate Tax-Free Bond Fund™</b> |  |   |  |  |
| Actual Return  | 0.61%                                      | \$1,000                                 | \$1,002.90   | \$3.03 <sup>3</sup>                              |
| Hypothetical 5% Return   | 0.61%                                      | \$1,000                                 | \$1,021.77   | \$3.06 <sup>3</sup>                              |
| <b>Schwab California Long-Term<br/>Tax-Free Bond Fund™</b>           |  |   |  |  |
| Actual Return  | 0.61%                                      | \$1,000                                 | \$1,026.00   | \$3.06 <sup>3</sup>                              |
| Hypothetical 5% Return   | 0.61%                                      | \$1,000                                 | \$1,021.77   | \$3.06 <sup>3</sup>                              |

<sup>1</sup> Based on the most recent six-month expense ratio; may differ from the expense ratio provided in Financial Highlights.

<sup>2</sup> Schwab and the investment adviser have guaranteed that "annual operating expenses" (excluding interest, taxes, and certain non-routine expense) of Investor Shares and Select Shares will equal 0.00% from 12/16/04 (commencement of operations) through 5/01/05.

<sup>3</sup> Expenses for each fund are equal to its annualized expense ratio, multiplied by the average account value over the period, multiplied by 181 days of the period, and divided by 365 days of the fiscal year.

# Schwab Tax-Free YieldPlus Fund™

## Financial Statements

### Financial Highlights

| Investor Shares                            | 12/16/04 <sup>1</sup> –<br>2/28/05* |
|--|-------------------------------------|
| <b>Per-Share Data (\$)</b>                 |                                     |
| Net asset value at beginning of period     | 10.00                               |
| Income from investment operations:         |                                     |
| Net investment income                      | 0.04                                |
| Net realized and unrealized losses         | (0.01)                              |
| Total income from investment operations    | 0.03                                |
| Less distributions:                        |                                     |
| Dividends from net investment income       | (0.04)                              |
| Net asset value at end of period           | 9.99                                |
| Total return (%)                           | 0.33 <sup>2</sup>                   |
| <b>Ratios/Supplemental Data (%)</b>        |                                     |
| Ratios to average net assets:              |                                     |
| Net operating expenses                     | —                                   |
| Gross operating expenses                   | 0.71 <sup>3</sup>                   |
| Net investment income                      | 2.26 <sup>3</sup>                   |
| Portfolio turnover rate                    | —                                   |
| Net assets, end of period (\$ x 1,000,000) | 23                                  |

\* Unaudited.

<sup>1</sup> Commencement of operations.

<sup>2</sup> Not annualized.

<sup>3</sup> Annualized.

| Select Shares                              | 12/16/04 <sup>1</sup> –<br>2/28/05 <sup>*</sup> |
|--|---|
| <b>Per-Share Data (\$)</b>                 |   |
| Net asset value at beginning of period     | 10.00   |
| Income from investment operations:         |   |
| Net investment income                      | 0.04  |
| Net realized and unrealized losses         | (0.01)  |
| Total income from investment operations    | 0.03  |
| Less distributions:                        |   |
| Dividends from net investment income       | (0.04)  |
| Net asset value at end of period           | 9.99  |
| Total return (%)                           | 0.33 <sup>2</sup>                               |
| <b>Ratios/Supplemental Data (%)</b>        |   |
| Ratios to average net assets:              |   |
| Net operating expenses                     | —   |
| Gross operating expenses                   | 0.57 <sup>3</sup>                               |
| Net investment income                      | 2.26 <sup>3</sup>                               |
| Portfolio turnover rate                    | —   |
| Net assets, end of period (\$ x 1,000,000) | 298   |

\* Unaudited.

<sup>1</sup> Commencement of operations.

<sup>2</sup> Not annualized.

<sup>3</sup> Annualized.

**Portfolio Holdings** as of February 28, 2005, unaudited

This section shows all the securities in the fund's portfolio and their value, as of the report date.

Beginning with the fiscal quarter ended May 31, 2005, the fund will file its complete schedule of portfolio holdings with the SEC for the first and third quarters of each fiscal year on Form N-Q. The fund's Forms N-Q will be available on the SEC's website at <http://www.sec.gov> and may be reviewed and copied at the SEC's Public Reference Room in Washington, D.C. Call 1-800-SEC-0330 for information on the operation of the Public Reference Room. The information filed on a fund's most recent Form N-Q will be available by visiting Schwab's website at [www.schwab.com/schwabfunds](http://www.schwab.com/schwabfunds).

We use the symbols below to designate certain characteristics of the securities.

- + Credit-enhanced security
- ▷ Liquidity-enhanced security
- ▲ Delayed-delivery security
- All or a portion of this security is held as collateral for futures contracts and delayed-delivery security

For fixed-rate obligations, the rate shown is the interest rate (the rate established when the obligation was issued) and the maturity date shown is the stated legal maturity. For variable-rate obligations, the rate shown is the rate as of the report date, and the maturity shown is the later of the next interest rate change date or demand date.

| <b>Holdings by Category</b> |                                     | <b>Cost</b><br>(\$x1,000) | <b>Value</b><br>(\$x1,000) |
|-----------------------------|-------------------------------------|---------------------------|----------------------------|
| <b>105.6%</b>               | <b>Municipal Bonds</b>              | 340,019                   | 339,480                    |
| <b>0.1%</b>                 | <b>Other Investment Companies</b>   | 219                       | 219                        |
| <b>105.7%</b>               | <b>Total Investments</b>            | <b>340,238</b>            | <b>339,699</b>             |
| <b>(5.7)%</b>               | <b>Other Assets and Liabilities</b> |                           | (18,240)                   |
| <b>100.0%</b>               | <b>Net Assets</b>                   |                           | <b>321,459</b>             |

| <b>Issuer</b><br><b>Project</b><br>Type of Security, Series | <b>Rate</b> | <b>Maturity Date</b> | <b>Face Amount</b><br>(\$ x 1,000) | <b>Value</b><br>(\$ x 1,000) |
|---|-------------|----------------------|------------------------------------|------------------------------|
|---|-------------|----------------------|------------------------------------|------------------------------|

**Municipal Bonds** 105.6% of net assets

**Fixed-Rate Obligations** 81.4%

**Alabama** 3.3%

|  |       |          |        |               |
|--|-------|----------|--------|---------------|
| <b>+▲ Huntsville Health Care Authority</b> |       |          |        |               |
| Revenue Bonds, Series 2005A                | 5.00% | 03/03/08 | 10,000 | <b>10,540</b> |

**Arizona** 2.1%

**Phoenix Civic Improvement Corp.**
*Wastewater System*

|                                       |       |          |       |       |
|---------------------------------------|-------|----------|-------|-------|
| Refunding Revenue Bonds, Series 2004B | 5.00% | 07/01/07 | 4,000 | 4,208 |
|---------------------------------------|-------|----------|-------|-------|

**Pinal County**

|  |       |          |       |              |
|--|-------|----------|-------|--------------|
| Certificates of Participation, Series 2004 | 4.00% | 12/01/06 | 1,435 | 1,462        |
| Certificates of Participation, Series 2004 | 4.00% | 12/01/07 | 1,150 | 1,177        |
|  |       |          |       | <b>6,847</b> |

**California** 19.9%

**California State**

|   |       |          |       |       |
|---|-------|----------|-------|-------|
| Revenue Anticipation Notes, Series 2004-05A       | 3.00% | 06/30/05 | 7,000 | 7,021 |
| <b>+ Various Purpose General Obligation Bonds</b> | 8.00% | 11/01/07 | 3,000 | 3,253 |

**Portfolio Holdings** continued

| Issuer<br>Project<br>Type of Security, Series                 | Rate  | Maturity<br>Date | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|---|-------|------------------|-----------------------------|-----------------------|
| <b>California Pollution Control Financing Authority</b>       |       |                  |                             |                       |
| <i>Southern California Edison Co.</i>                         |       |                  |                             |                       |
| Pollution Control Refunding Revenue Bonds,<br>Series 1985C    | 2.00% | 03/01/06         | 7,000                       | 6,939                 |
| Pollution Control Refunding Revenue Bonds,<br>Series 1986C    | 2.00% | 03/01/06         | 2,400                       | 2,379                 |
| <b>+ California School Cash Reserve Program Authority</b>     |       |                  |                             |                       |
| Pool Bonds, Series 2004A                                      | 3.00% | 07/06/05         | 7,000                       | 7,021                 |
| <b>California Statewide Communities Development Authority</b> |       |                  |                             |                       |
| <i>Kaiser Permanente</i>                                      |       |                  |                             |                       |
| Revenue Bonds, Series 2001A                                   | 2.55% | 01/04/07         | 8,500                       | 8,444                 |
| <b>Long Beach Aquarium of the Pacific</b>                     |       |                  |                             |                       |
| Revenue Bonds, Series 1995A                                   | 6.10% | 07/01/05         | 4,500                       | 4,648                 |
| <b>Los Angeles County</b>                                     |       |                  |                             |                       |
| Tax & Revenue Anticipation Notes, Series 2004-05A             | 3.00% | 06/30/05         | 7,000                       | 7,021                 |
| <b>+ Orange County California Transportation Authority</b>    |       |                  |                             |                       |
| Sales Tax Revenue Commercial Paper Notes                      | 2.04% | 04/12/05         | 10,000                      | 10,000                |
| <b>Santa Clara Valley Transportation Authority</b>            |       |                  |                             |                       |
| <i>Measure A</i>  |       |                  |                             |                       |
| <b>+ Sales Tax Revenue Bonds, Series 2003</b>                 | 4.00% | 10/02/06         | 3,000                       | 3,064                 |
| <b>+ Sales Tax Revenue Bonds, Series 2004B</b>                | 5.00% | 10/02/06         | 4,000                       | 4,146                 |
|   |       |                  |                             | <b>63,936</b>         |
| <b>Colorado 0.7%</b>  |       |                  |                             |                       |
| <b>Central Colorado Water Conservancy District</b>            |       |                  |                             |                       |
| <i>Well Augmentation Subdistrict</i>                          |       |                  |                             |                       |
| Limited Tax General Obligation Notes, Series 2005             | 3.88% | 03/01/07         | 750                         | 749                   |
| <b>Colorado Health Facilities Authority</b>                   |       |                  |                             |                       |
| <i>Evangelical Lutheran Good Samaritan Society</i>            |       |                  |                             |                       |
| Health Facilities Revenue Bonds, Series 2000                  | 6.00% | 12/01/06         | 1,365                       | 1,400                 |
|   |       |                  |                             | <b>2,149</b>          |
| <b>District of Columbia 1.2%</b>                              |       |                  |                             |                       |
| <b>+ Washington DC Metro Area Transit Authority</b>           |       |                  |                             |                       |
| Gross Revenue Transit Bonds, Series 2003B                     | 4.00% | 07/01/05         | 3,870                       | <b>3,893</b>          |
| <b>Florida 4.2%</b>   |       |                  |                             |                       |
| <b>Escambia County Health Facilities Authority</b>            |       |                  |                             |                       |
| <i>Ascension Health Credit Group</i>                          |       |                  |                             |                       |
| Revenue Bonds, Series 2003A                                   | 5.00% | 11/15/07         | 1,500                       | 1,583                 |
| <b>+ Florida Dept of Transportation</b>                       |       |                  |                             |                       |
| Turnpike Revenue Bonds, Series 2000A                          | 1.30% | 04/29/05         | 11,820                      | 11,820                |
|   |       |                  |                             | <b>13,403</b>         |
| <b>Illinois 1.5%</b>  |       |                  |                             |                       |
| <b>Illinois Health Facilities Authority</b>                   |       |                  |                             |                       |
| <i>Advocate Health Care Network</i>                           |       |                  |                             |                       |
| Revenue Bonds, Series 2003B                                   | 2.30% | 01/04/06         | 5,000                       | <b>4,993</b>          |



| Issuer<br>Project<br>Type of Security, Series                      | Rate  | Maturity<br>Date | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|--|-------|------------------|-----------------------------|-----------------------|
| <b>Indiana 2.0%</b>  |       |                  |                             |                       |
| <b>Indiana Health Facility Financing Authority</b>                 |       |                  |                             |                       |
| <i>Ascension Health Subordinate Credit Group</i>                   |       |                  |                             |                       |
| Revenue Bonds, Series 2005 A-3                                     | 5.00% | 05/01/08         | 6,000                       | <b>6,324</b>          |
| <b>Louisiana 0.3%</b>  |       |                  |                             |                       |
| <b>Calcasieu Parish Industrial Development Board, Inc.</b>         |       |                  |                             |                       |
| <i>Occidental Petroleum Corp.</i>                                  |       |                  |                             |                       |
| Pollution Control Refunding Revenue Bonds, Series 2001             | 4.80% | 12/01/06         | 1,000                       | <b>1,032</b>          |
| <b>Massachusetts 13.3%</b>   |       |                  |                             |                       |
| <b>Duxbury</b>   |       |                  |                             |                       |
| Bond Anticipation Notes  | 3.25% | 01/13/06         | 8,000                       | 8,053                 |
| <b>Fall River</b>  |       |                  |                             |                       |
| Bond Anticipation Notes  | 3.00% | 07/28/05         | 10,000                      | 10,025                |
| <b>Lawrence</b>  |       |                  |                             |                       |
| School Bond Anticipation Notes                                     | 3.25% | 12/22/05         | 5,000                       | 5,031                 |
| <b>Massachusetts</b>   |       |                  |                             |                       |
| <i>Consolidated Loan of 1992</i>                                   |       |                  |                             |                       |
| + General Obligation Bonds, Series D                               | 8.00% | 05/01/06         | 1,820                       | 1,890                 |
| General Obligation Bonds, Series D                                 | 6.00% | 05/01/08         | 2,320                       | 2,533                 |
| <b>Massachusetts Health &amp; Educational Facilities Authority</b> |       |                  |                             |                       |
| <i>Caritas Christi Obligated Group</i>                             |       |                  |                             |                       |
| Revenue Bonds, Series A  | 5.25% | 07/01/07         | 5,960                       | 6,191                 |
| + <b>Massachusetts Water Resources Authority</b>                   |       |                  |                             |                       |
| Commercial Paper Notes, Series 1994                                | 2.00% | 04/05/05         | 9,000                       | 9,000                 |
|  |       |                  |                             | <b>42,723</b>         |
| <b>New Hampshire 2.2%</b>  |       |                  |                             |                       |
| <b>Merrimack County</b>  |       |                  |                             |                       |
| Tax Anticipation Notes, Series 2005                                | 3.35% | 12/28/05         | 7,000                       | <b>7,031</b>          |
| <b>New Jersey 7.6%</b>   |       |                  |                             |                       |
| <b>Hammonton</b>   |       |                  |                             |                       |
| Bond Anticipation Notes  | 3.00% | 01/12/06         | 5,000                       | 5,017                 |
| <b>Jersey City</b>   |       |                  |                             |                       |
| School Promissory Notes, Series 2005A                              | 3.25% | 02/24/06         | 6,000                       | 6,044                 |
| + <b>New Jersey Health Care Facilities Financing Authority</b>     |       |                  |                             |                       |
| <i>St. Clare's Hospital</i>  |       |                  |                             |                       |
| Refunding Revenue Bonds, Series 2004B                              | 5.00% | 07/01/08         | 2,085                       | 2,223                 |
| +■ <b>New Jersey Transit Corp.</b>                                 |       |                  |                             |                       |
| Capital Grant Anticipation Notes, Series 2000B                     | 5.75% | 02/01/07         | 2,000                       | 2,114                 |
| <b>New Jersey Transportation Trust Fund Authority</b>              |       |                  |                             |                       |
| Transportation System Bonds, Series 2005B                          | 5.00% | 12/15/07         | 4,870                       | 5,146                 |
| <b>Sparta Township</b>   |       |                  |                             |                       |
| Bond Anticipation Notes  | 3.00% | 01/13/06         | 3,767                       | 3,781                 |
|  |       |                  |                             | <b>24,325</b>         |

**Portfolio Holdings** continued

| Issuer<br>Project<br>Type of Security, Series  | Rate  | Maturity<br>Date | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|--|-------|------------------|-----------------------------|-----------------------|
| <b>New Mexico 1.5%</b>   |       |                  |                             |                       |
| <b>Farmington</b>  |       |                  |                             |                       |
| <i>Public Service Co. of NM - San Juan &amp; Four Corners</i><br>Pollution Control Refunding Revenue Bonds,<br>Series 2003B  | 2.10% | 04/01/06         | 5,000                       | <b>4,943</b>          |
| <b>New York 8.9%</b>   |       |                  |                             |                       |
| <b>Board of Cooperative Education Services</b><br><i>(Cattaraugus, Allegany, Erie &amp; Wyoming Counties)</i><br>Revenue Anticipation Notes, Series 2005               |       |                  |                             |                       |
|  | 3.50% | 12/30/05         | 3,000                       | 3,025                 |
| <b>Metropolitan Transportation Authority</b><br><i>Commuter Facilities</i><br>Service Contract Bonds, Series 1987-3  |       |                  |                             |                       |
|  | 7.38% | 07/01/08         | 1,840                       | 1,993                 |
| <b>New York City</b><br>General Obligation Bonds, Series Fiscal 2002E  |       |                  |                             |                       |
|  | 5.00% | 08/01/06         | 6,215                       | 6,418                 |
| <b>New York City Municipal Water Finance Authority</b><br>▶ Commercial Paper Notes, Series One   |       |                  |                             |                       |
|  | 1.80% | 03/08/05         | 8,000                       | 8,000                 |
| <b>New York State Urban Development Corp.</b><br><i>State Personal Income Tax</i><br>Revenue Bonds, Series 2004-A4   |       |                  |                             |                       |
|  | 2.25% | 03/15/06         | 2,045                       | 2,042                 |
| ■ <i>State Personal Income Tax</i><br>Revenue Bonds, Series 2004-A4  |       |                  |                             |                       |
|  | 4.00% | 03/15/07         | 1,000                       | 1,029                 |
| ▶ <b>Port Authority of New York &amp; New Jersey</b><br>Commercial Paper Obligations, Series B   |       |                  |                             |                       |
|  | 1.95% | 04/06/05         | 6,100                       | 6,100                 |
|  |       |                  |                             | <b>28,607</b>         |
| <b>Pennsylvania 0.3%</b>   |       |                  |                             |                       |
| <b>Pennsylvania Higher Educational Facilities Authority</b><br><i>University of Pennsylvania Health Services</i><br>Revenue Bonds, Series 2005A                        |       |                  |                             |                       |
|  | 4.00% | 08/15/06         | 1,000                       | <b>1,018</b>          |
| <b>Puerto Rico 0.6%</b>  |       |                  |                             |                       |
| <b>Puerto Rico</b><br>Public Improvement Refunding Revenue Bonds,<br>Series 2003C  |       |                  |                             |                       |
|  | 5.00% | 07/01/08         | 1,900                       | <b>2,008</b>          |
| <b>South Carolina 0.3%</b>   |       |                  |                             |                       |
| <b>Richland County</b><br><i>International Paper Co.</i><br>Environmental Improvement Refunding Revenue Bonds,<br>Series 2002A   |       |                  |                             |                       |
|  | 4.25% | 10/01/07         | 1,000                       | <b>1,025</b>          |
| <b>Tennessee 1.7%</b>  |       |                  |                             |                       |
| + <b>Metropolitan Nashville &amp; Davidson County</b><br><b>Health &amp; Education Facilities Board</b><br><i>Vanderbilt University</i><br>Revenue Bonds, Series 2005B |       |                  |                             |                       |
|  | 5.00% | 04/01/08         | 5,000                       | <b>5,319</b>          |

| Issuer<br>Project<br>Type of Security, Series             | Rate  | Maturity<br>Date | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|---|-------|------------------|-----------------------------|-----------------------|
| <b>Texas 8.9%</b>   |       |                  |                             |                       |
| <b>Bexar Metropolitan Water District</b>                  |       |                  |                             |                       |
| + Commercial Paper Notes                                  | 2.25% | 03/17/05         | 5,000                       | 5,000                 |
| + Commercial Paper Notes                                  | 2.25% | 04/07/05         | 5,000                       | 5,002                 |
| <b>Spring Independent School District</b>                 |       |                  |                             |                       |
| +▶ Schoolhouse Bonds, Series 2005A                        | 5.00% | 08/15/08         | 5,000                       | 5,325                 |
| +▶ Unlimited Tax Schoolhouse Bonds, Series 2005A          | 5.00% | 08/15/06         | 3,000                       | 3,100                 |
| <b>Texas</b>  |       |                  |                             |                       |
| Tan & Revenue Anticipation Notes, Series 2004             | 3.00% | 08/31/05         | 5,000                       | 5,020                 |
| + <b>Texas Municipal Power Authority</b>                  |       |                  |                             |                       |
| Subordinate Lien Refunding Revenue Bonds,<br>Series 2004A | 6.00% | 09/01/05         | 5,190                       | 5,287                 |
|   |       |                  |                             | <b>28,734</b>         |
| <b>Virginia 0.9%</b>                                      |       |                  |                             |                       |
| <b>Russell County</b>                                     |       |                  |                             |                       |
| <i>Appalachian Power Co.</i>                              |       |                  |                             |                       |
| Pollution Control Refunding Revenue Bonds, Series I       | 2.70% | 11/01/06         | 3,000                       | <b>2,990</b>          |
| <b>Variable Rate Obligations 24.2%</b>                    |       |                  |                             |                       |
| <b>Arizona 1.6%</b>                                       |       |                  |                             |                       |
| <b>+▶ Arizona School Facilities Board</b>                 |       |                  |                             |                       |
| <i>State School Trust</i>                                 |       |                  |                             |                       |
| Revenue Bonds, Series 2004A                               | 1.90% | 03/07/05         | 4,995                       | <b>4,995</b>          |
| <b>California 2.8%</b>                                    |       |                  |                             |                       |
| <b>+ California</b>                                       |       |                  |                             |                       |
| Economic Recovery Bonds, Series 2004C-9                   | 1.80% | 03/01/05         | 2,500                       | 2,500                 |
| <b>+ California Dept of Water Resources</b>               |       |                  |                             |                       |
| Power Supply Revenue Bonds, Series 2002B-2                | 1.78% | 03/01/05         | 6,400                       | 6,400                 |
|   |       |                  |                             | <b>8,900</b>          |
| <b>Florida 0.8%</b>                                       |       |                  |                             |                       |
| <b>+▶ Dade County</b>                                     |       |                  |                             |                       |
| <i>Water &amp; Sewer System</i>                           |       |                  |                             |                       |
| Revenue Bonds, Series 1994                                | 1.84% | 03/07/05         | 2,600                       | <b>2,600</b>          |
| <b>Georgia 2.1%</b>                                       |       |                  |                             |                       |
| <b>+ Columbus Development Authority</b>                   |       |                  |                             |                       |
| <i>Foundation Properties</i>                              |       |                  |                             |                       |
| Revenue Bonds, Series 2000                                | 1.91% | 03/07/05         | 3,845                       | 3,845                 |
| <b>Fulton County Development Authority</b>                |       |                  |                             |                       |
| <i>General Motors Corp.</i>                               |       |                  |                             |                       |
| Pollution Control Refunding Revenue Bonds,<br>Series 1987 | 2.27% | 03/07/05         | 3,000                       | 3,000                 |
|   |       |                  |                             | <b>6,845</b>          |

**Portfolio Holdings** continued

| Issuer<br>Project<br>Type of Security, Series   | Rate  | Maturity<br>Date | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|---|-------|------------------|-----------------------------|-----------------------|
| <b>Louisiana 1.6%</b>   |       |                  |                             |                       |
| <b>+■ Louisiana Public Facility Authority</b><br><i>Tiger Athletic Foundation</i><br>Revenue Bonds, Series 2004   | 1.89% | 03/07/05         | 5,200                       | <b>5,200</b>          |
| <b>New Jersey 4.0%</b>  |       |                  |                             |                       |
| <b>+►■ University of Medicine &amp; Dentistry</b><br>Revenue Bonds, Series 2002B  | 1.86% | 03/07/05         | 12,950                      | <b>12,950</b>         |
| <b>New Mexico 0.9%</b>  |       |                  |                             |                       |
| <b>+ Farmington</b><br><i>San Juan Regional Medical Center</i><br>Hospital Revenue Bonds, Series 2004B  | 1.89% | 03/07/05         | 3,000                       | <b>3,000</b>          |
| <b>New York 3.9%</b>  |       |                  |                             |                       |
| <b>New York City Municipal Water Finance Authority</b>  |       |                  |                             |                       |
| +► Water & Sewer System Revenue Bonds, Fiscal 1993C   | 1.65% | 03/01/05         | 2,200                       | 2,200                 |
| +► Water & Sewer System Revenue Bonds, Fiscal 1993C   | 1.76% | 03/03/05         | 4,000                       | 4,000                 |
| +►■ Water & Sewer System Revenue Bonds, Fiscal 2005C  | 1.88% | 03/03/05         | 5,000                       | 5,000                 |
| <b>■ New York City Transitional Finance Authority</b><br>Future Tax Secured Bonds Fiscal, 2001B   | 1.77% | 03/01/05         | 1,200                       | 1,200                 |
|   |       |                  |                             | <b>12,400</b>         |
| <b>Ohio 2.6%</b>  |       |                  |                             |                       |
| <b>+■ Cuyahoga County</b><br><i>Hathaway Brown School</i><br>Economic Development Revenue Bonds, Series 1999  | 1.89% | 03/03/05         | 8,200                       | <b>8,200</b>          |
| <b>Texas 2.6%</b>   |       |                  |                             |                       |
| <b>+ Amarillo Health Facility Corp.</b><br><i>Evangelical Lutheran Good Samaritan Society</i><br>Health Facilities Refunding Revenue Bonds, Series 1997 | 1.95% | 03/03/05         | 3,155                       | 3,155                 |
| <b>+►■ Austin Electric, Water &amp; Sewer System</b><br>Water & Wastewater Refunding Revenue Bonds,<br>Series 2001A & B                                 | 1.91% | 03/02/05         | 5,200                       | 5,200                 |
|   |       |                  |                             | <b>8,355</b>          |
| <b>Washington 1.3%</b>  |       |                  |                             |                       |
| <b>+►■ Energy Northwest</b><br>Refunding Electric Revenue Bonds, Series 2002A   | 1.90% | 03/03/05         | 4,195                       | <b>4,195</b>          |

| Security and Number of Shares                         |         | Value<br>(\$ x 1,000) |
|---|---------|-----------------------|
| Other Investment Companies 0.1% of net assets         |         |                       |
| Provident Institutional Funds—<br>Muni Fund Portfolio | 219,490 | 219                   |
| End of investments.                                   |         |                       |

In addition to the above, the fund held the following at 2/28/05. All numbers are x 1,000 except number of futures contracts.

| Futures Contracts                                       |                        |                   |                     |
|---|------------------------|-------------------|---------------------|
|   | Number of<br>Contracts | Contract<br>Value | Unrealized<br>Gains |
| 2 Year, Short<br>U.S. Treasury Note,<br>expires 6/30/05 | 75                     | 15,554            | 42                  |

## Statement of

**Assets and Liabilities**

As of February 28, 2005; unaudited. All numbers All numbers are x 1,000 except NAV.

**Assets**

|                              |                |
|------------------------------|----------------|
| Investments, at value        | \$339,699      |
| Receivables:                 |                |
| Fund shares sold             | 1,493          |
| Interest                     | 1,869          |
| Due from adviser             | 19             |
| Due from brokers for futures | 16             |
| Prepaid expenses             | + 53           |
| <b>Total assets</b>          | <b>343,149</b> |

**Liabilities**

|                           |               |
|---------------------------|---------------|
| Payables:                 |               |
| Fund shares redeemed      | 1,795         |
| Dividends to shareholders | 124           |
| Investments bought        | 19,742        |
| Accrued expenses          | + 29          |
| <b>Total liabilities</b>  | <b>21,690</b> |

**Net Assets**

|                          |                  |
|--------------------------|------------------|
| <b>Total assets</b>      | 343,149          |
| <b>Total liabilities</b> | – 21,690         |
| <b>Net assets</b>        | <b>\$321,459</b> |

**Net Assets by Source**

|   |         |
|---|---------|
| Capital received from investors           | 321,885 |
| Net investment income not yet distributed | 25      |
| Net realized capital gains                | 46      |
| Net unrealized capital losses             | (497)   |

**Net Asset Value (NAV) by Share Class**

| Share Class     | Net Assets | ÷ | Shares Outstanding | = | NAV    |
|-----------------|------------|---|--------------------|---|--------|
| Investor Shares | \$23,287   |   | 2,331              |   | \$9.99 |
| Select Shares   | \$298,172  |   | 29,859             |   | \$9.99 |

Unless stated, all numbers x 1,000.

The amortized cost of the fund's securities was \$340,238.

Not counting short-term obligations, the fund's security transactions during the period were:

|                  |           |
|------------------|-----------|
| Purchases        | \$145,353 |
| Sales/maturities | \$–       |

The fund's total security transactions with other Schwab Funds during the period were \$220,611.

These derive from investments and futures.

**Federal Tax Data**

|   |                |
|---|----------------|
| <b>Portfolio cost</b>                   | \$340,213      |
| <b>Net unrealized gains and losses:</b> |                |
| Gains                                   | \$54           |
| Losses                                  | + (568)        |
|   | <b>(\$514)</b> |

## Statement of

**Operations**

For December 16, 2004 (commencement of operations) through February 28, 2005; unaudited. All numbers are x 1,000.

**Investment Income**

|          |                |
|----------|----------------|
| Interest | <b>\$1,008</b> |
|----------|----------------|

**Net Realized Gains and Losses**

|                                    |           |
|------------------------------------|-----------|
| Net realized gains on futures sold | <b>46</b> |
|------------------------------------|-----------|

**Net Unrealized Gains and Losses**

|   |              |
|---|--------------|
| Net unrealized losses on investments      | (539)        |
| Net unrealized gains on futures contracts | + 42         |
| <b>Net unrealized losses</b>              | <b>(497)</b> |

**Expenses**

|   |          |
|---|----------|
| Investment adviser and administrator fees   | 156      |
| Transfer agent and shareholder service fees |          |
| Investor Shares                             | 7        |
| Select Shares                               | 42       |
| Trustees' fees                              | 2        |
| Custodian and portfolio accounting fees     | 10       |
| Professional fees                           | 6        |
| Registration fees                           | 24       |
| Shareholder reports                         | 9        |
| Other expenses                              | + 1      |
| Total expenses                              | 257      |
| Expense reduction                           | - 257    |
| <b>Net expenses</b>                         | <b>-</b> |

**Increase in Net Assets from Operations**

|   |              |
|---|--------------|
| <b>Total investment income</b>                | 1,008        |
| <b>Net expenses</b>                           | - -          |
| <b>Net investment income</b>                  | <b>1,008</b> |
| <b>Net realized gains</b>                     | 46           |
| <b>Net unrealized losses</b>                  | + (497)      |
| <b>Increase in net assets from operations</b> | <b>\$557</b> |

Unless stated, all numbers are x 1,000.

Calculated as a percentage of average daily net assets: 0.35% of the first \$500 million and 0.30% of assets beyond that. These fees are paid to Charles Schwab Investments Management, Inc. (CSIM).

Calculated as a percentage of average daily net assets: for transfer agent services, 0.05% of the fund's assets; for shareholder services, 0.20% and 0.05% of the fund's assets of each respective share class. These fees are paid to Charles Schwab & Co., Inc. (Schwab).

For the fund's independent trustees only.

Includes \$205 from the investment advisor (CSIM) and \$49 from the transfer agent and shareholder service agent (Schwab). These reductions reflect a guarantee by CSIM and Schwab that through May 1, 2005 the annual operating expenses will equal 0.00% for both Investor and Select Shares. For the period May 2, 2005 through at least November 15, 2005, CSIM and Schwab have guaranteed to limit the annual operating expenses (excluding interest, taxes and certain non-routine expenses) to 0.64% for Investor Shares and 0.49% for Select Shares.

These add up to a net loss on investments of \$451.

Statements of

**Changes in Net Assets**

For the current report period only. Because the fund commenced operations on December 16, 2004, it has no prior report period. All numbers are x 1,000.

Figures for current period are unaudited.

**Operations**

|   | 12/16/04-2/28/05 |
|---|------------------|
| Net investment income                         | \$1,008          |
| Net realized gains                            | 46               |
| Net unrealized losses                         | + (497)          |
| <b>Increase in net assets from operations</b> | <b>557</b>       |

**Distributions Paid****Dividends from Net Investment Income**

|   |              |
|---|--------------|
| Investor Shares                                   | 66           |
| Select Shares                                     | + 917        |
| <b>Total dividends from net investment income</b> | <b>\$983</b> |

**Transactions in Fund Shares**

|  | 12/16/04-2/28/05 |                   |
|--|------------------|-------------------|
|  | SHARES           | VALUE             |
| <b>Shares sold</b>                     |                  |                   |
| Investor Shares                        | 2,737            | \$27,369          |
| Select Shares                          | + 33,216         | 332,122           |
| <b>Total shares sold</b>               | <b>35,953</b>    | <b>359,491</b>    |
| <b>Shares Reinvested</b>               |                  |                   |
| Investor Shares                        | 4                | \$48              |
| Select Shares                          | + 68             | 679               |
| <b>Total shares reinvested</b>         | <b>72</b>        | <b>\$727</b>      |
| <b>Shares Redeemed</b>                 |                  |                   |
| Investor Shares                        | (410)            | (\$4,101)         |
| Select Shares                          | + (3,425)        | (34,232)          |
| <b>Total shares redeemed</b>           | <b>(3,835)</b>   | <b>(\$38,333)</b> |
| <b>Net transactions in fund shares</b> | <b>32,190</b>    | <b>\$321,885</b>  |

**Shares Outstanding and Net Assets**

|                      | 12/16/04-2/28/05 |                   |
|----------------------|------------------|-------------------|
|                      | SHARES           | NET ASSETS        |
| Beginning of period  | —                | \$ —              |
| Total increase       | + 32,190         | 321,459           |
| <b>End of period</b> | <b>32,190</b>    | <b>\$ 321,459</b> |

Unless stated, all numbers x 1,000.

Figures for shares represent shares sold plus shares reinvested, minus shares redeemed. Figures for net assets represent the changes in net assets from operations plus the changes in value from transactions in fund shares, minus distributions paid.

Includes net investment income not yet distributed in the amount of \$25.



# Schwab Short/Intermediate Tax-Free Bond Fund™

## Financial Statements

### Financial Highlights

|   | 9/1/04–<br>2/28/05* | 9/1/03–<br>8/31/04 | 9/1/02–<br>8/31/03 | 9/1/01–<br>8/31/02 | 9/1/00–<br>8/31/01 | 9/1/99–<br>8/31/00 |
|---|---------------------|--------------------|--------------------|--------------------|--------------------|--------------------|
| <b>Per-Share Data (\$)</b>                  |                     |                    |                    |                    |                    |                    |
| Net asset value at beginning of period      | 10.69               | 10.59              | 10.63              | 10.42              | 10.08              | 10.05              |
| Income from investment operations:          |                     |                    |                    |                    |                    |                    |
| Net investment income                       | 0.14                | 0.29               | 0.30               | 0.35               | 0.39               | 0.41               |
| Net realized and unrealized gains or losses | (0.15)              | 0.10               | (0.04)             | 0.20               | 0.34               | 0.03               |
| Total income from investment operations     | (0.01)              | 0.39               | 0.26               | 0.55               | 0.73               | 0.44               |
| Less distributions:                         |                     |                    |                    |                    |                    |                    |
| Dividends from net investment income        | (0.14)              | (0.29)             | (0.30)             | (0.34)             | (0.39)             | (0.41)             |
| Net asset value at end of period            | 10.54               | 10.69              | 10.59              | 10.63              | 10.42              | 10.08              |
| Total return (%)                            | (0.10) <sup>1</sup> | 3.74               | 2.50               | 5.37               | 7.42               | 4.50               |
| <b>Ratios/Supplemental Data (%)</b>         |                     |                    |                    |                    |                    |                    |
| Ratios to average net assets:               |                     |                    |                    |                    |                    |                    |
| Net operating expenses                      | 0.63 <sup>2</sup>   | 0.63               | 0.60               | 0.49               | 0.49               | 0.50 <sup>3</sup>  |
| Gross operating expenses                    | 0.63 <sup>2</sup>   | 0.63               | 0.63               | 0.70               | 0.73               | 0.75               |
| Net investment income                       | 2.66 <sup>2</sup>   | 2.73               | 2.83               | 3.29               | 3.84               | 4.11               |
| Portfolio turnover rate                     | —                   | 19                 | 11                 | 28                 | 14                 | 11                 |
| Net assets, end of period (\$ x 1,000,000)  | 151                 | 161                | 159                | 139                | 109                | 76                 |

\* Unaudited.

<sup>1</sup> Not annualized.

<sup>2</sup> Annualized.

<sup>3</sup> The ratio of net operating expenses would have been 0.49% if certain non-routine expenses (proxy fees) had not been included.

**Portfolio Holdings** as of February 28, 2005, unaudited

This section shows all the securities in the fund's portfolio and their value, as of the report date.

The fund files its complete schedule of portfolio holdings with the SEC for the first and third quarters of each fiscal year on Form N-Q. The fund's Forms N-Q is available on the SEC's website at <http://www.sec.gov> and may be reviewed and copied at the SEC's Public Reference Room in Washington, D.C. Call 1-800-SEC-0330 for information on the operation of the Public Reference Room. The schedule of portfolio holdings filed on a fund's most recent Form N-Q is available by visiting Schwab's website at [www.schwab.com/schwabfunds](http://www.schwab.com/schwabfunds).

We use the symbols below to designate certain characteristics of the securities.

- + Credit-enhanced security
- ▷ Liquidity-enhanced security

For fixed-rate obligations, the rate shown is the interest rate (the rate established when the obligation was issued) and the maturity date shown is the stated legal maturity. For variable-rate obligations, the rate shown is the rate as of the report date, and the maturity shown is the later of the next interest rate change date or demand date.

| <b>Holdings by Category</b> |                                     | <b>Cost</b><br>(\$x1,000) | <b>Value</b><br>(\$x1,000) |
|-----------------------------|-------------------------------------|---------------------------|----------------------------|
| <b>98.6%</b>                | <b>Municipal Bonds</b>              | 146,331                   | 148,675                    |
| <b>0.2%</b>                 | <b>Other Investment Companies</b>   | 306                       | 306                        |
| <b>98.8%</b>                | <b>Total Investments</b>            | <b>146,637</b>            | <b>148,981</b>             |
| <b>1.2%</b>                 | <b>Other Assets and Liabilities</b> |                           | 1,739                      |
| <b>100.0%</b>               | <b>Net Assets</b>                   |                           | <b>150,720</b>             |

**Issuer****Project****Type of Security, Series****Rate****Maturity Date****Face Amount**  
(\$ x 1,000)**Value**  
(\$ x 1,000)**Municipal Bonds** 98.6% of net assets**Fixed-Rate Obligations** 93.8%**Arizona** 5.3%**+ Arizona State**

Refunding Certificates of Participation, Series 2002B

5.00% 09/01/07 5,000 5,281

**Catalina Foothills Unified School District No. 16**

+ General Obligation Refunding Bonds, Series 2004

4.25% 07/01/06 1,235 1,263

+ General Obligation Refunding Bonds, Series 2004

5.00% 07/01/07 1,315 1,385

**7,929**

**California** 10.2%**Alameda Public Financing Authority**

1997 Revenue Bond Refinancing

Revenue Bonds, Series 1999

4.95% 09/02/07 2,065 2,118

**California Department of Water Resources**

Power Supply Revenue Bonds, Series 2002A

5.50% 05/01/10 1,000 1,104

**+ California State Public Works Board**

Department of Corrections

Lease Revenue Refunding Bonds,  
Series 2004D

5.00% 12/01/09 5,500 5,990

**California Statewide Communities Development Authority**

Kaiser Permanente

Revenue Bonds, Series 2002D

4.35% 03/01/07 3,000 3,081

| Issuer<br>Project<br>Type of Security, Series               | Rate  | Maturity<br>Date | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|---|-------|------------------|-----------------------------|-----------------------|
| <b>Santa Clara County Financing Authority</b>               |       |                  |                             |                       |
| <i>Measure B</i>  |       |                  |                             |                       |
| Special Obligation Bonds, Series 2003                       | 4.00% | 08/01/06         | 3,000                       | 3,063                 |
|   |       |                  |                             | <b>15,356</b>         |
| <b>Colorado 1.4%</b>  |       |                  |                             |                       |
| <b>+ Adams County, School District #50</b>                  |       |                  |                             |                       |
| General Obligation Refunding Bonds, Series 2004             | 4.00% | 12/01/07         | 2,000                       | <b>2,068</b>          |
| <b>Connecticut 0.7%</b>                                     |       |                  |                             |                       |
| <b>+ Connecticut State</b>                                  |       |                  |                             |                       |
| General Obligation Refunding Bonds, Series 2004B            | 4.00% | 12/01/09         | 1,000                       | <b>1,042</b>          |
| <b>District of Columbia 2.7%</b>                            |       |                  |                             |                       |
| <b>+ Washington D.C. Convention Center Authority</b>        |       |                  |                             |                       |
| Dedicated Tax Senior Lien Revenue Bonds, Series 1998        | 5.00% | 10/01/06         | 4,000                       | <b>4,146</b>          |
| <b>Florida 2.3%</b>   |       |                  |                             |                       |
| <b>+ Miami – Dade County</b>                                |       |                  |                             |                       |
| <i>Miami International Airport</i>                          |       |                  |                             |                       |
| Aviation Revenue Refunding Revenue Bonds,<br>Series 2004C   | 2.00% | 10/01/05         | 3,450                       | <b>3,441</b>          |
| <b>Georgia 4.7%</b>   |       |                  |                             |                       |
| <b>+ Atlanta</b>  |       |                  |                             |                       |
| Airport General Revenue Refunding Bonds,<br>Series 2003RF-A | 5.00% | 01/01/10         | 3,660                       | 3,932                 |
| <b>Georgia State</b>  |       |                  |                             |                       |
| General Obligation Bonds, Series 2000D                      | 6.00% | 10/01/07         | 2,865                       | 3,105                 |
|   |       |                  |                             | <b>7,037</b>          |
| <b>Illinois 0.7%</b>  |       |                  |                             |                       |
| <b>+ Chicago Public Building Commission</b>                 |       |                  |                             |                       |
| <i>Board of Education</i>                                   |       |                  |                             |                       |
| Building Revenue Bonds, Series 1999C                        | 5.50% | 02/01/06         | 1,000                       | <b>1,027</b>          |
| <b>Indiana 1.5%</b>   |       |                  |                             |                       |
| <b>+ Lake County</b>  |       |                  |                             |                       |
| First Mortgage Lease Revenue Bonds, Series 2000             | 5.25% | 08/01/09         | 2,040                       | <b>2,226</b>          |
| <b>Kentucky 2.6%</b>  |       |                  |                             |                       |
| <b>Kentucky Property &amp; Building Commission</b>          |       |                  |                             |                       |
| <i>Project No. 71</i>                                       |       |                  |                             |                       |
| Revenue Bonds   | 5.50% | 08/01/09         | 3,500                       | <b>3,863</b>          |
| <b>Louisiana 1.1%</b>                                       |       |                  |                             |                       |
| <b>+ New Orleans</b>  |       |                  |                             |                       |
| Refunding Certificates of Participation, Series 1998B       | 4.50% | 12/01/05         | 1,600                       | <b>1,613</b>          |

Portfolio Holdings continued

| Issuer<br>Project<br>Type of Security, Series               | Rate  | Maturity<br>Date | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|---|-------|------------------|-----------------------------|-----------------------|
| <b>Massachusetts 3.3%</b>                                   |       |                  |                             |                       |
| <b>Massachusetts State</b>                                  |       |                  |                             |                       |
| General Obligation Refunding Bonds, Series 2001A            | 5.50% | 01/01/11         | 2,500                       | 2,782                 |
| + <i>Consolidated Loan of 2002</i>                          |       |                  |                             |                       |
| Special Obligation Revenue Bonds, Series A                  | 5.00% | 06/01/10         | 2,000                       | 2,183                 |
|   |       |                  |                             | <b>4,965</b>          |
| <b>Michigan 3.4%</b>  |       |                  |                             |                       |
| + <b>Detroit</b>  |       |                  |                             |                       |
| Capital Improvement Bonds, Series 2002A                     | 5.00% | 04/01/07         | 1,000                       | 1,048                 |
| + <b>Wayne County</b>                                       |       |                  |                             |                       |
| Airport Refunding Revenue Bonds, Series 2002D               | 5.00% | 12/01/10         | 3,900                       | 4,154                 |
|   |       |                  |                             | <b>5,202</b>          |
| <b>Missouri 1.5%</b>  |       |                  |                             |                       |
| + <b>St. Louis Municipal Finance Corp.</b>                  |       |                  |                             |                       |
| Leasehold Refunding Revenue Bonds, Series 2003              | 5.25% | 07/15/10         | 2,000                       | <b>2,207</b>          |
| <b>Nevada 1.1%</b>  |       |                  |                             |                       |
| + <b>Henderson</b>  |       |                  |                             |                       |
| <i>Seven Hills</i>  |       |                  |                             |                       |
| Senior Limited Obligation Refunding Bonds, Series 2001A     | 4.63% | 08/01/11         | 1,535                       | <b>1,649</b>          |
| <b>New Jersey 3.4%</b>                                      |       |                  |                             |                       |
| + <b>Mercer County</b>                                      |       |                  |                             |                       |
| <i>Regional Sludge Project</i>                              |       |                  |                             |                       |
| Refunding Revenue Bonds, Series 2003                        | 5.00% | 12/15/09         | 1,300                       | 1,412                 |
| + <b>New Jersey Transit Corp.</b>                           |       |                  |                             |                       |
| <i>Federal Transit Administration Grants</i>                |       |                  |                             |                       |
| Certificates of Participation, Series 2000B                 | 5.50% | 09/15/07         | 3,500                       | 3,723                 |
|   |       |                  |                             | <b>5,135</b>          |
| <b>New Mexico 1.0%</b>                                      |       |                  |                             |                       |
| <b>Farmington</b>   |       |                  |                             |                       |
| Pollution Control Refunding Revenue Bonds,<br>Series 2003A  | 2.10% | 04/01/06         | 1,500                       | <b>1,483</b>          |
| <b>New York 9.3%</b>  |       |                  |                             |                       |
| + <b>Franklin County</b>                                    |       |                  |                             |                       |
| General Obligation Public Improvement Bonds,<br>Series 1998 | 4.25% | 11/01/06         | 715                         | 736                   |
| <b>New York City</b>  |       |                  |                             |                       |
| General Obligation Bonds, Fiscal 1999 Series H              | 4.75% | 03/15/07         | 3,000                       | 3,120                 |
| General Obligation Bonds, Fiscal 2003 Series A              | 5.25% | 08/01/09         | 1,825                       | 1,977                 |
| General Obligation Bonds, Fiscal 2003 Series B              | 5.25% | 08/01/09         | 1,000                       | 1,083                 |
| General Obligation Bonds, Fiscal 2003 Series J              | 5.00% | 06/01/09         | 2,500                       | 2,676                 |
| + <b>New York State Thruway Authority</b>                   |       |                  |                             |                       |
| <i>Second General Highway &amp; Bridge</i>                  |       |                  |                             |                       |
| Trust Fund Bonds, Series 2003A                              | 5.25% | 04/01/12         | 4,000                       | 4,459                 |
|   |       |                  |                             | <b>14,051</b>         |

| Issuer<br>Project<br>Type of Security, Series  | Rate  | Maturity<br>Date | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|--|-------|------------------|-----------------------------|-----------------------|
| <b>North Carolina 7.7%</b>   |       |                  |                             |                       |
| <b>Charlotte</b>   |       |                  |                             |                       |
| <i>Fiscal Year 2004 Equipment Acquisition Project</i><br>Certificates of Participation, Series 2004C                           | 4.00% | 03/01/07         | 4,540                       | 4,666                 |
| <b>+ Durham County</b><br>Enterprise System Revenue Bonds, Series 2002   | 5.00% | 06/01/09         | 1,495                       | 1,619                 |
| <b>North Carolina Municipal Power Agency</b>   |       |                  |                             |                       |
| <i>Catawaba Electric</i>   |       |                  |                             |                       |
| <b>+ Revenue Bonds, Series 1995A</b>   | 5.10% | 01/01/07         | 2,000                       | 2,082                 |
| <b>+ Revenue Bonds, Series 1999A</b>   | 5.75% | 01/01/09         | 3,000                       | 3,306                 |
|  |       |                  |                             | <b>11,673</b>         |
| <b>Ohio 4.6%</b>   |       |                  |                             |                       |
| <b>Ohio State</b>  |       |                  |                             |                       |
| Higher Education Capital Facilities Bonds,<br>Series II-2001A  | 5.50% | 12/01/08         | 3,000                       | 3,277                 |
| <i>Administrative Building Fund Projects</i><br>State Facilities Bonds, Series 1998A   | 5.13% | 10/01/06         | 3,580                       | 3,721                 |
|  |       |                  |                             | <b>6,998</b>          |
| <b>Oregon 1.9%</b>   |       |                  |                             |                       |
| <b>+ Oregon State</b><br><i>Department of Administrative Services</i><br>Refunding Certificates of Participation, Series 2002C | 5.00% | 11/01/07         | 2,705                       | <b>2,868</b>          |
| <b>Pennsylvania 3.7%</b>   |       |                  |                             |                       |
| <b>+ Pennsylvania Industrial Development Authority</b><br>Economic Development Revenue Bonds, Series 1994                      | 7.00% | 07/01/07         | 1,000                       | 1,094                 |
| <b>+ Philadelphia</b><br>Water & Wastewater Refunding Revenue Bonds,<br>Series 2001B   | 5.50% | 11/01/11         | 4,000                       | 4,510                 |
|  |       |                  |                             | <b>5,604</b>          |
| <b>Puerto Rico 1.4%</b>  |       |                  |                             |                       |
| <b>+ Puerto Rico Highway and Transportation Authority</b><br>Transportation Refunding Revenue Bonds, Series 2003H              | 5.00% | 07/01/35         | 2,000                       | <b>2,170</b>          |
| <b>South Carolina 2.1%</b>   |       |                  |                             |                       |
| <b>+ Charleston County</b><br><i>Care Alliance Health Services</i><br>Revenue Bonds, Series 1999A                              | 4.25% | 08/15/07         | 3,000                       | <b>3,106</b>          |
| <b>Texas 7.4%</b>  |       |                  |                             |                       |
| <b>+ Dallas Water &amp; Sewer Utilities</b><br>Refunding & Improvement Revenue Bonds, Series 2003                              | 5.00% | 10/01/10         | 5,000                       | 5,432                 |
| <b>+ Denton Utility System</b><br>Refunding & Improvement Revenue Bonds, Series 2001   | 5.00% | 12/01/12         | 2,030                       | 2,185                 |

**Portfolio Holdings** continued

| Issuer<br>Project<br>Type of Security, Series  | Rate  | Maturity<br>Date | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|--|-------|------------------|-----------------------------|-----------------------|
| <b>Fort Worth</b>  |       |                  |                             |                       |
| General Purpose Improvement & Refunding Bonds,<br>Series 2001  | 5.00% | 03/01/10         | 1,090                       | 1,178                 |
| <b>+ Houston Port Authority</b>  |       |                  |                             |                       |
| Port Improvement General Obligation Bonds,<br>Series 2001B   | 5.25% | 10/01/10         | 2,205                       | 2,403                 |
|  |       |                  |                             | <b>11,198</b>         |
| <b>Washington 6.4%</b>   |       |                  |                             |                       |
| <b>+ Port of Seattle</b>   |       |                  |                             |                       |
| <i>Passenger Facility Charge</i><br>Revenue Bonds, Series 1998B  | 5.00% | 12/01/07         | 1,395                       | 1,467                 |
| <b>+ Snohomish County</b>  |       |                  |                             |                       |
| Refunding Limited General Obligation Bonds   | 4.50% | 12/01/12         | 1,920                       | 2,019                 |
| <b>+ Washington</b>  |       |                  |                             |                       |
| <i>Department of Ecology State Office Building Project</i><br>Refunding Certificates of Participation, Series 2001 | 4.75% | 04/01/12         | 1,710                       | 1,811                 |
| <b>+ Washington Public Power Supply System</b>   |       |                  |                             |                       |
| <i>Nuclear Project No. 2</i><br>Refunding Revenue Bonds, Series 1993A  | 5.70% | 07/01/08         | 4,000                       | 4,365                 |
|  |       |                  |                             | <b>9,662</b>          |
| <b>Wisconsin 2.4%</b>  |       |                  |                             |                       |
| <b>Wisconsin Health &amp; Educational Facilities Authority</b>   |       |                  |                             |                       |
| <i>Carroll College, Inc. Project</i><br>Revenue Bonds, Series 1998   | 4.80% | 10/01/06         | 1,000                       | 1,021                 |
| <b>+ Wisconsin State</b>   |       |                  |                             |                       |
| Master Lease Certificates of Participation, Series 2002D   | 5.00% | 09/01/07         | 2,500                       | 2,635                 |
|  |       |                  |                             | <b>3,656</b>          |
| <b>Variable Rate Obligations 4.8%</b>  |       |                  |                             |                       |
| <b>California 4.8%</b>   |       |                  |                             |                       |
| <b>+ California</b>  |       |                  |                             |                       |
| Economic Recovery Bonds Series 2004C-6   | 1.80% | 03/01/05         | 250                         | 250                   |
| <b>+ California Dept of Water Resources</b>  |       |                  |                             |                       |
| Power Supply Revenue Bonds, Series 2002B-2   | 1.78% | 03/01/05         | 1,350                       | 1,350                 |
| <b>► Orange County Sanitation District</b>   |       |                  |                             |                       |
| Refunding Certificates of Participation, Series 2000B  | 1.87% | 03/01/05         | 600                         | 600                   |
| <b>► Southern California Metropolitan Water District</b>   |       |                  |                             |                       |
| Water Revenue Bonds 2000 Authorization, Series B-3   | 1.80% | 03/01/05         | 5,100                       | 5,100                 |
|  |       |                  |                             | <b>7,300</b>          |

| Security and Number of Shares                         |         | Value<br>(\$ x 1,000) |
|---|---------|-----------------------|
| Other Investment Companies 0.2% of net assets         |         |                       |
| Provident Institutional Funds—<br>Muni Fund Portfolio | 306,485 | 306                   |
| End of investments.                                   |         |                       |

## Statement of

**Assets and Liabilities**

As of February 28, 2005; unaudited. All numbers are x 1,000 except NAV.

**Assets**

|                       |                |
|-----------------------|----------------|
| Investments, at value | \$148,981      |
| Receivables:          |                |
| Fund shares sold      | 52             |
| Interest              | 1,904          |
| Prepaid expenses      | + 18           |
| <b>Total assets</b>   | <b>150,955</b> |

**Liabilities**

|   |            |
|---|------------|
| Payables:                                   |            |
| Fund shares redeemed                        | 92         |
| Dividends to shareholders                   | 97         |
| Investment adviser and administrator fees   | 4          |
| Transfer agent and shareholder service fees | 3          |
| Accrued expenses                            | + 39       |
| <b>Total liabilities</b>                    | <b>235</b> |

**Net Assets**

|                          |                  |
|--------------------------|------------------|
| <b>Total assets</b>      | 150,955          |
| <b>Total liabilities</b> | - 235            |
| <b>Net assets</b>        | <b>\$150,720</b> |

**Net Assets by Source**

|   |         |
|---|---------|
| Capital received from investors           | 148,658 |
| Net investment income not yet distributed | 22      |
| Net realized capital losses               | (304)   |
| Net unrealized capital gains              | 2,344   |

**Net Asset Value (NAV)**

| <b>Net Assets</b> | <b>+</b> | <b>Shares Outstanding</b> | <b>=</b> | <b>NAV</b> |
|-------------------|----------|---------------------------|----------|------------|
| \$150,720         |          | 14,301                    |          | \$10.54    |

Unless stated, all numbers are x 1,000.

The amortized cost of the fund's securities was \$146,637.

Not counting short-term obligations, the fund's security transactions during the period were:

|                  |         |
|------------------|---------|
| Purchases        | \$-     |
| Sales/maturities | \$9,515 |

The fund's total security transactions with other Schwab Funds during the period were \$17,475.

**Federal Tax Data**

|   |                |
|---|----------------|
| <b>Portfolio cost</b>                   | \$146,615      |
| <b>Net unrealized gains and losses:</b> |                |
| Gains                                   | \$3,086        |
| Losses                                  | + (720)        |
|   | <b>\$2,366</b> |

**As of August 31, 2004:****Undistributed earnings:**

|                         |       |
|-------------------------|-------|
| Tax-exempt income       | \$109 |
| Long-term capital gains | \$-   |

**Capital losses utilized** \$322

**Unused capital losses:**

|                   |              |
|-------------------|--------------|
| Expires 08/31 of: |              |
| 2009              | \$120        |
| 2010              | + 32         |
|                   | <b>\$152</b> |



## Statement of

**Operations**

For September 1, 2004 through February 28, 2005; unaudited. All numbers are x 1,000.

**Investment Income**

|          |                |
|----------|----------------|
| Interest | <b>\$2,523</b> |
|----------|----------------|

**Net Realized Gains and Losses**

|   |              |
|---|--------------|
| Net realized losses on investments sold | <b>(152)</b> |
|---|--------------|

**Net Unrealized Gains and Losses**

|                                      |                |
|--------------------------------------|----------------|
| Net unrealized losses on investments | <b>(2,057)</b> |
|--------------------------------------|----------------|

**Expenses**

|   |            |
|---|------------|
| Investment adviser and administrator fees   | 231        |
| Transfer agent and shareholder service fees | 192        |
| Trustees' fees                              | 4          |
| Custodian and portfolio accounting fees     | 8          |
| Professional fees                           | 15         |
| Registration fees                           | 13         |
| Shareholder reports                         | 12         |
| Other expenses                              | +          |
| <b>Total expenses</b>                       | <b>484</b> |

**Decrease in Net Assets from Operations**

|   |                |
|---|----------------|
| <b>Total investment income</b>                | 2,523          |
| <b>Total expenses</b>                         | - 484          |
| <b>Net investment income</b>                  | <b>2,039</b>   |
| <b>Net realized losses</b>                    | (152)          |
| <b>Net unrealized losses</b>                  | + (2,057)      |
| <b>Decrease in net assets from operations</b> | <b>(\$170)</b> |

Unless stated, all numbers are x 1,000.

Calculated as a percentage of average daily net assets: 0.30% of the first \$500 million and 0.22% of assets beyond that. These fees are paid to Charles Schwab Investments Management, Inc. (CSIM).

Calculated as a percentage of average daily net assets: for transfer agent services, 0.05% of the fund's assets; for shareholder services, 0.20% of the fund's assets. These fees are paid to Charles Schwab & Co., Inc. (Schwab).

For the fund's independent trustees only.

CSIM and Schwab have guaranteed that the annual operating expenses (excluding interest, taxes and certain non-routine expenses) will not exceed 0.65% of the fund's average daily net assets through November 15, 2005.

These add up to a net loss on investments of \$2,209.

Statements of

**Changes in Net Assets**

For the current and prior report periods. All numbers are x 1,000.  
Figures for current period are unaudited.

Unless stated, all numbers are x 1,000.

**Operations**

|   | 9/1/04-2/28/05 | 9/1/03-8/31/04 |
|---|----------------|----------------|
| Net investment income                                     | \$2,039        | \$4,557        |
| Net realized gains or losses                              | (152)          | 323            |
| Net unrealized gains or losses                            | + (2,057)      | 303            |
| <b>Increase or decrease in net assets from operations</b> | <b>(170)</b>   | <b>5,183</b>   |

**Distributions Paid**

|                                      |                |                |
|--------------------------------------|----------------|----------------|
| Dividends from net investment income | <b>\$2,038</b> | <b>\$4,553</b> |
|--------------------------------------|----------------|----------------|

**Transactions in Fund Shares**

|  | 9/1/04-2/28/05 |                  | 9/1/03-8/31/04 |                |
|--|----------------|------------------|----------------|----------------|
|  | SHARES         | VALUE            | SHARES         | VALUE          |
| Shares sold                            | 3,263          | \$34,712         | 9,625          | \$103,366      |
| Shares reinvested                      | 131            | 1,395            | 322            | 3,437          |
| Shares redeemed                        | + (4,188)      | (44,570)         | (9,895)        | (105,377)      |
| <b>Net transactions in fund shares</b> | <b>(794)</b>   | <b>(\$8,463)</b> | <b>52</b>      | <b>\$1,426</b> |

**Shares Outstanding and Net Assets**

|                            | 9/1/04-2/28/05 |                  | 9/1/03-8/31/04 |                  |
|----------------------------|----------------|------------------|----------------|------------------|
|                            | SHARES         | NET ASSETS       | SHARES         | NET ASSETS       |
| Beginning of period        | 15,095         | \$161,391        | 15,043         | \$159,335        |
| Total increase or decrease | + (794)        | (10,671)         | 52             | 2,056            |
| <b>End of period</b>       | <b>14,301</b>  | <b>\$150,720</b> | <b>15,095</b>  | <b>\$161,391</b> |

Figures for shares represent shares sold plus shares reinvested, minus shares redeemed. Figures for net assets represent the changes in net assets from operations plus the changes in value from transactions in fund shares, minus distributions paid.

Includes net investment income not yet distributed in the amount of \$22 and \$21 for the current and prior period, respectively.

# Schwab Long-Term Tax-Free Bond Fund™

## Financial Statements

### Financial Highlights

|   | 9/1/04–<br>2/28/05* | 9/1/03–<br>8/31/04 | 9/1/02–<br>8/31/03 | 9/1/01–<br>8/31/02 | 9/1/00–<br>8/31/01 | 9/1/99–<br>8/31/00 |
|---|---------------------|--------------------|--------------------|--------------------|--------------------|--------------------|
| <b>Per-Share Data (\$)</b>                  |                     |                    |                    |                    |                    |                    |
| Net asset value at beginning of period      | 11.33               | 11.04              | 11.05              | 10.87              | 10.24              | 10.11              |
| Income from investment operations:          |                     |                    |                    |                    |                    |                    |
| Net investment income                       | 0.22                | 0.45               | 0.45               | 0.49               | 0.50               | 0.50               |
| Net realized and unrealized gains or losses | (0.04)              | 0.29               | (0.01)             | 0.17               | 0.63               | 0.13               |
| Total income from investment operations     | 0.18                | 0.74               | 0.44               | 0.66               | 1.13               | 0.63               |
| Less distributions:                         |                     |                    |                    |                    |                    |                    |
| Dividends from net investment income        | (0.22)              | (0.45)             | (0.45)             | (0.48)             | (0.50)             | (0.50)             |
| Net asset value at end of period            | 11.29               | 11.33              | 11.04              | 11.05              | 10.87              | 10.24              |
| Total return (%)                            | 1.61 <sup>1</sup>   | 6.77               | 4.01               | 6.24               | 11.29              | 6.59               |
| <b>Ratios/Supplemental Data (%)</b>         |                     |                    |                    |                    |                    |                    |
| Ratios to average net assets:               |                     |                    |                    |                    |                    |                    |
| Net operating expenses                      | 0.65 <sup>2</sup>   | 0.65               | 0.62               | 0.49               | 0.49               | 0.50 <sup>3</sup>  |
| Gross operating expenses                    | 0.66 <sup>2</sup>   | 0.66               | 0.65               | 0.74               | 0.74               | 0.76               |
| Net investment income                       | 3.97 <sup>2</sup>   | 4.00               | 4.06               | 4.49               | 4.73               | 5.11               |
| Portfolio turnover rate                     | —                   | 10                 | 22                 | 25                 | 35                 | 25                 |
| Net assets, end of period (\$ x 1,000,000)  | 89                  | 83                 | 81                 | 85                 | 88                 | 76                 |

\* Unaudited.

<sup>1</sup> Not annualized.

<sup>2</sup> Annualized.

<sup>3</sup> The ratio of net operating expenses would have been 0.49% if certain non-routine expenses (proxy fees) had not been included.

**Portfolio Holdings** as of February 28, 2005, unaudited

This section shows all the securities in the fund's portfolio and their value, as of the report date.

The fund files its complete schedule of portfolio holdings with the SEC for the first and third quarters of each fiscal year on Form N-Q. The fund's Forms N-Q is available on the SEC's website at <http://www.sec.gov> and may be reviewed and copied at the SEC's Public Reference Room in Washington, D.C. Call 1-800-SEC-0330 for information on the operation of the Public Reference Room. The schedule of portfolio holdings filed on a fund's most recent Form N-Q is available by visiting Schwab's website at [www.schwab.com/schwabfunds](http://www.schwab.com/schwabfunds).

We use the symbols below to designate certain characteristics of the securities.

- + Credit-enhanced security
- ▷ Liquidity-enhanced security

For fixed-rate obligations, the rate shown is the interest rate (the rate established when the obligation was issued) and the maturity date shown is the stated legal maturity. For variable-rate obligations, the rate shown is the rate as of the report date, and the maturity shown is the later of the next interest rate change date or demand date.

| <b>Holdings by Category</b> |                                     | <b>Cost</b><br>(\$x1,000) | <b>Value</b><br>(\$x1,000) |
|-----------------------------|-------------------------------------|---------------------------|----------------------------|
| <b>98.8%</b>                | <b>Municipal Bonds</b>              | 82,311                    | 88,012                     |
| <b>98.8%</b>                | <b>Total Investments</b>            | <b>82,311</b>             | <b>88,012</b>              |
| <b>1.2%</b>                 | <b>Other Assets and Liabilities</b> |                           | 1,097                      |
| <b>100.0%</b>               | <b>Net Assets</b>                   |                           | <b>89,109</b>              |

| <b>Issuer</b>                                   | <b>Project</b> | <b>Type of Security, Series</b>                                | <b>Rate</b> | <b>Maturity Date</b> | <b>Face Amount</b><br>(\$ x 1,000) | <b>Value</b><br>(\$ x 1,000) |
|---|----------------|--|-------------|----------------------|------------------------------------|------------------------------|
| <b>Municipal Bonds 98.8% of net assets</b>      |                |  |             |                      |                                    |                              |
| <b>Fixed-Rate Obligations 92.3%</b>             |                |  |             |                      |                                    |                              |
| <b>California 7.3%</b>                          |                |  |             |                      |                                    |                              |
| <b>California State</b>                         |                |  |             |                      |                                    |                              |
|   |                | Various Purpose General Obligation Bonds                       | 5.25%       | 11/01/17             | 2,000                              | 2,198                        |
| <b>California Department of Water Resources</b> |                |  |             |                      |                                    |                              |
|   |                | Power Supply Revenue Bonds, Series 2002A                       | 5.88%       | 05/01/16             | 2,000                              | 2,284                        |
| <b>+ Natomas Union School District</b>          |                |  |             |                      |                                    |                              |
|   |                | Certificates of Participation, Series B                        | 5.00%       | 02/01/35             | 1,865                              | 2,013                        |
|   |                |  |             |                      |                                    | <b>6,495</b>                 |
| <b>Colorado 3.8%</b>                            |                |  |             |                      |                                    |                              |
| <b>+ Colorado Department of Transportation</b>  |                |  |             |                      |                                    |                              |
|   |                | Transportation Revenue Anticipation Notes, Series 2002B        | 5.50%       | 06/15/15             | 2,000                              | 2,292                        |
| <b>+ Denver City &amp; County</b>               |                |  |             |                      |                                    |                              |
|   |                | <i>Airport System</i><br>Refunding Revenue Bonds, Series 2002E | 5.50%       | 11/15/15             | 1,000                              | 1,092                        |
|   |                |  |             |                      |                                    | <b>3,384</b>                 |
| <b>District of Columbia 2.5%</b>                |                |  |             |                      |                                    |                              |
| <b>+ District of Columbia</b>                   |                |  |             |                      |                                    |                              |
|   |                | Certificates of Participation, Series 2003                     | 5.50%       | 01/01/17             | 2,000                              | <b>2,243</b>                 |

| Issuer<br>Project<br>Type of Security, Series   | Rate  | Maturity<br>Date | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|---|-------|------------------|-----------------------------|-----------------------|
| <b>Florida 3.2%</b>   |       |                  |                             |                       |
| <b>+ Escambia County Health Facilities Authority</b><br><i>Ascension Health Credit Group</i><br>Revenue Bonds, Series 1999A-2   | 5.75% | 11/15/09         | 2,500                       | <b>2,816</b>          |
| <b>Georgia 1.5%</b>   |       |                  |                             |                       |
| <b>+ Fulton County Development Authority</b><br><i>TUFF Morehouse</i><br>Revenue Bonds, Series 2002A  | 5.50% | 02/01/22         | 1,180                       | <b>1,302</b>          |
| <b>Hawaii 1.9%</b>  |       |                  |                             |                       |
| <b>+ Hawaii</b><br>General Obligation Bonds, Series 1999CT  | 5.88% | 09/01/09         | 1,500                       | <b>1,697</b>          |
| <b>Indiana 1.2%</b>   |       |                  |                             |                       |
| <b>+ Marion County Convention &amp; Recreational Facilities Authority</b><br>Excise Taxes Lease Refunding Senior Revenue Bonds,<br>Series 2001A                       | 5.00% | 06/01/21         | 1,000                       | <b>1,047</b>          |
| <b>Kentucky 1.2%</b>  |       |                  |                             |                       |
| <b>+ Jefferson County</b><br><i>University Medical Center</i><br>Health Facilities Revenue Bonds, Series 1997   | 5.25% | 07/01/22         | 1,000                       | <b>1,055</b>          |
| <b>Maryland 0.3%</b>  |       |                  |                             |                       |
| <b>Maryland Department of Housing &amp; Community Development</b><br>Housing Revenue Bonds, Series 1996A  | 5.88% | 07/01/16         | 250                         | <b>260</b>            |
| <b>Michigan 5.7%</b>  |       |                  |                             |                       |
| <b>Delta County Economic Development Corp.</b><br><i>MeadWestvaco-Escanaba Paper Co. Project</i><br>Environmental Improvement Refunding Revenue Bonds,<br>Series 2002 | 6.25% | 04/15/27         | 1,000                       | 1,128                 |
| <b>+ Detroit</b><br><i>Water Supply System</i><br>Refunding Senior Lien Revenue Bonds, Series 2003C   | 5.25% | 07/01/16         | 2,620                       | 2,895                 |
| <b>+ Wayne County Michigan Community College</b><br>Improvement Bonds, Series 1999  | 5.50% | 07/01/19         | 1,000                       | 1,089                 |
|   |       |                  |                             | <b>5,112</b>          |
| <b>Mississippi 5.1%</b>   |       |                  |                             |                       |
| <b>+ Mississippi Hospital Equipment &amp; Facilities Authority</b><br><i>Mississippi Baptist Medical Center</i><br>Refunding Revenue Bonds, Series 1995               | 6.00% | 05/01/13         | 2,150                       | 2,205                 |
| <b>+ Walnut Grove Correctional Authority</b><br><i>Walnut Grove Correctional Facility Project</i><br>Certificates of Participation, Series 1999                       | 6.00% | 11/01/19         | 2,000                       | 2,290                 |
|   |       |                  |                             | <b>4,495</b>          |

**Portfolio Holdings** continued

| Issuer<br>Project<br>Type of Security, Series                             | Rate  | Maturity<br>Date | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|---|-------|------------------|-----------------------------|-----------------------|
| <b>Nevada 5.0%</b>  |       |                  |                             |                       |
| <b>+ Nevada State</b>   |       |                  |                             |                       |
| Motor Vehicle Fuel Tax<br>Highway Improvement Revenue Bonds, Series 2004  | 5.50% | 12/01/18         | 2,000                       | 2,263                 |
| <b>+ Nevada State Department of Business &amp; Industry</b>               |       |                  |                             |                       |
| Las Vegas Monorail Project<br>First Tier Revenue Bonds, Series 2000       | 5.63% | 01/01/32         | 2,000                       | 2,219                 |
|   |       |                  |                             | <b>4,482</b>          |
| <b>New York 5.4%</b>  |       |                  |                             |                       |
| <b>+ Metropolitan Transportation Authority</b>                            |       |                  |                             |                       |
| Transportation Refunding Revenue Bonds, Series 2002A                      | 5.50% | 11/15/18         | 2,000                       | 2,251                 |
| <b>New York City</b>  |       |                  |                             |                       |
| General Obligation Bonds, Series 2002G                                    | 5.75% | 08/01/16         | 1,325                       | 1,485                 |
| General Obligation Bonds, Series 2005B                                    | 5.25% | 08/01/15         | 1,000                       | 1,103                 |
|   |       |                  |                             | <b>4,839</b>          |
| <b>Oregon 4.3%</b>  |       |                  |                             |                       |
| <b>+ Columbia River Peoples Utility District</b>                          |       |                  |                             |                       |
| Electric System Revenue Obligations, Series 2000B                         | 5.50% | 12/01/19         | 1,180                       | 1,294                 |
| <b>+ Morrow County School District</b>                                    |       |                  |                             |                       |
| General Obligation Bonds, Series 2001                                     | 5.63% | 06/15/16         | 2,235                       | 2,532                 |
|   |       |                  |                             | <b>3,826</b>          |
| <b>Pennsylvania 4.1%</b>  |       |                  |                             |                       |
| <b>Pennsylvania Higher Education Facilities Authority</b>                 |       |                  |                             |                       |
| University of Pennsylvania Health Services<br>Revenue Bonds, Series 1996A | 5.75% | 01/01/17         | 2,000                       | 2,075                 |
| <b>+ Seneca Valley Unified School District</b>                            |       |                  |                             |                       |
| General Obligation Refunding Bonds, Series 1998AA                         | 5.15% | 02/15/20         | 1,500                       | 1,581                 |
|   |       |                  |                             | <b>3,656</b>          |
| <b>Rhode Island 0.0%</b>  |       |                  |                             |                       |
| <b>Rhode Island Housing &amp; Mortgage Finance Corp.</b>                  |       |                  |                             |                       |
| Homeownership Opportunity Revenue Bonds, Series 10A                       | 6.50% | 10/01/22         | 20                          | 20                    |
| <b>Texas 18.8%</b>  |       |                  |                             |                       |
| <b>+ Austin Combined Utilities</b>  |       |                  |                             |                       |
| Refunding Revenue Bonds, Series 1997                                      | 5.13% | 11/15/16         | 3,000                       | 3,165                 |
| <b>+ Brazos River Authority</b>   |       |                  |                             |                       |
| Houston Industries, Inc.<br>Refunding Revenue Bonds, Series 1998A         | 5.13% | 05/01/19         | 1,750                       | 1,842                 |
| <b>+ Conroe Independent School District</b>                               |       |                  |                             |                       |
| Unlimited Tax Schoolhouse & Refunding Bonds,<br>Series 1997               | 5.25% | 02/15/21         | 1,000                       | 1,046                 |
| <b>+ Dallas Fort Worth International Airport</b>                          |       |                  |                             |                       |
| Joint Revenue Bonds, Series 2000A   | 6.00% | 11/01/24         | 3,500                       | 3,831                 |
| <b>Harris County</b>  |       |                  |                             |                       |
| Permanent Improvement Refunding Bonds, Series 2004A                       | 5.00% | 10/01/18         | 1,885                       | 2,037                 |

| Issuer<br>Project<br>Type of Security, Series   | Rate  | Maturity<br>Date | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|---|-------|------------------|-----------------------------|-----------------------|
| <b>+ Harris County Hospital District</b><br>Refunding Revenue Bonds, Series 2000  | 6.00% | 02/15/16         | 1,000                       | 1,125                 |
| <b>+ North Texas Tollway Authority</b><br>Refunding Revenue Bonds, Series 2003C   | 5.00% | 07/01/08         | 2,000                       | 2,131                 |
| <b>+ Texas Public Finance Authority</b><br><i>Texas Southern University</i><br>Financing System Refunding Revenue Bonds,<br>Series 1998A-1              | 4.75% | 11/01/17         | 1,545                       | 1,593                 |
|   |       |                  |                             | <b>16,770</b>         |
| <b>Vermont 2.5%</b>   |       |                  |                             |                       |
| <b>+ Vermont Education &amp; Health Buildings Financing Agency</b><br><i>Fletcher Allen Health Care Project</i><br>Hospital Revenue Bonds, Series 2000A | 6.00% | 12/01/23         | 2,000                       | <b>2,254</b>          |
| <b>Washington 18.5%</b>   |       |                  |                             |                       |
| <b>+ Clark County School District</b><br>Unlimited Tax General Obligation Bonds, Series 1999  | 5.50% | 12/01/17         | 3,000                       | 3,324                 |
| <b>Kent School District No. 415</b><br>Unlimited Tax General Obligation Refunding Bonds,<br>Series 1993A  | 5.55% | 12/01/11         | 500                         | 561                   |
| <b>King County</b><br>Limited Tax General Obligation Bonds, Series 1997D  | 5.75% | 12/01/11         | 3,500                       | 3,848                 |
| <b>+ King Street Center Project</b><br>Lease Revenue Bonds, Series 1997   | 5.13% | 06/01/17         | 1,000                       | 1,046                 |
| <b>+ Ocean Shores</b><br>Water and Sewer Revenue Bonds, Series 2001   | 5.50% | 12/01/21         | 2,000                       | 2,258                 |
| <b>Washington State Health Care Facilities Authority</b>  |       |                  |                             |                       |
| <b>+ Catholic Health Initiatives</b><br>Revenue Bonds, Series 2000A   | 6.00% | 12/01/20         | 3,000                       | 3,375                 |
| <b>+ Swedish Health System</b><br>Revenue Bonds, Series 1998  | 5.13% | 11/15/18         | 2,000                       | 2,107                 |
|   |       |                  |                             | <b>16,519</b>         |
| <b>Variable Rate Obligations 6.5%</b>   |       |                  |                             |                       |
| <b>Alaska 0.5%</b>  |       |                  |                             |                       |
| <b>Valdez</b><br><i>Exxon Pipeline Co.</i><br>Marine Terminal Refunding Revenue Bonds,<br>Series 1993A  | 1.78% | 03/01/05         | 450                         | <b>450</b>            |
| <b>California 4.2%</b>  |       |                  |                             |                       |
| <b>+ California Department of Water Resources</b><br>Power Supply Revenue Bonds, Series 2002B-2   | 1.78% | 03/01/05         | 1,925                       | 1,925                 |
| <b>+ Irvine Assessment District</b><br>Limited Obligation Improvement Bonds, Series 2000  | 1.80% | 03/01/05         | 265                         | 265                   |

**Portfolio Holdings** continued

| Issuer<br>Project<br>Type of Security, Series             | Rate  | Maturity<br>Date | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|---|-------|------------------|-----------------------------|-----------------------|
| <b>Orange County Sanitation District</b>                  |       |                  |                             |                       |
| ▶ Refunding Certificates of Participation, Series 2000A   | 1.77% | 03/01/05         | 300                         | 300                   |
| ▶ Refunding Certificates of Participation, Series 2000B   | 1.77% | 03/01/05         | 650                         | 650                   |
| <b>▶ Southern California Metropolitan Water District</b>  |       |                  |                             |                       |
| Water Revenue Bonds, Authorization, Series 2000B-1        | 1.77% | 03/01/05         | 600                         | 600                   |
|   |       |                  |                             | <b>3,740</b>          |
| <b>Mississippi 0.2%</b>                                   |       |                  |                             |                       |
| <b>Jackson County</b>                                     |       |                  |                             |                       |
| <i>Chevron USA</i>  |       |                  |                             |                       |
| Pollution Control Refunding Revenue Bonds,<br>Series 1993 | 1.80% | 03/01/05         | 150                         | <b>150</b>            |
| <b>New York 0.7%</b>                                      |       |                  |                             |                       |
| <b>+ Long Island Power Authority</b>                      |       |                  |                             |                       |
| <i>Electric System</i>                                    |       |                  |                             |                       |
| Subordinated Revenue Bonds, Series 2001 3-B               | 1.77% | 03/01/05         | 500                         | 500                   |
| <b>+▶ New York City</b>                                   |       |                  |                             |                       |
| General Obligation Bonds, Fiscal 2002 Series A-6          | 1.77% | 03/01/05         | 100                         | 100                   |
|   |       |                  |                             | <b>600</b>            |
| <b>Wyoming 0.9%</b>                                       |       |                  |                             |                       |
| <b>Uinta County</b>                                       |       |                  |                             |                       |
| <i>Chevron USA Project</i>                                |       |                  |                             |                       |
| Pollution Control Refunding Revenue Bonds,<br>Series 1993 | 1.80% | 03/01/05         | 800                         | <b>800</b>            |

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**End of investments.**



## Statement of

**Assets and Liabilities**

As of February 28, 2005; unaudited. All numbers are x 1,000 except NAV.

**Assets**

|                       |               |
|-----------------------|---------------|
| Investments, at value | \$88,012      |
| Receivables:          |               |
| Fund shares sold      | 191           |
| Interest              | 1,022         |
| Prepaid expenses      | + 10          |
| <b>Total assets</b>   | <b>89,235</b> |

**Liabilities**

|   |            |
|---|------------|
| Payables:                                   |            |
| Due to custodian                            | 10         |
| Dividends to shareholders                   | 82         |
| Investment adviser and administrator fees   | 2          |
| Transfer agent and shareholder service fees | 2          |
| Accrued expenses                            | + 30       |
| <b>Total liabilities</b>                    | <b>126</b> |

**Net Assets**

|                          |                 |
|--------------------------|-----------------|
| <b>Total assets</b>      | 89,235          |
| <b>Total liabilities</b> | - 126           |
| <b>Net assets</b>        | <b>\$89,109</b> |

**Net Assets by Source**

|   |         |
|---|---------|
| Capital received from investors           | 85,010  |
| Net investment income not yet distributed | 161     |
| Net realized capital losses               | (1,763) |
| Net unrealized capital gains              | 5,701   |

**Net Asset Value (NAV)**

| <b>Net Assets</b> | <b>÷</b> | <b>Shares Outstanding</b> | <b>=</b> | <b>NAV</b> |
|-------------------|----------|---------------------------|----------|------------|
| \$89,109          |          | 7,891                     |          | \$11.29    |

Unless stated, all numbers are x 1,000.

The amortized cost of the fund's securities was \$82,311.

Not counting short-term obligations, the fund's security transactions during the period were:

|                  |         |
|------------------|---------|
| Purchases        | \$4,043 |
| Sales/maturities | \$—     |

The fund's total security transactions with other Schwab Funds during the period were \$10,540.

**Federal Tax Data**

|   |                |
|---|----------------|
| <b>Portfolio cost</b>                   | \$82,150       |
| <b>Net unrealized gains and losses:</b> |                |
| Gains                                   | \$5,877        |
| Losses                                  | + (15)         |
|   | <b>\$5,862</b> |

**As of August 31, 2004:****Undistributed earnings:**

|                         |      |
|-------------------------|------|
| Tax-exempt income       | \$79 |
| Long-term capital gains | \$—  |

**Capital loss utilized** \$601

**Unused capital losses:**

|                   |         |
|-------------------|---------|
| Expires 08/31 of: |         |
| 2009              | \$1,763 |

## Statement of

**Operations**

For September 1, 2004 through February 28, 2005; unaudited. All numbers are x 1,000.

**Investment Income**

|          |                |
|----------|----------------|
| Interest | <b>\$1,961</b> |
|----------|----------------|

**Net Unrealized Gains and Losses**

|                                      |              |
|--------------------------------------|--------------|
| Net unrealized losses on investments | <b>(327)</b> |
|--------------------------------------|--------------|

**Expenses**

|   |            |
|---|------------|
| Investment adviser and administrator fees   | 127        |
| Transfer agent and shareholder service fees | 106        |
| Trustees' fees                              | 4          |
| Custodian and portfolio accounting fees     | 5          |
| Professional fees                           | 14         |
| Registration fees                           | 10         |
| Shareholder reports                         | 8          |
| Other expenses                              | +          |
|   | 7          |
| Total expenses                              | 281        |
| Expense reduction                           | -          |
|   | 5          |
| <b>Net expenses</b>                         | <b>276</b> |

**Increase in Net Assets from Operations**

|   |                |
|---|----------------|
| <b>Total investment income</b>                | 1,961          |
| <b>Net expenses</b>                           | -              |
|   | 276            |
| <b>Net investment income</b>                  | <b>1,685</b>   |
| <b>Net unrealized losses</b>                  | +              |
|   | (327)          |
| <b>Increase in net assets from operations</b> | <b>\$1,358</b> |

Unless stated, all numbers are x 1,000.

Calculated as a percentage of average daily net assets: 0.30% of the first \$500 million and 0.22% of assets beyond that. These fees are paid to Charles Schwab Investments Management, Inc. (CSIM).

Calculated as a percentage of average daily net assets: for transfer agent services, 0.05% of the fund's assets; for shareholder services, 0.20% of the fund's assets. These fees are paid to Charles Schwab & Co., Inc. (Schwab).

For the fund's independent trustees only.

This reduction was made by the investment adviser (CSIM). It reflects a guarantee by CSIM and the transfer agent and shareholder service agent (Schwab) to limit the annual operating expenses of this fund through at least November 15, 2005, to 0.65% of average daily net assets. This limit excludes interest, taxes and certain non-routine expenses.

Statements of

**Changes in Net Assets**

For the current and prior report periods. All numbers are x 1,000.  
Figures for current period are unaudited.

Unless stated, all numbers are x 1,000.

**Operations**

|   | 9/1/04-2/28/05 | 9/1/03-8/31/04 |
|---|----------------|----------------|
| Net investment income                         | \$1,685        | \$3,302        |
| Net realized gains                            | —              | 595            |
| Net unrealized gains or losses                | + (327)        | 1,340          |
| <b>Increase in net assets from operations</b> | <b>1,358</b>   | <b>5,237</b>   |

**Distributions Paid**

|                                      |                |                |
|--------------------------------------|----------------|----------------|
| Dividends from net investment income | <b>\$1,671</b> | <b>\$3,274</b> |
|--------------------------------------|----------------|----------------|

**Transactions in Fund Shares**

|  | 9/1/04-2/28/05 |                | 9/1/03-8/31/04 |                |
|--|----------------|----------------|----------------|----------------|
|  | SHARES         | VALUE          | SHARES         | VALUE          |
| Shares sold                            | 1,317          | \$14,960       | 2,619          | \$29,632       |
| Shares reinvested                      | 100            | 1,135          | 218            | 2,453          |
| Shares redeemed                        | + (830)        | (9,429)        | (2,901)        | (32,623)       |
| <b>Net transactions in fund shares</b> | <b>587</b>     | <b>\$6,666</b> | <b>(64)</b>    | <b>(\$538)</b> |

**Shares Outstanding and Net Assets**

|                            | 9/1/04-2/28/05 |                 | 9/1/03-8/31/04 |                 |
|----------------------------|----------------|-----------------|----------------|-----------------|
|                            | SHARES         | NET ASSETS      | SHARES         | NET ASSETS      |
| Beginning of period        | 7,304          | \$82,756        | 7,368          | \$81,331        |
| Total increase or decrease | + 587          | 6,353           | (64)           | 1,425           |
| <b>End of period</b>       | <b>7,891</b>   | <b>\$89,109</b> | <b>7,304</b>   | <b>\$82,756</b> |

Figures for shares represent shares sold plus shares reinvested, minus shares redeemed. Figures for net assets represent the changes in net assets from operations plus the changes in value from transactions in fund shares, minus distributions paid.

Includes net investment income not yet distributed in the amount of \$161 and \$147 for the current and prior period, respectively.

# Schwab California Tax-Free YieldPlus Fund™

## Financial Statements

### Financial Highlights

| Investor Shares                            | 12/16/04 <sup>1</sup> –<br>2/28/05* |
|--|-------------------------------------|
| <b>Per-Share Data (\$)</b>                 |                                     |
| Net asset value at beginning of period     | 10.00                               |
| Income from investment operations:         |                                     |
| Net investment income                      | 0.04                                |
| Net realized and unrealized losses         | (0.02)                              |
| Total income from investment operations    | 0.02                                |
| Less distributions:                        |                                     |
| Dividends from net investment income       | (0.04)                              |
| Net asset value at end of period           | 9.98                                |
| Total return (%)                           | 0.22 <sup>2</sup>                   |
| <b>Ratios/Supplemental Data (%)</b>        |                                     |
| Ratios to average net assets:              |                                     |
| Net operating expenses                     | —                                   |
| Gross operating expenses                   | 0.67 <sup>3</sup>                   |
| Net investment income                      | 2.13 <sup>3</sup>                   |
| Portfolio turnover rate                    | 3 <sup>2</sup>                      |
| Net assets, end of period (\$ x 1,000,000) | 11                                  |

\* Unaudited.

<sup>1</sup> Commencement of operations.

<sup>2</sup> Not annualized.

<sup>3</sup> Annualized.

| Select Shares                              | 12/16/04 <sup>1</sup> –<br>2/28/05 <sup>*</sup> |
|--|---|
| <b>Per-Share Data (\$)</b>                 |   |
| Net asset value at beginning of period     | 10.00   |
| Income from investment operations:         |   |
| Net investment income                      | 0.04  |
| Net realized and unrealized losses         | (0.02)  |
| Total income from investment operations    | 0.02  |
| Less distributions:                        |   |
| Dividends from net investment income       | (0.04)  |
| Net asset value at end of period           | 9.98  |
| Total return (%)                           | 0.22 <sup>2</sup>                               |
| <b>Ratios/Supplemental Data (%)</b>        |   |
| Ratios to average net assets:              |   |
| Net operating expenses                     | –   |
| Gross operating expenses                   | 0.52 <sup>3</sup>                               |
| Net investment income                      | 2.14 <sup>3</sup>                               |
| Portfolio turnover rate                    | 3 <sup>2</sup>                                  |
| Net assets, end of period (\$ x 1,000,000) | 382   |

\* Unaudited.

<sup>1</sup> Commencement of operations.

<sup>2</sup> Not annualized.

<sup>3</sup> Annualized.

**Portfolio Holdings** as of February 28, 2005, unaudited

This section shows all the securities in the fund's portfolio and their value, as of the report date.

Beginning with the fiscal quarter ended May 31, 2005, the fund will file its complete schedule of portfolio holdings with the SEC for the first and third quarters of each fiscal year on Form N-Q. The fund's Forms N-Q will be available on the SEC's website at <http://www.sec.gov> and may be reviewed and copied at the SEC's Public Reference Room in Washington, D.C. Call 1-800-SEC-0330 for information on the operation of the Public Reference Room. The information filed on a fund's most recent Form N-Q will be available by visiting Schwab's website at [www.schwab.com/schwabfunds](http://www.schwab.com/schwabfunds).

We use the symbols below to designate certain characteristics of the securities.

- + Credit-enhanced security
- ▷ Liquidity-enhanced security
- ▲ Delayed-delivery security
- All or a portion of this security is held as collateral for futures contracts and delayed-delivery security

For fixed-rate obligations, the rate shown is the interest rate (the rate established when the obligation was issued) and the maturity date shown is the stated legal maturity. For variable-rate obligations, the rate shown is the rate as of the report date, and the maturity shown is the later of the next interest rate change date or demand date.

| <b>Holdings by Category</b> |                                     | <b>Cost</b><br>(\$x1,000) | <b>Value</b><br>(\$x1,000) |
|-----------------------------|-------------------------------------|---------------------------|----------------------------|
| <b>106.6%</b>               | <b>Municipal Bonds</b>              | 418,679                   | 417,875                    |
| <b>0.0%</b>                 | <b>Other Investment Companies</b>   | 116                       | 116                        |
| <b>106.6%</b>               | <b>Total Investments</b>            | <b>418,795</b>            | <b>417,991</b>             |
| <b>(6.6)%</b>               | <b>Other Assets and Liabilities</b> |                           | (25,856)                   |
| <b>100.0%</b>               | <b>Net Assets</b>                   |                           | <b>392,135</b>             |

| <b>Issuer</b><br><b>Project</b><br>Type of Security, Series | <b>Rate</b> | <b>Maturity Date</b> | <b>Face Amount</b><br>(\$ x 1,000) | <b>Value</b><br>(\$ x 1,000) |
|---|-------------|----------------------|------------------------------------|------------------------------|
|---|-------------|----------------------|------------------------------------|------------------------------|

**Municipal Bonds** 106.6% of net assets

**Fixed-Rate Obligations 69.0%****California 68.2%****+■ Alameda County**

*Santa Rita Jail*

|  |       |          |       |       |
|--|-------|----------|-------|-------|
| Refunding Certificates of Participation, Series 1993 | 5.38% | 06/01/09 | 5,000 | 5,293 |
|--|-------|----------|-------|-------|

**California State**

|   |       |          |        |        |
|---|-------|----------|--------|--------|
| Economic Recovery Bonds, Series 2004A       | 4.50% | 01/01/07 | 4,285  | 4,429  |
| Economic Recovery Bonds, Series 2004A       | 5.00% | 07/01/07 | 8,500  | 8,950  |
| Economic Recovery Bonds, Series 2004A       | 5.00% | 01/01/08 | 5,000  | 5,308  |
| Economic Recovery Bonds, Series 2004A       | 5.00% | 07/01/08 | 22,145 | 23,704 |
| Economic Recovery Bonds, Series 2004B-4     | 3.00% | 07/01/07 | 1,000  | 1,004  |
| Economic Recovery Bonds, Series 2004B-4     | 5.00% | 07/01/08 | 16,500 | 17,553 |
| Revenue Anticipation Notes, Series 2004-05A | 3.00% | 06/30/05 | 8,000  | 8,024  |
| + Various Purpose General Obligation Bonds  | 8.00% | 11/01/07 | 4,100  | 4,446  |

**California Dept of Water Resources**

|  |       |          |       |       |
|--|-------|----------|-------|-------|
| Power Supply Revenue Bonds, Series 2002A | 5.50% | 05/01/05 | 1,745 | 1,754 |
| Power Supply Revenue Bonds, Series 2002A | 5.50% | 05/01/07 | 1,325 | 1,400 |
| Power Supply Revenue Bonds, Series 2002A | 5.50% | 05/01/08 | 3,125 | 3,363 |

| Issuer<br>Project<br>Type of Security, Series  | Rate  | Maturity<br>Date | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|--|-------|------------------|-----------------------------|-----------------------|
| <b>+ California Educational Facilities Authority</b><br><i>Pooled College &amp; University Projects</i><br>Revenue Bonds, Series 1997A                         | 5.05% | 04/01/05         | 1,010                       | 1,013                 |
| <b>California Infrastructure &amp; Economic Development Bank</b><br><i>J. David Gladstone Institutes</i><br>Revenue Bonds, Series 2001                         | 4.00% | 10/01/07         | 2,000                       | 2,057                 |
| <b>California Pollution Control Financing Authority</b><br><i>Southern California Edison Co.</i><br>Pollution Control Refunding Revenue Bonds,<br>Series 1985B | 2.00% | 03/01/06         | 3,165                       | 3,138                 |
| Pollution Control Refunding Revenue Bonds,<br>Series 1985C   | 2.00% | 03/01/06         | 5,500                       | 5,452                 |
| Pollution Control Refunding Revenue Bonds,<br>Series 1986C   | 2.00% | 03/01/06         | 2,400                       | 2,379                 |
| <b>+ California School Cash Reserve Program Authority</b><br>Pool Bonds, Series 2004A  | 3.00% | 07/06/05         | 8,000                       | 8,024                 |
| <b>California State Public Works Board</b><br><b>+ Department of Corrections (State Prison-Coalinga)</b><br>Lease Refunding Revenue Bonds, Series 2004D        | 4.50% | 12/01/07         | 3,550                       | 3,724                 |
| <b>+ University of California</b><br>Lease Revenue Bonds, Series 1997C   | 5.50% | 09/01/08         | 5,185                       | 5,640                 |
| <b>California State University Channel Islands Financing Authority</b><br><b>+ For-Sale Housing Construction</b><br>Revenue Bonds, 2004A                       | 2.50% | 08/01/07         | 15,750                      | 15,720                |
| <b>+ Rental Housing &amp; Town Center</b><br>Revenue Bonds, Series 2004A   | 2.50% | 08/01/07         | 10,000                      | 9,951                 |
| <b>California Statewide Communities Development Authority</b><br><b>+ Chadwick School</b><br>Revenue Bonds, Series 2002  | 2.25% | 12/01/06         | 8,000                       | 8,000                 |
| <i>Daughters of Charity Health System</i><br>▲ Revenue Bonds, Series 2005F   | 5.00% | 07/01/08         | 1,255                       | 1,321                 |
| ▲ Revenue Bonds, Series 2005F  | 5.00% | 07/01/09         | 3,030                       | 3,220                 |
| ▲ Revenue Bonds, Series 2005G  | 5.25% | 07/01/11         | 1,000                       | 1,083                 |
| <i>Kaiser Permanente</i><br>Revenue Bonds, Series 2001A  | 2.55% | 01/04/07         | 7,000                       | 6,954                 |
| Revenue Bonds, Series 2004G  | 2.30% | 05/01/07         | 2,750                       | 2,709                 |
| Revenue Bonds, Series 2004H  | 2.63% | 05/01/08         | 1,245                       | 1,227                 |
| <b>Los Angeles Convention &amp; Exhibition Center Authority</b><br>Certificates of Participation, Series 1985  | 9.00% | 12/01/05         | 6,270                       | 6,586                 |
| <b>Los Angeles County</b><br>Tax & Revenue Anticipation Notes, Series 2004-05A   | 3.00% | 06/30/05         | 8,000                       | 8,023                 |
| <b>+ Los Angeles County Capital Asset Leasing Corp.</b><br>Lease Revenue Commercial Paper Notes  | 2.03% | 04/11/05         | 10,000                      | 10,000                |
| <b>+ Los Angeles County Metropolitan Transportation Authority</b><br>Second Subordinate Sales Tax Revenue Commercial<br>Paper Notes, Series A                  | 2.03% | 04/05/05         | 10,000                      | 10,000                |

**Portfolio Holdings** continued

| Issuer<br>Project<br>Type of Security, Series               | Rate  | Maturity<br>Date | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|---|-------|------------------|-----------------------------|-----------------------|
| <b>Los Angeles County Public Works Financing Authority</b>  |       |                  |                             |                       |
| <i>2005 Master Refunding</i>                                |       |                  |                             |                       |
| ▲▲ Lease Refunding Revenue Bonds, Series A                  | 4.00% | 12/01/06         | 10,000                      | 10,270                |
| ▲▲ Lease Refunding Revenue Bonds, Series A                  | 5.00% | 12/01/08         | 1,000                       | 1,075                 |
| <b>+ Modesta Irrigation District Financing Authority</b>    |       |                  |                             |                       |
| Refunding Revenue Bonds, Series A                           | 6.00% | 10/01/15         | 7,000                       | 7,525                 |
| <b>+ Orange County Local Transportation Authority</b>       |       |                  |                             |                       |
| Sales Tax Revenue Commercial Paper Notes                    | 2.04% | 04/12/05         | 10,000                      | 10,000                |
| <b>San Bernardino County</b>                                |       |                  |                             |                       |
| <i>Medical Center Financing</i>                             |       |                  |                             |                       |
| Certificates of Participation, Series 1995                  | 6.50% | 08/01/05         | 2,540                       | 2,638                 |
| <b>► San Francisco County Transportation Authority</b>      |       |                  |                             |                       |
| Commercial Paper Notes, Series A & B                        | 2.07% | 05/11/05         | 2,500                       | 2,500                 |
| <b>+ San Gabriel Valley Council of Governments</b>          |       |                  |                             |                       |
| Alameda Corridor-East Construction Grant Anticipation Notes | 1.97% | 04/07/05         | 10,000                      | 10,000                |
| <b>Santa Clara County Financing Authority</b>               |       |                  |                             |                       |
| <i>Measure B</i>  |       |                  |                             |                       |
| Special Obligation Bonds, Series 2003                       | 4.00% | 08/01/05         | 9,605                       | 9,676                 |
| <b>Santa Clara Valley Transportation Authority</b>          |       |                  |                             |                       |
| <i>Measure A</i>  |       |                  |                             |                       |
| + Sales Tax Revenue Bonds, Series 2003                      | 4.00% | 10/02/06         | 6,000                       | 6,127                 |
| + Sales Tax Revenue Bonds, Series 2004B                     | 5.00% | 10/02/06         | 6,000                       | 6,219                 |
|   |       |                  |                             | <b>267,479</b>        |
| <b>Puerto Rico 0.8%</b>                                     |       |                  |                             |                       |
| <b>Puerto Rico</b>  |       |                  |                             |                       |
| Public Improvement Refunding Revenue Bonds, Series 2003C    | 5.00% | 07/01/08         | 3,000                       | <b>3,171</b>          |
| <b>Variable Rate Obligations 37.6%</b>                      |       |                  |                             |                       |
| <b>California 35.7%</b>                                     |       |                  |                             |                       |
| <b>► Association of Bay Area Governments</b>                |       |                  |                             |                       |
| Lease Revenue Pass-Through Obligations, Series 2003A        | 1.90% | 03/07/05         | 7,000                       | 7,000                 |
| <b>California State</b>                                     |       |                  |                             |                       |
| ■ Economic Recovery Bonds, Series 2004C-3                   | 1.80% | 03/01/05         | 11,000                      | 11,000                |
| ► Economic Recovery Bonds, Series 2004C-4                   | 1.76% | 03/01/05         | 4,000                       | 4,000                 |
| Economic Recovery Bonds, Series 2004C-5                     | 1.80% | 03/01/05         | 3,965                       | 3,965                 |
| ■ Economic Recovery Bonds, Series 2004C-9                   | 1.76% | 03/01/05         | 17,900                      | 17,900                |
| ► Economic Recovery Bonds, Series 2004C-12                  | 1.83% | 03/07/05         | 2,400                       | 2,400                 |
| + General Obligation Bonds, Series 2004B-2                  | 1.60% | 03/07/05         | 6,400                       | 6,400                 |
| <b>California Dept of Water Resources</b>                   |       |                  |                             |                       |
| + Power Supply Revenue Bonds, Series 2002B-1                | 1.76% | 03/01/05         | 2,000                       | 2,000                 |
| + Power Supply Revenue Bonds, Series 2002B-2                | 1.78% | 03/01/05         | 100                         | 100                   |
| + Power Supply Revenue Bonds, Series 2002B-3                | 1.76% | 03/01/05         | 3,400                       | 3,400                 |



| Issuer<br>Project<br>Type of Security, Series  | Rate  | Maturity<br>Date | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|--|-------|------------------|-----------------------------|-----------------------|
| <b>➔ California Infrastructure &amp; Economic Development Bank</b><br><i>California ISO Corp.</i><br>Revenue Bonds, Series 2004A     | 1.83% | 03/07/05         | 5,000                       | 5,000                 |
| <b>+ California Statewide Communities Development Authority</b><br><i>National Public Radio</i><br>Revenue Bonds, Series 2002        | 1.86% | 03/07/05         | 6,200                       | 6,200                 |
| <b>+ Diamond Bar Public Financing Authority</b><br><i>Community/Senior Center</i><br>Lease Revenue Bonds, Series 2002A               | 1.95% | 03/07/05         | 4,000                       | 4,000                 |
| <b>+ Irvine Assessment District</b><br>Limited Obligation Improvement Bonds, Series 1999   | 1.77% | 03/01/05         | 4,400                       | 4,400                 |
| <b>+ Irvine Public Facilities Authority</b><br><i>Capital Improvements</i><br>Lease Revenue Bonds, Series 1985                       | 1.95% | 03/07/05         | 10,330                      | 10,330                |
| <b>■ Los Angeles Dept of Water &amp; Power</b><br>Power System Revenue Bonds, Series 2001B-1   | 1.82% | 03/07/05         | 6,000                       | 6,000                 |
| <b>+ Mount San Jacinto Winter Park Authority</b><br><i>Palm Springs Aerial Tramway</i><br>Certificates of Participation, Series 1998 | 1.86% | 03/07/05         | 4,000                       | 4,000                 |
| <b>+ Orange County</b><br><i>Vintage Woods</i><br>Apartment Development Refunding Revenue Bonds,<br>Series 1998H                     | 1.83% | 03/07/05         | 3,500                       | 3,500                 |
| <b>+ Orange County Housing Authority</b><br><i>Lantern Pines</i><br>Apartment Development Revenue Bonds, Series 1985CC               | 1.87% | 03/07/05         | 6,200                       | 6,200                 |
| <b>➔ San Bernardino County</b><br><i>Medical Center Financing</i><br>Certificates of Participation, Series 1998                      | 1.81% | 03/07/05         | 2,000                       | 2,000                 |
| <b>Southern California Metropolitan Water District</b><br>■ Water Refunding Revenue Bonds, Series 2003 C-1                           | 1.81% | 03/07/05         | 10,000                      | 10,000                |
| Water Revenue Bonds Authorization, Series 2000B-3  | 1.80% | 03/01/05         | 2,600                       | 2,600                 |
| <b>Southern California Public Power Authority</b><br><i>Transmission Project</i><br>Subordinate Refunding Revenue Bonds, Series 1991 | 1.81% | 03/07/05         | 8,100                       | 8,100                 |
| <b>➔■ Sunnyvale</b><br><i>Government Center Site Acquisition</i><br>Certificates of Participation, Series 2001A                      | 1.83% | 03/07/05         | 6,200                       | 6,200                 |
| <b>+ Union City</b><br><i>Greenhaven Apartments</i><br>Multi-Family Housing Refunding Revenue Bonds,<br>Series 1997A                 | 1.83% | 03/07/05         | 3,000                       | 3,000                 |
|  |       |                  |                             | <b>139,695</b>        |

Portfolio Holdings continued

| Issuer<br>Project<br>Type of Security, Series | Rate  | Maturity<br>Date | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|---|-------|------------------|-----------------------------|-----------------------|
| Puerto Rico 1.9%                              |       |                  |                             |                       |
| Puerto Rico                                   |       |                  |                             |                       |
| ➤ Public Improvement Bonds Series 2000        | 1.86% | 03/07/05         | 1,930                       | 1,930                 |
| ➤ Public Improvement Bonds Series 2001A       | 1.89% | 03/07/05         | 5,600                       | 5,600                 |
|   |       |                  |                             | 7,530                 |

Security and Number of Shares

|                            |                    |
|----------------------------|--------------------|
| Other Investment Companies | 0.0% of net assets |
|----------------------------|--------------------|

|   |         |     |
|---|---------|-----|
| Provident Institutional Funds—<br>California Money Fund Portfolio | 115,980 | 116 |
|---|---------|-----|

End of investments.

In addition to the above, the fund held the following at 2/28/05. All numbers are x 1,000 except number of futures contracts.

| Futures Contracts                                       |                        |                   |                     |
|---|------------------------|-------------------|---------------------|
|   | Number of<br>Contracts | Contract<br>Value | Unrealized<br>Gains |
| 2 Year, Short<br>U.S. Treasury Note,<br>expires 6/30/05 | 75                     | 15,554            | 42                  |

## Statement of

**Assets and Liabilities**

As of February 28, 2005; unaudited. All numbers are x 1,000 except NAV.

**Assets**

|                             |                |
|-----------------------------|----------------|
| Investments, at value       | \$417,991      |
| Receivables:                |                |
| Fund shares sold            | 584            |
| Investments sold            | 5,001          |
| Interest                    | 2,497          |
| Due from adviser            | 13             |
| Due from broker for futures | 16             |
| Prepaid expenses            | + 2            |
| <b>Total assets</b>         | <b>426,104</b> |

**Liabilities**

|                           |               |
|---------------------------|---------------|
| Payables:                 |               |
| Fund shares redeemed      | 587           |
| Dividends to shareholders | 169           |
| Investments bought        | 33,184        |
| Accrued expenses          | + 29          |
| <b>Total liabilities</b>  | <b>33,969</b> |

**Net Assets**

|                          |                  |
|--------------------------|------------------|
| <b>Total assets</b>      | 426,104          |
| <b>Total liabilities</b> | - 33,969         |
| <b>Net assets</b>        | <b>\$392,135</b> |

**Net Assets by Source**

|   |         |
|---|---------|
| Capital received from investors           | 392,855 |
| Net investment income not yet distributed | 11      |
| Net realized capital gains                | 31      |
| Net unrealized capital losses             | (762)   |

**Net Asset Value (NAV) by Share Class**

| Share Class     | Net Assets | ÷ | Shares Outstanding | = | NAV    |
|-----------------|------------|---|--------------------|---|--------|
| Investor Shares | \$10,546   |   | 1,057              |   | \$9.98 |
| Select Shares   | \$381,589  |   | 38,237             |   | \$9.98 |

Unless stated, all numbers x 1,000.

The amortized cost of the fund's securities was \$418,795.

Not counting short-term obligations, the fund's security transactions during the period were:

|                  |           |
|------------------|-----------|
| Purchases        | \$207,204 |
| Sales/maturities | \$3,014   |

The fund's total security transactions with other Schwab Funds during the period were \$249,449.

These derive from investments and futures.

**Federal Tax Data**

|   |                |
|---|----------------|
| <b>Portfolio cost</b>                   | \$418,784      |
| <b>Net unrealized gains and losses:</b> |                |
| Gains                                   | \$44           |
| Losses                                  | + (837)        |
|   | <b>(\$793)</b> |

## Statement of

**Operations**

From December 16, 2004 (commencement of operations) through February 28, 2005; unaudited. All numbers are x 1,000.

**Investment Income**

|          |                |
|----------|----------------|
| Interest | <b>\$1,145</b> |
|----------|----------------|

**Net Realized Gains and Losses**

|                                    |           |
|------------------------------------|-----------|
| Net realized gains on futures sold | <b>31</b> |
|------------------------------------|-----------|

**Net Unrealized Gains and Losses**

|   |              |
|---|--------------|
| Net unrealized losses on investments      | (804)        |
| Net unrealized gains on futures contracts | + 42         |
| <b>Net unrealized losses</b>              | <b>(762)</b> |

**Expenses**

|   |          |
|---|----------|
| Investment adviser and administrator fees   | 187      |
| Transfer agent and shareholder service fees |          |
| Investor Shares                             | 4        |
| Select Shares                               | 52       |
| Trustees' fees                              | 2        |
| Custodian and portfolio accounting fees     | 11       |
| Professional fees                           | 6        |
| Registration fees                           | 9        |
| Shareholder reports                         | 9        |
| Other expenses                              | + 1      |
| Total expenses                              | 281      |
| Expense reduction                           | - (281)  |
| <b>Net expenses</b>                         | <b>-</b> |

**Increase in Net Assets from Operations**

|   |                |
|---|----------------|
| <b>Total investment income</b>                | <b>1,145</b>   |
| <b>Total expenses</b>                         | <b>-</b>       |
| <b>Net investment income</b>                  | <b>1,145</b>   |
| <b>Net realized gains</b>                     | <b>31</b>      |
| <b>Net unrealized losses</b>                  | <b>+ (762)</b> |
| <b>Increase in net assets from operations</b> | <b>\$414</b>   |

Unless stated, all numbers x 1,000.

Calculated as a percentage of average daily net assets: 0.35% of the first \$500 million and 0.30% of assets beyond that. These fees are paid to Charles Schwab Investments Management, Inc. (CSIM).

Calculated as a percentage of average daily net assets: for transfer agent services, 0.05% of the fund's assets; for shareholder services, 0.20% and 0.05% of the fund's assets of each respective share class. These fees are paid to Charles Schwab & Co., Inc. (Schwab).

For the fund's independent trustees only.

Includes \$221 from the investment advisor (CSIM) and \$56 from the transfer agent and shareholder service agent (Schwab). These reductions reflect a guarantee by CSIM and Schwab that through May 1, 2005 the annual operating expenses will equal 0.00% for both Investor and Select Shares. For the period May 2, 2005 through at least November 15, 2005, CSIM and Schwab have guaranteed to limit the annual operating expenses (excluding interest, taxes and certain non-routine expenses) to 0.64% for Investor Shares and 0.49% for Select Shares.

These add up to a net loss on investments of \$731.

Statements of

**Changes in Net Assets**

For the current report period only. Because the fund commenced operations on December 16, 2004, it has no prior report period. All numbers are x 1,000.

Figures for current period are unaudited.

**Operations**

|   | 12/16/04-2/28/05 |
|---|------------------|
| Net investment income                         | \$1,145          |
| Net realized gains                            | 31               |
| Net unrealized losses                         | + (762)          |
| <b>Increase in net assets from operations</b> | <b>414</b>       |

**Distributions Paid****Dividends from Net Investment Income**

|   |                |
|---|----------------|
| Investor Shares                                   | 33             |
| Select Shares                                     | + 1,101        |
| <b>Total dividends from net investment income</b> | <b>\$1,134</b> |

**Transactions in Fund Shares**

|  | 12/16/04-2/28/05 |                   |
|--|------------------|-------------------|
|  | SHARES           | VALUE             |
| <b>Shares sold</b>                     |                  |                   |
| Investor Shares                        | 1,249            | \$12,485          |
| Select Shares                          | + 42,316         | 423,048           |
| <b>Total shares sold</b>               | <b>43,565</b>    | <b>\$435,533</b>  |
| <b>Shares Reinvested</b>               |                  |                   |
| Investor Shares                        | 2                | \$25              |
| Select Shares                          | + 75             | 752               |
| <b>Total shares reinvested</b>         | <b>77</b>        | <b>\$777</b>      |
| <b>Shares Redeemed</b>                 |                  |                   |
| Investor Shares                        | (194)            | (\$1,944)         |
| Select Shares                          | + (4,154)        | (41,511)          |
| <b>Total shares redeemed</b>           | <b>(4,348)</b>   | <b>(\$43,455)</b> |
| <b>Net transactions in fund shares</b> | <b>39,294</b>    | <b>\$392,855</b>  |

**Shares Outstanding and Net Assets**

|                      | 12/16/04-2/28/05 |                  |
|----------------------|------------------|------------------|
|                      | SHARES           | NET ASSETS       |
| Beginning of period  | —                | \$ —             |
| Total increase       | + 39,294         | 392,135          |
| <b>End of period</b> | <b>39,294</b>    | <b>\$392,135</b> |

Unless stated, all numbers x 1,000.

Figures for shares represent shares sold plus shares reinvested minus shares redeemed. Figures for net assets represent the changes in net assets from operations plus the changes in value from transactions in fund shares, minus distributions paid.

Includes net investment income not yet distributed in the amount of \$11.

# Schwab California Short/Intermediate Tax-Free Bond Fund<sup>™</sup>

## Financial Statements

### Financial Highlights

|   | 9/1/04–<br>2/28/05* | 9/1/03–<br>8/31/04 | 9/1/02–<br>8/31/03 | 9/1/01–<br>8/31/02 | 9/1/00–<br>8/31/01 | 9/1/99–<br>8/31/00 |
|---|---------------------|--------------------|--------------------|--------------------|--------------------|--------------------|
| <b>Per-Share Data (\$)</b>                  |                     |                    |                    |                    |                    |                    |
| Net asset value at beginning of period      | 10.63               | 10.57              | 10.66              | 10.51              | 10.22              | 10.09              |
| Income from investment operations:          |                     |                    |                    |                    |                    |                    |
| Net investment income                       | 0.16                | 0.31               | 0.32               | 0.34               | 0.40               | 0.39               |
| Net realized and unrealized gains or losses | (0.13)              | 0.06               | (0.09)             | 0.15               | 0.29               | 0.13               |
| Total income from investment operations     | 0.03                | 0.37               | 0.23               | 0.49               | 0.69               | 0.52               |
| Less distributions:                         |                     |                    |                    |                    |                    |                    |
| Dividends from net investment income        | (0.16)              | (0.31)             | (0.32)             | (0.34)             | (0.40)             | (0.39)             |
| Net asset value at end of period            | 10.50               | 10.63              | 10.57              | 10.66              | 10.51              | 10.22              |
| Total return (%)                            | 0.29 <sup>1</sup>   | 3.59               | 2.15               | 4.66               | 6.95               | 5.32               |
| <b>Ratios/Supplemental Data (%)</b>         |                     |                    |                    |                    |                    |                    |
| Ratios to average net assets:               |                     |                    |                    |                    |                    |                    |
| Net operating expenses                      | 0.61 <sup>2</sup>   | 0.61               | 0.58               | 0.49               | 0.49               | 0.50 <sup>3</sup>  |
| Gross operating expenses                    | 0.61 <sup>2</sup>   | 0.61               | 0.60               | 0.66               | 0.67               | 0.71               |
| Net investment income                       | 3.06 <sup>2</sup>   | 2.97               | 2.96               | 3.29               | 3.83               | 3.91               |
| Portfolio turnover rate                     | —                   | 17                 | 11                 | 17                 | 30                 | 42                 |
| Net assets, end of period (\$ x 1,000,000)  | 149                 | 164                | 174                | 184                | 145                | 124                |

\* Unaudited.

<sup>1</sup> Not annualized.

<sup>2</sup> Annualized.

<sup>3</sup> The ratio of net operating expenses would have been 0.49% if certain non-routine expenses (proxy fees) had not been included.

**Portfolio Holdings** as of February 28, 2005, unaudited

This section shows all the securities in the fund's portfolio and their value, as of the report date.

The fund files its complete schedule of portfolio holdings with the SEC for the first and third quarters of each fiscal year on Form N-Q. The fund's Forms N-Q is available on the SEC's website at <http://www.sec.gov> and may be reviewed and copied at the SEC's Public Reference Room in Washington, D.C. Call 1-800-SEC-0330 for information on the operation of the Public Reference Room. The schedule of portfolio holdings filed on a fund's most recent Form N-Q is available by visiting Schwab's website at [www.schwab.com/schwabfunds](http://www.schwab.com/schwabfunds).

We use the symbols below to designate certain characteristics of the securities.

- + Credit-enhanced security
- Liquidity-enhanced security

For fixed-rate obligations, the rate shown is the interest rate (the rate established when the obligation was issued) and the maturity date shown is the stated legal maturity. For variable-rate obligations, the rate shown is the rate as of the report date, and the maturity shown is the later of the next interest rate change date or demand date.

| <b>Holdings by Category</b> |                                     | <b>Cost</b><br>(\$x1,000) | <b>Value</b><br>(\$x1,000) |
|-----------------------------|-------------------------------------|---------------------------|----------------------------|
| <b>98.7%</b>                | <b>Municipal Bonds</b>              | 143,482                   | 147,398                    |
| <b>98.7%</b>                | <b>Total Investments</b>            | <b>143,482</b>            | <b>147,398</b>             |
| <b>1.3%</b>                 | <b>Other Assets and Liabilities</b> |                           | 1,935                      |
| <b>100.0%</b>               | <b>Net Assets</b>                   |                           | <b>149,333</b>             |

| <b>Issuer</b><br><b>Project</b><br><b>Type of Security, Series</b> | <b>Rate</b> | <b>Maturity</b><br><b>Date</b> | <b>Face Amount</b><br>(\$ x 1,000) | <b>Value</b><br>(\$ x 1,000) |
|--|-------------|--------------------------------|------------------------------------|------------------------------|
| <b>Municipal Bonds</b> 98.7% of net assets                         |             |                                |                                    |                              |
| <b>Fixed-Rate Obligations</b> 96.8%                                |             |                                |                                    |                              |
| <b>California</b> 92.5%  |             |                                |                                    |                              |
| <b>Alameda County</b>  |             |                                |                                    |                              |
| <i>Refunding &amp; Capital Projects</i>                            |             |                                |                                    |                              |
| + Certificates of Participation, Series 1998A                      | 5.00%       | 12/01/06                       | 3,480                              | 3,633                        |
| + Certificates of Participation, Series 2001A                      | 5.38%       | 12/01/09                       | 5,000                              | 5,552                        |
| <b>+ Association of Bay Area Governments</b>                       |             |                                |                                    |                              |
| <i>Brandeis Hillel Day School Project</i>                          |             |                                |                                    |                              |
| Revenue Bonds, Series 2001   | 3.75%       | 08/01/31                       | 4,000                              | 4,069                        |
| <b>+ Burbank Unified School District</b>                           |             |                                |                                    |                              |
| <i>Election of 1997</i>  |             |                                |                                    |                              |
| General Obligation Bonds, Series C                                 | 3.00%       | 08/01/06                       | 1,820                              | 1,836                        |
| <b>California State</b>  |             |                                |                                    |                              |
| + Economic Recovery Bonds Series 2004A                             | 5.25%       | 07/01/14                       | 3,000                              | 3,364                        |
| + Federal Highway Grant Anticipation Bonds, Series 2004A           | 5.00%       | 02/01/08                       | 1,360                              | 1,450                        |
| General Obligation Bonds, Series 1992                              | 6.30%       | 09/01/06                       | 2,235                              | 2,355                        |
| + General Obligation Bonds, Series 1998                            | 5.50%       | 12/01/11                       | 1,665                              | 1,891                        |
| General Obligation Bonds, Series 2001                              | 4.00%       | 11/01/05                       | 1,000                              | 1,011                        |
| General Obligation Bonds, Series 2002                              | 5.25%       | 02/01/11                       | 3,500                              | 3,850                        |
| + General Obligation Refunding Bonds, Series 2002                  | 5.00%       | 02/01/12                       | 4,000                              | 4,401                        |
| <b>California Department of Water Resources</b>                    |             |                                |                                    |                              |
| Power Supply Revenue Bonds, Series 2002A                           | 5.50%       | 05/01/10                       | 1,315                              | 1,452                        |

## Portfolio Holdings continued

| Issuer<br>Project<br>Type of Security, Series  | Rate  | Maturity<br>Date | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|--|-------|------------------|-----------------------------|-----------------------|
| <b>California Health Facilities Finance Authority</b><br><i>Kaiser Permanente</i><br>Revenue Bonds, Series 1998B                                   | 5.00% | 10/01/08         | 2,500                       | 2,702                 |
| <b>California Pollution Control Finance Authority</b><br><i>Waste Management, Inc. Project</i><br>Solid Waste Disposal Revenue Bonds, Series 2002B | 4.45% | 07/01/05         | 2,000                       | 2,007                 |
| <b>California State Public Works Board</b><br>+ Energy Efficiency Refunding Revenue Bonds,<br>Series 1998B   | 4.00% | 09/01/06         | 1,155                       | 1,179                 |
| + <i>UCLA Replacement Hospitals</i><br>Lease Revenue Bonds, Series 2002A   | 4.75% | 10/01/09         | 3,005                       | 3,226                 |
| <i>University of California</i><br>Lease Refunding Revenue Bonds, Series 1998A   | 5.25% | 12/01/07         | 2,000                       | 2,137                 |
| <b>California Statewide Communities Development Authority</b><br><i>Kaiser Permanente</i><br>Revenue Bonds, Series 2002D                           | 4.35% | 03/01/07         | 2,000                       | 2,054                 |
| + <i>Sherman Oaks</i><br>Refunding Revenue Bonds, Series 1998A   | 5.00% | 08/01/06         | 2,500                       | 2,587                 |
| + <b>El Dorado County Public Agency Financing Authority</b><br>Revenue Bonds, Series 1996  | 5.60% | 02/15/12         | 3,000                       | 3,154                 |
| <b>Fremont Union High School District</b><br><i>Election of 1998</i><br>General Obligation Bonds, Series 2000B                                     | 5.75% | 09/01/08         | 1,520                       | 1,678                 |
| <b>Intermodal Container Transfer Facility Joint Powers Authority</b><br>+ Refunding Revenue Bonds, Series 1999A                                    | 5.00% | 11/01/08         | 1,210                       | 1,305                 |
| + Refunding Revenue Bonds, Series 1999A  | 5.00% | 11/01/09         | 1,375                       | 1,502                 |
| <b>Long Beach</b><br>Harbor Revenue Bonds, Series 2000A  | 5.50% | 05/15/10         | 4,000                       | 4,379                 |
| + <b>Long Beach Harbor Facilities Corp.</b><br>Harbor Refunding Revenue Bonds, Series 1998A  | 5.50% | 05/15/05         | 3,985                       | 4,009                 |
| <b>Los Angeles Community Redevelopment Agency</b><br>+ Pooled Financing Refunding Revenue Bonds,<br>Series 1998F                                   | 5.00% | 09/01/07         | 810                         | 858                   |
| <i>Bunker Hill Project</i><br>Subordinate Lien Tax Allocation Bonds, Series 2004   | 4.00% | 03/01/10         | 1,950                       | 1,968                 |
| + <b>Los Angeles State Building Authority</b><br><i>California Department of General Services</i><br>Lease Refunding Revenue Bonds, Series 1993A   | 5.63% | 05/01/11         | 3,500                       | 3,890                 |
| <b>Los Angeles Unified School District</b><br><i>Election of 1997</i><br>General Obligation Bonds, Series 2000D                                    | 5.50% | 07/01/10         | 4,000                       | 4,460                 |
| <b>Northern California Power Agency</b><br><i>Geothermal Project No. 3</i><br>Refunding Revenue Bonds, Series 1993A                                | 5.60% | 07/01/06         | 2,000                       | 2,084                 |
| <b>Oakland</b><br><i>Oakland Museum</i><br>+ Refunding Certificates of Participation, Series 2002A   | 5.00% | 04/01/10         | 2,015                       | 2,209                 |
| + Refunding Certificates of Participation, Series 2002A  | 5.00% | 04/01/11         | 1,460                       | 1,609                 |



| Issuer<br>Project<br>Type of Security, Series                        | Rate  | Maturity<br>Date | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|--|-------|------------------|-----------------------------|-----------------------|
| <b>+ Oceanside Community Development Commission</b>                  |       |                  |                             |                       |
| <i>Vista del Ora Apartments</i>                                      |       |                  |                             |                       |
| Multi-Family Rental Housing Refunding<br>Revenue Bonds, Series 2001A | 4.45% | 04/01/31         | 1,250                       | 1,303                 |
| <b>+ Orange County</b>   |       |                  |                             |                       |
| Recovery Certificates of Participation, Series 1996A                 | 6.00% | 07/01/08         | 3,000                       | 3,306                 |
| <b>+ Port of Oakland</b>   |       |                  |                             |                       |
| Revenue Bonds, Series 2000K  | 5.50% | 11/01/08         | 3,000                       | 3,240                 |
| <b>+ Rancho California Water District Financing Authority</b>        |       |                  |                             |                       |
| Refunding Revenue Bonds, Series 1995                                 | 5.88% | 11/01/10         | 1,500                       | 1,567                 |
| <b>+ Redding Joint Powers Financing Authority</b>                    |       |                  |                             |                       |
| Electric System Revenue Bonds, Series 1996A                          | 5.50% | 06/01/11         | 2,000                       | 2,113                 |
| <b>Riverside</b>   |       |                  |                             |                       |
| <i>Capital Improvement Projects</i>                                  |       |                  |                             |                       |
| + Certificates of Participation, Series 2003                         | 5.00% | 09/01/14         | 1,470                       | 1,617                 |
| + Certificates of Participation, Series 2003                         | 5.00% | 09/01/15         | 1,545                       | 1,688                 |
| <b>+ Riverside County Asset Leasing Corp</b>                         |       |                  |                             |                       |
| <i>Riverside County Hospital Project</i>                             |       |                  |                             |                       |
| Leasehold Revenue Bonds, Series 2003A                                | 5.00% | 06/01/09         | 2,555                       | 2,766                 |
| <b>Sacramento Finance Authority</b>                                  |       |                  |                             |                       |
| Refunding Revenue Bonds, Series 2002                                 | 4.50% | 07/01/08         | 2,865                       | 3,003                 |
| <b>+ San Bernardino County</b>                                       |       |                  |                             |                       |
| Multi-Family Housing Refunding Revenue Bonds,<br>Series 2001A        | 4.45% | 05/01/31         | 1,300                       | 1,397                 |
| <b>+ San Diego Unified School District</b>                           |       |                  |                             |                       |
| <i>Election of 1998</i>  |       |                  |                             |                       |
| General Obligation Bonds, Series 2004F                               | 5.00% | 07/01/15         | 1,095                       | 1,205                 |
| <b>San Francisco Airports Commission</b>                             |       |                  |                             |                       |
| <i>San Francisco International Airport</i>                           |       |                  |                             |                       |
| + Second Series Revenue Bonds, Issue 15A                             | 5.50% | 05/01/09         | 2,000                       | 2,164                 |
| + Second Series Revenue Bonds, Issue 22                              | 5.25% | 05/01/11         | 3,065                       | 3,291                 |
| <b>San Francisco Bay Area Transit Financing Authority</b>            |       |                  |                             |                       |
| Bridge Toll Notes, Series 1999                                       | 5.00% | 02/01/07         | 500                         | 516                   |
| <b>San Francisco State University</b>                                |       |                  |                             |                       |
| <i>Auxiliary Organization</i>  |       |                  |                             |                       |
| Student Housing Revenue Bonds, Series 1999                           | 4.30% | 07/01/05         | 540                         | 543                   |
| Student Housing Revenue Bonds, Series 1999                           | 5.00% | 07/01/08         | 400                         | 420                   |
| <b>+ San Jose</b>  |       |                  |                             |                       |
| Airport Refunding Revenue Bonds, Series 2002B                        | 5.00% | 03/01/11         | 2,625                       | 2,823                 |
| <b>+ San Jose Redevelopment Agency</b>                               |       |                  |                             |                       |
| <i>Merged Area Redevelopment Project</i>                             |       |                  |                             |                       |
| Tax Allocation Bonds, Series 2002                                    | 4.00% | 08/01/10         | 5,000                       | 5,256                 |
| <b>+ Santa Clara</b>   |       |                  |                             |                       |
| Insurance Funding Bonds, Series 1987                                 | 3.25% | 04/01/12         | 3,000                       | 3,003                 |
| <b>Santa Clara County Financing Authority</b>                        |       |                  |                             |                       |
| <i>Measure B</i>   |       |                  |                             |                       |
| Special Obligation Bonds, Series 2003                                | 4.00% | 08/01/05         | 4,000                       | 4,029                 |

**Portfolio Holdings** continued

| Issuer<br>Project<br>Type of Security, Series          | Rate  | Maturity<br>Date | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|--|-------|------------------|-----------------------------|-----------------------|
| <b>+ Multi-Facilities Projects</b>                     |       |                  |                             |                       |
| Lease Revenue Bonds, Series 2000B                      | 5.50% | 05/15/05         | 3,290                       | 3,313                 |
| <b>+ VMC Facility Replacement Projects</b>             |       |                  |                             |                       |
| Lease Revenue Bonds, Series 1994A                      | 7.75% | 11/15/10         | 1,000                       | 1,233                 |
| <b>+ Temecula Valley Unified School District</b>       |       |                  |                             |                       |
| General Obligation Refunding Bonds, Series 2004        | 6.00% | 08/01/07         | 1,000                       | 1,079                 |
| <b>Vernon</b>  |       |                  |                             |                       |
| <i>Malburg Generating Station Project</i>              |       |                  |                             |                       |
| Electric System Revenue Bonds, Series 2003C            | 5.00% | 04/01/11         | 1,320                       | 1,415                 |
| Electric System Revenue Bonds, Series 2003C            | 5.25% | 04/01/15         | 1,905                       | 2,056                 |
|  |       |                  |                             | <b>138,207</b>        |
| <b>Puerto Rico 4.3%</b>                                |       |                  |                             |                       |
| <b>+ Puerto Rico Aqueduct &amp; Sewerage Authority</b> |       |                  |                             |                       |
| Refunding Bonds, Series 1995                           | 6.00% | 07/01/06         | 3,000                       | 3,141                 |
| <b>+ Puerto Rico Electric Power Authority</b>          |       |                  |                             |                       |
| Power Refunding Revenue Bonds, Series CC               | 5.50% | 07/01/08         | 3,000                       | 3,224                 |
|  |       |                  |                             | <b>6,365</b>          |
| <b>Variable Rate Obligations 1.9%</b>                  |       |                  |                             |                       |
| <b>California 1.9%</b>                                 |       |                  |                             |                       |
| <b>+ California Department of Water Resources</b>      |       |                  |                             |                       |
| Power Supply Revenue Bonds, Series 2002B-2             | 1.78% | 03/01/05         | 250                         | 250                   |
| <b>+ Fontana Unified School District</b>               |       |                  |                             |                       |
| <i>School Facility Bridge Funding Program</i>          |       |                  |                             |                       |
| Certificates of Participation, Series 2004B            | 3.00% | 03/01/05         | 1,250                       | 1,254                 |
| <b>+ Los Angeles</b>                                   |       |                  |                             |                       |
| <i>American Academy of Dramatic Arts</i>               |       |                  |                             |                       |
| Certificates of Participation, Series 2000A            | 4.70% | 11/01/05         | 1,300                       | 1,322                 |
|  |       |                  |                             | <b>2,826</b>          |

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End of investments.

## Statement of

**Assets and Liabilities**

As of February 28, 2005; unaudited. All numbers are x 1,000 except NAV.

**Assets**

|                       |                |
|-----------------------|----------------|
| Investments, at value | \$147,398      |
| Receivables:          |                |
| Fund shares sold      | 321            |
| Interest              | 1,821          |
| Prepaid expenses      | <u>2</u>       |
| <b>Total assets</b>   | <b>149,542</b> |

**Liabilities**

|   |   |            |
|---|---|------------|
| Payables:                                   |   |            |
| Due to custodian                            |   | 8          |
| Fund shares redeemed                        |   | 45         |
| Dividends to shareholders                   |   | 107        |
| Investment adviser and administrator fees   |   | 4          |
| Transfer agent and shareholder service fees |   | 3          |
| Accrued expenses                            | + | 42         |
| <b>Total liabilities</b>                    |   | <b>209</b> |

**Net Assets**

|                   |                  |
|-------------------|------------------|
| Total assets      | 149,542          |
| Total liabilities | — 209            |
| Net assets        | <u>\$149,333</u> |

**Net Assets by Source**

|   |         |
|---|---------|
| Capital received from investors           | 145,453 |
| Net investment income not yet distributed | 11      |
| Net realized capital losses               | (47)    |
| Net unrealized capital gains              | 3,916   |

**Net Asset Value (NAV)**

|                   |          |                           |          |            |
|-------------------|----------|---------------------------|----------|------------|
| <b>Net Assets</b> | <b>+</b> | <b>Shares Outstanding</b> | <b>=</b> | <b>NAV</b> |
| \$149,333         |          | 14,227                    |          | \$10.50    |

Unless stated, all numbers are x 1,000.

The amortized cost of the fund's securities was \$143,482.

Not counting short-term obligations, the fund's security transactions during the period were:

|                  |         |
|------------------|---------|
| Purchases        | \$–     |
| Sales/maturities | \$3,668 |

The fund's total security transactions with other Schwab Funds during the period were \$15,283.

**Federal Tax Data**

|                                  |                |
|----------------------------------|----------------|
| Portfolio cost                   | \$143,470      |
| Net unrealized gains and losses: |                |
| Gains                            | \$4,056        |
| Losses                           | + (128)        |
|                                  | <u>\$3,928</u> |

**As of August 31, 2004:****Undistributed earnings:**

|                         |       |
|-------------------------|-------|
| Tax-exempt income       | \$116 |
| Long-term capital gains | \$–   |

**Unused capital losses:**

|                   |             |
|-------------------|-------------|
| Expires 08/31 of: |             |
| 2008              | \$28        |
| 2012              | + 10        |
|                   | <hr/>       |
|                   | <b>\$38</b> |

|                                |             |
|--------------------------------|-------------|
| <b>Deferred capital losses</b> | <b>\$22</b> |
|--------------------------------|-------------|

## Statement of

**Operations**

For September 1, 2004 through February 28, 2005; unaudited. All numbers are x 1,000.

**Investment Income**

|          |                |
|----------|----------------|
| Interest | <b>\$2,865</b> |
|----------|----------------|

**Net Realized Gains and Losses**

|  |           |
|--|-----------|
| Net realized gains on investments sold | <b>13</b> |
|--|-----------|

**Net Unrealized Gains and Losses**

|                                      |                |
|--------------------------------------|----------------|
| Net unrealized losses on investments | <b>(2,020)</b> |
|--------------------------------------|----------------|

**Expenses**

|   |            |
|---|------------|
| Investment adviser and administrator fees   | 234        |
| Transfer agent and shareholder service fees | 195        |
| Trustees' fees                              | 4          |
| Custodian and portfolio accounting fees     | 7          |
| Professional fees                           | 15         |
| Registration                                | 1          |
| Shareholder reports                         | 11         |
| Other expenses                              | +          |
|   | 9          |
| <b>Total expenses</b>                       | <b>476</b> |

**Increase in Net Assets from Operations**

|   |              |
|---|--------------|
| <b>Total investment income</b>                | 2,865        |
| <b>Total expenses</b>                         | – 476        |
| <b>Net investment income</b>                  | <b>2,389</b> |
| <b>Net realized gains</b>                     | 13           |
| <b>Net unrealized losses</b>                  | + (2,020)    |
| <b>Increase in net assets from operations</b> | <b>\$382</b> |

Unless stated, all numbers are x 1,000.

Calculated as a percentage of average daily net assets: 0.30% of the first \$500 million and 0.22% of assets beyond that. These fees are paid to Charles Schwab Investments Management, Inc. (CSIM).

Calculated as a percentage of average daily net assets: for transfer agent services, 0.05% of the fund's assets; for shareholder services, 0.20% of the fund's assets. These fees are paid to Charles Schwab & Co., Inc. (Schwab).

For the fund's independent trustees only.

CSIM and Schwab have guaranteed that the annual operating expenses (excluding interest, taxes and certain non-routine expenses) will not exceed 0.65% of the fund's average daily net assets through November 15, 2005.

These add up to a net loss on investments of \$2,007.

Statements of

**Changes in Net Assets**

For the current and prior report periods. All numbers are x 1,000.  
Figures for current period are unaudited.

**Operations**

|   | 9/1/04-2/28/05 | 9/1/03-8/31/04 |
|---|----------------|----------------|
| Net investment income                         | \$2,389        | \$5,034        |
| Net realized gains or losses                  | 13             | (47)           |
| Net unrealized gains or losses                | + (2,020)      | 896            |
| <b>Increase in net assets from operations</b> | <b>382</b>     | <b>5,883</b>   |

**Distributions Paid**

|                                      |                |                |
|--------------------------------------|----------------|----------------|
| Dividends from net investment income | <b>\$2,388</b> | <b>\$5,029</b> |
|--------------------------------------|----------------|----------------|

**Transactions in Fund Shares**

|  | 9/1/04-2/28/05 |                   | 9/1/03-8/31/04 |                   |
|--|----------------|-------------------|----------------|-------------------|
|  | SHARES         | VALUE             | SHARES         | VALUE             |
| Shares sold                            | 1,095          | \$11,599          | 4,542          | \$48,371          |
| Shares reinvested                      | 159            | 1,678             | 361            | 3,835             |
| Shares redeemed                        | + (2,408)      | (25,490)          | (5,948)        | (63,157)          |
| <b>Net transactions in fund shares</b> | <b>(1,154)</b> | <b>(\$12,213)</b> | <b>(1,045)</b> | <b>(\$10,951)</b> |

**Shares Outstanding and Net Assets**

|                      | 9/1/04-2/28/05 |                  | 9/1/03-8/31/04 |                  |
|----------------------|----------------|------------------|----------------|------------------|
|                      | SHARES         | NET ASSETS       | SHARES         | NET ASSETS       |
| Beginning of period  | 15,381         | \$163,552        | 16,426         | \$173,649        |
| Total decrease       | + (1,154)      | (14,219)         | (1,045)        | (10,097)         |
| <b>End of period</b> | <b>14,227</b>  | <b>\$149,333</b> | <b>15,381</b>  | <b>\$163,552</b> |

Unless stated, all numbers are x 1,000.

Figures for shares represent shares sold plus shares reinvested, minus shares redeemed. Figures for net assets represent the changes in net assets from operations plus the changes in value from transactions in fund shares, minus distributions paid.

Includes net investment income not yet distributed in the amount of \$11 and \$10 for the current and prior period, respectively.

# Schwab California Long-Term Tax-Free Bond Fund™

## Financial Statements

### Financial Highlights

|   | 9/1/04–<br>2/28/05* | 9/1/03–<br>8/31/04 | 9/1/02–<br>8/31/03 | 9/1/01–<br>8/31/02 | 9/1/00–<br>8/31/01 | 9/1/99–<br>8/31/00 |
|---|---------------------|--------------------|--------------------|--------------------|--------------------|--------------------|
| <b>Per-Share Data (\$)</b>                  |                     |                    |                    |                    |                    |                    |
| Net asset value at beginning of period      | 11.78               | 11.45              | 11.69              | 11.63              | 11.06              | 10.82              |
| Income from investment operations:          |                     |                    |                    |                    |                    |                    |
| Net investment income                       | 0.25                | 0.50               | 0.49               | 0.53               | 0.55               | 0.55               |
| Net realized and unrealized gains or losses | 0.06                | 0.33               | (0.24)             | 0.05               | 0.57               | 0.24               |
| Total income from investment operations     | 0.31                | 0.83               | 0.25               | 0.58               | 1.12               | 0.79               |
| Less distributions:                         |                     |                    |                    |                    |                    |                    |
| Dividends from net investment income        | (0.25)              | (0.50)             | (0.49)             | (0.52)             | (0.55)             | (0.55)             |
| Distributions from net realized gains       | (0.05)              | —                  | —                  | —                  | —                  | —                  |
| Total distributions                         | (0.30)              | (0.50)             | (0.49)             | (0.52)             | (0.55)             | (0.55)             |
| Net asset value at end of period            | 11.79               | 11.78              | 11.45              | 11.69              | 11.63              | 11.06              |
| Total return (%)                            | 2.60 <sup>1</sup>   | 7.36               | 2.14               | 5.14               | 10.38              | 7.67               |
| <b>Ratios/Supplemental Data (%)</b>         |                     |                    |                    |                    |                    |                    |
| Ratios to average net assets:               |                     |                    |                    |                    |                    |                    |
| Net operating expenses                      | 0.61 <sup>2</sup>   | 0.61               | 0.58               | 0.49               | 0.49               | 0.50 <sup>3</sup>  |
| Gross operating expenses                    | 0.61 <sup>2</sup>   | 0.61               | 0.60               | 0.64               | 0.65               | 0.69               |
| Net investment income                       | 4.26 <sup>2</sup>   | 4.30               | 4.16               | 4.58               | 4.86               | 5.19               |
| Portfolio turnover rate                     | 0 <sup>1,4</sup>    | 15                 | 29                 | 34                 | 37                 | 36                 |
| Net assets, end of period (\$ x 1,000,000)  | 189                 | 180                | 194                | 238                | 215                | 179                |

\* Unaudited.

<sup>1</sup> Not annualized.

<sup>2</sup> Annualized.

<sup>3</sup> The ratio of net operating expenses would have been 0.49% if certain non-routine expenses (proxy fees) had not been included.

<sup>4</sup> Portfolio turnover rate is less than 1%.

**Portfolio Holdings** as of February 28, 2005, unaudited

This section shows all the securities in the fund's portfolio and their value, as of the report date.

The fund files its complete schedule of portfolio holdings with the SEC for the first and third quarters of each fiscal year on Form N-Q. The fund's Forms N-Q is available on the SEC's website at <http://www.sec.gov> and may be reviewed and copied at the SEC's Public Reference Room in Washington, D.C. Call 1-800-SEC-0330 for information on the operation of the Public Reference Room. The schedule of portfolio holdings filed on a fund's most recent Form N-Q is available by visiting Schwab's website at [www.schwab.com/schwabfunds](http://www.schwab.com/schwabfunds).

We use the symbols below to designate certain characteristics of the securities.

- ▲ Delayed-delivery security
- ✚ Credit-enhanced security
- ▷ Liquidity-enhanced security
- All or a portion of this security is held as collateral for delayed-delivery security

For fixed-rate obligations, the rate shown is the interest rate (the rate established when the obligation was issued) and the maturity date shown is the stated legal maturity. For variable-rate obligations, the rate shown is the rate as of the report date, and the maturity shown is the later of the next interest rate change date or demand date.

| <b>Holdings by Category</b> |                                     | <b>Cost</b><br>(\$x1,000) | <b>Value</b><br>(\$x1,000) |
|-----------------------------|-------------------------------------|---------------------------|----------------------------|
| <b>101.0%</b>               | <b>Municipal Bonds</b>              | 179,226                   | 190,396                    |
| <b>0.0%</b>                 | <b>Other Investment Companies</b>   | 79                        | 79                         |
| <b>101.0%</b>               | <b>Total Investments</b>            | <b>179,305</b>            | <b>190,475</b>             |
| <b>(1.0)%</b>               | <b>Other Assets and Liabilities</b> |                           | (1,859)                    |
| <b>100.0%</b>               | <b>Net Assets</b>                   |                           | <b>188,616</b>             |

| <b>Issuer</b><br><b>Project</b><br><b>Type of Security, Series</b> | <b>Rate</b> | <b>Maturity Date</b> | <b>Face Amount</b><br>(\$ x 1,000) | <b>Value</b><br>(\$ x 1,000) |
|--|-------------|----------------------|------------------------------------|------------------------------|
|--|-------------|----------------------|------------------------------------|------------------------------|

**Municipal Bonds** 101.0% of net assets

**Fixed-Rate Obligations 97.3%**
**California 97.3%**

|   |          |          |       |       |
|---|----------|----------|-------|-------|
| <b>✚ Alameda Corridor Transportation Authority</b><br>Senior Lien Revenue Bonds, Series 1999A                         | 5.13%    | 10/01/16 | 1,170 | 1,280 |
| <b>✚ Alameda County</b><br><i>Alameda County Medical Center Project</i><br>Certificates of Participation, Series 1998 | 5.38%    | 06/01/18 | 3,400 | 3,669 |
| <b>✚ Anaheim Public Financing Authority</b><br>Senior Lease Revenue Bonds, Series 1997A                               | 6.00%    | 09/01/24 | 5,000 | 6,058 |
| <b>Association of Bay Area Governments</b>  |          |          |       |       |
| <b>✚ Brandeis Hillel Day School Project</b><br>Revenue Bonds, Series 2001   | 3.75%    | 08/01/31 | 1,700 | 1,729 |
| <b>✚ Redevelopment Agency Pool</b><br>Tax Allocation Revenue Bonds, Series 1997A-%<br><i>Lytton Gardens, Inc.</i>     | 12/15/17 | 1,200    | 1,303 |       |
| Revenue Certificates of Participation, Series 1999<br><i>Schools of the Sacred Heart - San Francisco</i>              | 6.00%    | 02/15/30 | 3,000 | 3,201 |
| Revenue Bonds, Series 2000A   | 6.45%    | 06/01/30 | 1,500 | 1,609 |

## Portfolio Holdings continued

| Issuer<br>Project<br>Type of Security, Series  | Rate  | Maturity<br>Date | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|--|-------|------------------|-----------------------------|-----------------------|
| <b>+ Brea Olinda Unified School District</b><br>General Obligation Bonds, Series 1999A   | 5.60% | 08/01/20         | 1,000                       | 1,117                 |
| <b>Burbank Public Finance Authority</b><br><i>Golden State Redevelopment Project</i>   |       |                  |                             |                       |
| <b>+</b> Revenue Bonds, Series 2003A   | 5.25% | 12/01/17         | 2,825                       | 3,143                 |
| <b>+</b> Revenue Bonds, Series 2003A   | 5.25% | 12/01/18         | 2,175                       | 2,409                 |
| <b>California State</b><br>General Obligation Bonds, Series 2000   | 5.63% | 05/01/18         | 1,000                       | 1,123                 |
| Various Purpose General Obligation Bonds   | 5.25% | 11/01/17         | 3,000                       | 3,297                 |
| <b>+ Department of Veterans Affairs</b><br>Home Purchase Revenue Bonds, Series 2002A   | 5.30% | 12/01/21         | 5,000                       | 5,246                 |
| <b>California Department of Water Resources</b><br>Power Supply Revenue Bonds, Series 2002A  | 5.75% | 05/01/17         | 3,000                       | 3,374                 |
| <b>California Educational Facilities Authority</b><br><i>California College of Arts and Crafts</i><br>Revenue Bonds, Series 2001     | 5.75% | 06/01/25         | 1,800                       | 1,896                 |
| <i>Pepperdine University</i><br>Revenue Bonds, Series 2000   | 5.75% | 09/15/30         | 3,000                       | 3,262                 |
| <b>California Health Facilities Finance Authority</b><br><i>Cedars-Sinai Medical Center</i><br>Revenue Bonds, Series 1999A           | 6.13% | 12/01/19         | 2,750                       | 3,038                 |
| <b>+ Childrens Hospital - San Diego</b><br>Hospital Revenue Refunding Revenue Bonds,<br>Series 1996                                  | 5.38% | 07/01/16         | 5,180                       | 5,471                 |
| <b>California Housing Finance Agency</b><br>Multi-Unit Rental Housing Revenue Bonds II,<br>Series 1992B                              | 6.70% | 08/01/15         | 865                         | 882                   |
| <b>California Infrastructure and Economic Development Bank</b><br><i>J. David Gladstone Institutes</i><br>Revenue Bonds, Series 2001 | 5.50% | 10/01/19         | 1,250                       | 1,367                 |
| <b>California Public Works Board</b><br><i>Department of Corrections</i><br>Lease Revenue Bonds, Series 2003                         | 5.50% | 06/01/17         | 6,970                       | 7,702                 |
| <b>California Statewide Communities Development Authority</b><br><b>+</b> Collateralized Revenue Bonds, Series 2001A                 | 7.00% | 04/20/36         | 4,000                       | 4,533                 |
| <i>Cedars-Sinai Medical Center</i><br>Hospital Revenue Certificates of Participation, Series 1992                                    | 6.50% | 08/01/15         | 365                         | 366                   |
| <i>Daughters of Charity Health System</i>  |       |                  |                             |                       |
| <b>▲</b> Revenue Bonds, Series 2005A   | 5.25% | 07/01/24         | 1,500                       | 1,573                 |
| <b>▲</b> Revenue Bonds, Series 2005G   | 5.00% | 07/01/22         | 1,000                       | 1,035                 |
| <b>▲</b> Revenue Bonds, Series 2005H   | 5.25% | 07/01/25         | 1,000                       | 1,045                 |
| <b>■ Internext Group</b><br>Certificates of Participation, Series 1999   | 5.38% | 04/01/17         | 5,000                       | 5,131                 |
| <i>Kaiser Permanente</i><br>Revenue Bonds, Series 2002D  | 4.35% | 03/01/07         | 2,000                       | 2,054                 |
| <b>+ Colton Public Finance Authority</b><br>Special Tax Revenue Bonds, Series 1996   | 5.45% | 09/01/19         | 3,020                       | 3,204                 |



| Issuer<br>Project<br>Type of Security, Series  | Rate  | Maturity<br>Date | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|--|-------|------------------|-----------------------------|-----------------------|
| <b>Contra Costa County Public Financing Authority</b><br>Tax Allocation Revenue Bonds, Series 2003A  | 5.63% | 08/01/33         | 5,000                       | 5,188                 |
| <b>East Bay Municipal Utility District</b><br><i>Water System</i><br>Subordinate Revenue Bonds, Series 1998  | 5.25% | 06/01/19         | 2,600                       | 2,791                 |
| <b>+ Escondido</b><br>Revenue Certificates of Participation, Series 2000A  | 6.00% | 09/01/31         | 1,945                       | 2,179                 |
| <b>Fontana Redevelopment Agency</b><br><i>Jurupa Hills Redevelopment Project</i><br>Tax Allocation Refunding Bonds, Series 1997A                   | 5.50% | 10/01/19         | 3,500                       | 3,682                 |
| <b>+ Foothill-Eastern Transportation Corridor Agency</b><br>Toll Road Refunding Revenue Bonds, Series 1999   | 5.13% | 01/15/19         | 5,000                       | 5,333                 |
| <b>+ Huntington Beach</b><br><i>Capital Improvement Financing Project</i><br>Lease Revenue Bonds, Series 2000A                                     | 5.50% | 09/01/20         | 1,500                       | 1,653                 |
| <b>+ Inglewood Redevelopment Agency</b><br><i>Merged Redevelopment Project</i><br>Tax Allocation Refunding Revenue Bonds, Series 1998A             | 5.25% | 05/01/16         | 1,000                       | 1,125                 |
| <b>+ Los Angeles Municipal Improvement Corp.</b><br><i>Los Angeles Central Library Project</i><br>Leasehold Refunding Revenue Bonds, Series 2003A  | 5.25% | 06/01/13         | 3,730                       | 4,180                 |
| <b>+ Lynwood Public Financing Authority</b><br><i>Public Capital Improvement Project</i><br>Lease Refunding Revenue Bonds, Series 2003             | 5.00% | 09/01/18         | 1,000                       | 1,083                 |
| <b>Oakland Joint Power Financing Authority</b><br>Reassessment Revenue Bonds, Series 1999  | 5.50% | 09/02/24         | 990                         | 1,060                 |
| <b>+ Oakland Redevelopment Agency</b><br><i>Central District Redevelopment Project</i><br>Subordinated Tax Allocation Bonds, Series 2003           | 5.50% | 09/01/14         | 1,615                       | 1,830                 |
| <b>+ Orange County</b><br>Recovery Certificates of Participation, Series 1996A   | 5.70% | 07/01/10         | 1,450                       | 1,538                 |
| <b>+ Port of Oakland</b><br>Revenue Bonds, Series 2000K  | 5.75% | 11/01/29         | 3,500                       | 3,773                 |
| <b>■ Riverside County Public Finance Authority</b><br><i>Riverside County Redevelopment Projects</i><br>Tax Allocation Revenue Bonds, Series 1997A | 5.63% | 10/01/33         | 4,905                       | 5,057                 |
| <b>Sacramento County Sanitation District</b><br>Revenue Bonds, Series 2000A  | 5.88% | 12/01/27         | 1,000                       | 1,038                 |
| <b>Sacramento Finance Authority</b><br>+■ Capital Improvement Revenue Bonds, Series 1999   | 5.88% | 12/01/29         | 3,000                       | 3,365                 |
| + Revenue Bonds, Series 2002A  | 5.38% | 12/01/20         | 2,875                       | 3,205                 |
| + <i>California EPA Building Project</i><br>Lease Revenue Bonds, Series 1998A  | 5.25% | 05/01/19         | 1,575                       | 1,708                 |
| <b>+ Salinas Valley Solid Waste Authority</b><br>Revenue Bonds, Series 2002  | 5.13% | 08/01/22         | 2,210                       | 2,327                 |

## Portfolio Holdings continued

| Issuer<br>Project<br>Type of Security, Series   | Rate  | Maturity<br>Date | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|---|-------|------------------|-----------------------------|-----------------------|
| <b>San Diego Redevelopment Agency</b><br><i>Horton Plaza Redevelopment Project</i><br>Subordinate Tax Allocation Bonds, Series 2000 | 5.80% | 11/01/21         | 2,500                       | 2,704                 |
| <b>San Francisco Airports Commission</b><br><i>San Francisco International Airport</i>  |       |                  |                             |                       |
| +■ Second Series Revenue Bonds, Issue 11  | 6.20% | 05/01/05         | 1,500                       | 1,525                 |
| + Second Series Revenue Bonds, Issue 12B  | 5.63% | 05/01/21         | 2,000                       | 2,089                 |
| + Second Series Revenue Bonds, Issue 22   | 5.00% | 05/01/19         | 2,000                       | 2,079                 |
| + Second Series Revenue Bonds, Issue 30   | 5.00% | 05/01/17         | 2,000                       | 2,173                 |
| <b>San Francisco Bay Area Rapid Transit</b>   |       |                  |                             |                       |
| + Sales Tax Revenue Bonds, Series 1999  | 5.50% | 07/01/26         | 1,000                       | 1,104                 |
| + Sales Tax Revenue Bonds, Series 1999  | 5.50% | 07/01/34         | 2,500                       | 2,761                 |
| <b>+ San Francisco Port Commission</b><br>Refunding Revenue Bonds, Series 2004  | 4.00% | 07/01/08         | 1,200                       | 1,249                 |
| <b>San Francisco State University</b><br><i>Auxiliary Organization</i><br>Student Housing Revenue Bonds, Series 1999                | 5.20% | 07/01/19         | 1,150                       | 1,187                 |
| <b>+ San Luis Obispo County Finance Authority</b><br><i>Lopez Dam</i><br>Improvement Revenue Bonds, Series 2000A                    | 5.38% | 08/01/24         | 1,000                       | 1,074                 |
| <b>+■ Santa Ana Unified School District</b><br><i>Election of 1999</i><br>General Obligation Bonds, Series 2000                     | 5.70% | 08/01/29         | 6,000                       | 6,692                 |
| <b>+ Santa Clara County Financing Authority</b><br><i>VMC Facility Replacement Projects</i><br>Lease Revenue Bonds, Series 1994A    | 7.75% | 11/15/10         | 1,460                       | 1,800                 |
| <b>+ Santa Clara Redevelopment Agency</b><br><i>Bayshore North Project</i><br>Tax Allocation Revenue Refunding Bonds, Series 1992   | 7.00% | 07/01/10         | 1,500                       | 1,696                 |
| <b>+ South Orange County Public Financing Authority</b><br>Special Tax Revenue Bonds, Series 1999A                                  | 5.25% | 08/15/18         | 3,095                       | 3,351                 |
| <b>Stockton Community Facilities District</b><br><i>Mello Roos</i><br>Revenue Bonds, Series 1998A                                   | 5.80% | 09/01/14         | 5,875                       | 6,258                 |
| <b>+ Taft City Elementary School District</b><br>General Obligation Bonds, Series 2001A   | 4.90% | 08/01/20         | 1,080                       | 1,145                 |
| <b>+ Tri City Hospital District</b><br>Refunding Revenue Bonds, Series 1996A  | 5.63% | 02/15/17         | 1,000                       | 1,048                 |
| <b>+ Truckee Public Financing Authority</b><br>Lease Revenue Bonds, Series 2000A  | 5.88% | 11/01/25         | 1,490                       | 1,670                 |
| <b>+ University of California</b><br><i>UC Davis Medical Center</i><br>Hospital Revenue Bonds, Series 1996                          | 5.75% | 07/01/06         | 500                         | 528                   |
| <b>+ Vallejo</b><br><i>Water Improvement Project</i><br>Refunding Revenue Bonds, Series 1996A                                       | 5.70% | 05/01/16         | 2,000                       | 2,113                 |

| Issuer<br>Project<br>Type of Security, Series  | Rate  | Maturity<br>Date | Face Amount<br>(\$ x 1,000) | Value<br>(\$ x 1,000) |
|--|-------|------------------|-----------------------------|-----------------------|
| <b>West Basin Water District</b>   |       |                  |                             |                       |
| + Refunding Revenue Certificates of Participation,<br>Series 2003A                           | 5.25% | 08/01/14         | 2,500                       | 2,803                 |
| + 1992 Projects<br>Refunding Revenue Certificates of Participation,<br>Series 1997A          | 5.50% | 08/01/22         | 1,000                       | 1,075                 |
| <b>Whittier</b><br><i>Presbyterian Intercommunity Hospital</i><br>Revenue Bonds, Series 2002 | 5.60% | 06/01/22         | 2,000                       | 2,090                 |
|  |       |                  |                             | <b>183,446</b>        |

**Variable Rate Obligations 3.7%****California 3.7%****California State**

|  |       |          |       |              |
|--|-------|----------|-------|--------------|
| ▶ Economic Recovery Bonds, Series 2004C-3  | 1.80% | 03/01/05 | 1,900 | 1,900        |
| + Economic Recovery Bonds Series 2004C-6   | 1.80% | 03/01/05 | 900   | 900          |
| + General Obligation Bonds, Series 2003A-2   | 1.80% | 03/01/05 | 150   | 150          |
| <b>+ California Department of Water Resources</b><br>Power Supply Revenue Bonds, Series 2002B-2  | 1.78% | 03/01/05 | 3,000 | 3,000        |
| ▶ <b>Orange County Sanitation District</b><br>Refunding Certificates of Participation, Series 2000B  | 1.77% | 03/01/05 | 800   | 800          |
| ▶ <b>Southern California Metropolitan Water District</b><br>Water Revenue Certificates of Participation, Authorization,<br>2000 Series B-3 | 1.80% | 03/01/05 | 200   | 200          |
|  |       |          |       | <b>6,950</b> |

**Security and Number of Shares****Other Investment Companies** 0.0% of net assets

|   |        |           |
|---|--------|-----------|
| <b>Provident Institutional Funds—<br/>California Money Fund Portfolio</b> | 78,970 | <b>79</b> |
|---|--------|-----------|

End of investments.

## Statement of

**Assets and Liabilities**

As of February 28, 2005; unaudited. All numbers are x 1,000 except NAV.

**Assets**

|                       |                |
|-----------------------|----------------|
| Investments, at value | \$190,475      |
| Receivables:          |                |
| Fund shares sold      | 95             |
| Interest              | 2,552          |
| Prepaid expenses      | <u>2</u>       |
| <b>Total assets</b>   | <b>193,124</b> |

**Liabilities**

|   |              |
|---|--------------|
| Payables:                                   |              |
| Fund shares redeemed                        | 544          |
| Dividends to shareholders                   | 244          |
| Investments bought                          | 3,664        |
| Investment adviser and administrator fees   | 5            |
| Transfer agent and shareholder service fees | 4            |
| Accrued expenses                            | <u>47</u>    |
| <b>Total liabilities</b>                    | <b>4,508</b> |

**Net Assets**

|                   |                  |
|-------------------|------------------|
| Total assets      | 193,124          |
| Total liabilities | — 4,508          |
| Net assets        | <u>\$188,616</u> |

**Net Assets by Source**

|   |         |
|---|---------|
| Capital received from investors           | 177,192 |
| Net investment income not yet distributed | 254     |
| Net unrealized capital gains              | 11,170  |

**Net Asset Value (NAV)**

| <b>Net Assets</b> | <b>+</b> | <b>Shares Outstanding</b> | <b>=</b> | <b>NAV</b> |
|-------------------|----------|---------------------------|----------|------------|
| \$188,616         |          | 15,993                    |          | \$11.79    |

Unless stated, all numbers are x 1,000.

The amortized cost of the fund's securities was \$179,305.

Not counting short-term obligations, the fund's security transactions during the period were:

|                  |         |
|------------------|---------|
| Purchases        | \$5,873 |
| Sales/maturities | \$430   |

The fund's total security transactions with other Schwab Funds during the period were \$13,400.

**Federal Tax Data**

|                                  |                 |
|----------------------------------|-----------------|
| Portfolio cost                   | \$179,052       |
| Net unrealized gains and losses: |                 |
| Gains                            | \$11,458        |
| Losses                           | + (35)          |
|                                  | <u>\$11,423</u> |

**As of August 31, 2004:****Undistributed earnings:**

|                              |              |
|------------------------------|--------------|
| Tax-exempt income            | \$256        |
| Ordinary income              | \$51         |
| Long-term capital gains      | \$672        |
| <b>Capital loss utilized</b> | <b>\$115</b> |

## Statement of

**Operations**

For September 1, 2004 through February 28, 2005; unaudited. All numbers are x 1,000.

**Investment Income**

|          |                |
|----------|----------------|
| Interest | <b>\$4,458</b> |
|----------|----------------|

**Net Unrealized Gains and Losses**

|                                     |            |
|-------------------------------------|------------|
| Net unrealized gains on investments | <b>825</b> |
|-------------------------------------|------------|

**Expenses**

|   |            |
|---|------------|
| Investment adviser and administrator fees   | 275        |
| Transfer agent and shareholder service fees | 229        |
| Trustees' fees                              | 4          |
| Custodian and portfolio accounting fees     | 8          |
| Professional fees                           | 15         |
| Registration fees                           | 2          |
| Shareholder reports                         | 14         |
| Other expenses                              | +          |
|   | 9          |
| <b>Total expenses</b>                       | <b>556</b> |

**Increase in Net Assets from Operations**

|   |                |
|---|----------------|
| <b>Total investment income</b>                | 4,458          |
| <b>Total expenses</b>                         | –              |
|   | 556            |
| <b>Net investment income</b>                  | <b>3,902</b>   |
| <b>Net unrealized gains</b>                   | +              |
|   | 825            |
| <b>Increase in net assets from operations</b> | <b>\$4,727</b> |

Unless stated, all numbers are x 1,000.

Calculated as a percentage of average daily net assets: 0.30% of the first \$500 million and 0.22% of assets beyond that. These fees are paid to Charles Schwab Investments Management, Inc. (CSIM).

Calculated as a percentage of average daily net assets: for transfer agent services, 0.05% of the fund's assets; for shareholder services, 0.20% of the fund's assets. These fees are paid to Charles Schwab & Co., Inc. (Schwab).

For the fund's independent trustees only.

Statements of

**Changes in Net Assets**

For the current and prior report periods. All numbers are x 1,000.  
Figures for current period are unaudited.

**Operations**

|   | 9/1/04–2/28/05 | 9/1/03–8/31/04 |
|---|----------------|----------------|
| Net investment income                         | \$3,902        | \$8,065        |
| Net realized gains                            | —              | 828            |
| Net unrealized gains                          | + 825          | 4,282          |
| <b>Increase in net assets from operations</b> | <b>4,727</b>   | <b>13,175</b>  |

**Distributions Paid**

|                                       |                |                |
|---------------------------------------|----------------|----------------|
| Dividends from net investment income  | \$3,864        | \$8,013        |
| Distributions from net realized gains | + 723          | —              |
| <b>Total distributions</b>            | <b>\$4,587</b> | <b>\$8,013</b> |

**Transactions in Fund Shares**

|  | 9/1/04–2/28/05 |                | 9/1/03–8/31/04 |                   |
|--|----------------|----------------|----------------|-------------------|
|  | SHARES         | VALUE          | SHARES         | VALUE             |
| Shares sold                            | 1,971          | \$23,329       | 2,403          | \$28,163          |
| Shares reinvested                      | 234            | 2,762          | 452            | 5,275             |
| Shares redeemed                        | + (1,505)      | (17,800)       | (4,468)        | (52,007)          |
| <b>Net transactions in fund shares</b> | <b>700</b>     | <b>\$8,291</b> | <b>(1,613)</b> | <b>(\$18,569)</b> |

**Shares Outstanding and Net Assets**

|                            | 9/1/04–2/28/05 |                  | 9/1/03–8/31/04 |                  |
|----------------------------|----------------|------------------|----------------|------------------|
|                            | SHARES         | NET ASSETS       | SHARES         | NET ASSETS       |
| Beginning of period        | 15,293         | \$180,185        | 16,906         | \$193,592        |
| Total increase or decrease | + 700          | 8,431            | (1,613)        | (13,407)         |
| <b>End of period</b>       | <b>15,993</b>  | <b>\$188,616</b> | <b>15,293</b>  | <b>\$180,185</b> |

Unless stated, all numbers are x 1,000.

Figures for shares represent shares sold plus shares reinvested minus shares redeemed. Figures for net assets represent the changes in net assets from operations plus the changes in value from transactions in fund shares, minus distributions paid.

Includes net investment income not yet distributed in the amount of \$254 and \$216 for the current and prior period, respectively.

# Financial Notes unaudited

## Business Structure of the Funds

**Each of the funds discussed in this report is a series of Schwab Investments, a no-load, open-end management investment company.** The company is organized as a Massachusetts business trust and is registered under the Investment Company Act of 1940, as amended. The sidebar shows the funds in this report and their trust.

**Both Schwab Tax-Free YieldPlus Fund™ and Schwab California Tax-Free YieldPlus Fund™ offer two share classes:** Investor Shares and Select Shares®. Shares of each class represent interest in the same portfolio, but each class has different expenses and investment minimums. Schwab Short/Intermediate Tax-Free Bond Fund, Schwab Long-Term Tax-Free Bond Fund, California Short/Intermediate Tax-Free Bond Fund, and California Long-Term Tax-Free Bond Fund each offers one share class.

Shares are bought and sold at net asset value, or NAV, which is the price for all outstanding shares. Each share has a par value of 1/1,000 of a cent, and the trustees may issue as many shares as necessary.

## The Trust and Its Funds

This list shows all of the funds included in Schwab Investments. The funds discussed in this report are highlighted.

**Schwab Investments** organized October 26, 1990

Schwab 1000 Fund  
 Schwab YieldPlus Fund  
 Schwab Short-Term Bond Market Fund  
 Schwab Total Bond Market Fund  
 Schwab GNMA Fund  
 Schwab Tax-Free YieldPlus Fund  
 Schwab Short/Intermediate Tax-Free Bond Fund  
 Schwab Long-Term Tax-Free Bond Fund  
 Schwab California Tax-Free YieldPlus Fund  
 Schwab California Short/Intermediate Tax-Free Bond Fund  
 Schwab California Long-Term Tax-Free Bond Fund

## Fund Operations

Most of the funds' investments are described in the fund-by-fund sections earlier in this report. However, there are certain other investments and policies that may affect a fund's financials, as described below. Other policies concerning the funds' business operations also are described here.

**The funds declare dividends every day they are open for business.** These dividends, which are substantially equal to a fund's net investment income for that day, are paid out to shareholders once a month. The funds may make distributions from any net realized capital gains once a year.

**The funds may buy securities on a delayed-delivery basis.** In these transactions, a fund agrees to buy a security for a stated price, with settlement generally occurring within two weeks. If the security's value falls before settlement occurs, a fund could end up paying more for the security than its market value at the time of settlement. The funds have set aside sufficient securities as collateral for those securities bought on a delayed-delivery basis.

**The funds pay fees to affiliates of the investment adviser for various services.** Through their trust, the funds have agreements with Charles Schwab Investment Management, Inc. (CSIM) to provide investment advisory and administrative services and with Charles Schwab & Co., Inc. (Schwab) to provide transfer agent and shareholder services.

Although these agreements specify certain fees for these services, CSIM and Schwab have made additional agreements with the funds that may limit the total expenses charged. The rates and limitations for these fees vary from fund to fund, and are described in each fund's Statement of Operations.

**The funds may engage in certain transactions involving affiliates.** The funds may make direct transactions with certain other Schwab Funds® when practical.

When one fund is seeking to sell a security that another is seeking to buy, an interfund transaction can allow both funds to benefit by reducing transaction costs. This practice is limited to funds that share the same investment adviser, trustees and officers.

Pursuant to an exemptive order issued by the SEC, the funds may enter into interfund borrowing and lending transactions within the Schwab Funds®. All loans are for temporary or emergency purposes only. The interest rate charged on the loan is the average of the overnight repurchase agreement rate and the short-term bank loan rate. The interfund lending facility is subject to the oversight and periodic review of the Board of Trustees of the Schwab Funds.

**Trustees may include people who are officers and/or directors of the investment adviser or Schwab.** Federal securities law limits the percentage of such “interested persons” who may serve on a trust’s board, and the trust was in compliance with these limitations throughout the report period. The trust did not pay any of these persons for their service as trustees, but it did pay non-interested persons (independent trustees), as noted in each fund’s Statement of Operations.

**The funds may borrow money from banks and custodians.** The funds may obtain temporary bank loans through the trusts to which they belong, to use for meeting shareholder redemptions or for extraordinary or emergency purposes. The trusts have custodian overdraft facilities and line of credit arrangements of \$150 million and \$100 million with PNC Bank, N.A., and Bank of America, N.A., respectively. The funds pay interest on the amounts they borrow at rates that are negotiated periodically. There was no borrowing for any funds during the period.

**The funds intend to meet federal income and excise tax requirements for regulated investment companies.** Accordingly, the funds distribute substantially all of their net investment income and realized net capital gains (if any) to their respective shareholders

each year. As long as a fund meets the tax requirements, it is not required to pay federal income tax.

**Under the funds’ organizational documents, the officers and trustees are indemnified against certain liability arising out of the performance of their duties to the funds.** In addition, in the normal course of business the funds enter into contracts with their vendors and others that provide general indemnifications. The funds’ maximum exposure under these arrangements is unknown as this would involve future claims that may be made against the funds. However, based on experience, the funds expect the risk of loss to be remote.

## Accounting Policies

The following are the main policies the funds use in preparing their financial statements.

**The funds value the securities in their portfolios every business day.** The funds use the following policies to value various types of securities:

**Bonds and notes:** valued at halfway between the most recent bid and asked quotes or, if such quotes are unavailable, at prices for securities of comparable maturity, credit quality and type. Valuations for bonds and notes are provided by an independent bond-pricing service.

**Securities for which no quoted value is available:** valued at fair value, as determined in good faith by the fund’s investment adviser using guidelines adopted by the fund’s Board of Trustees. In the determination of a fair valuation the guidelines include but are not limited to the use of analytical data, business conditions, recent trades, general and/or specific market trends and any emergency or significant events that could have a material impact on the value of the security.

**Short-term securities (60 days or less to maturity):** valued at amortized cost.



**Security transactions** are recorded as of the date the order to buy or sell the security is executed.

**Interest income** is recorded as it accrues. If a fund buys a debt security at a discount (that is, for less than its face value) or a premium (more than face value), it amortizes the discount or premium from the current date up to maturity. The fund then increases (in the case of discounts) or reduces (in the case of premiums) the income it records from the security. If the security is callable (meaning that the issuer has the option to pay it off before its maturity date), then the fund amortizes the premium to the security's call date and price, rather than the maturity date and price.

**Realized gains and losses** from security transactions are based on the identified costs of the securities involved.

**Expenses** that are specific to a fund or a class are charged directly to that fund or class. Expenses that are common to all funds within the trust generally are allocated among the funds in proportion to their net assets.

**Each fund maintains its own account for purposes of holding assets and accounting**, and is considered a separate entity for tax purposes. Within its account, each fund also may keep certain assets in segregated accounts, required by securities law.

**The accounting policies described above conform with accounting principles generally accepted in the United States of America.** Notwithstanding this, shareholders should understand that in order to follow these principles, fund management has to make estimates and assumptions that affect the information reported in the financial statements. It's possible that once the results are known, they may turn out to be different from these estimates.

# Fund Trustees

A fund’s Board of Trustees is responsible for protecting the interests of that fund’s shareholders. The tables below give information about the people who serve as trustees and officers for the Schwab Funds®, including the funds covered in this report. Trustees remain in office until they resign, retire or are removed by shareholder vote.<sup>1</sup>

Under the Investment Company Act of 1940, any officer, director, or employee of Schwab or CSIM is considered an “interested person,” meaning that he or she is considered to have a business interest in Schwab or CSIM. These individuals are listed as “interested trustees.” The “independent trustees” are individuals who, under the 1940 Act, are not considered to have a business interest in Schwab or CSIM.

Each of the Schwab Funds (of which there were 52 as of 2/28/05) belongs to one of these trusts: The Charles Schwab Family of Funds, Schwab Investments, Schwab Capital Trust or Schwab Annuity Portfolios. Currently all these trusts have the same trustees and officers. The address for all trustees and officers is 101 Montgomery Street, San Francisco, CA 94104. You can find more information about the trustees and officers in the Statement of Additional Information, which is available free by calling 1-800-435-4000.

| Individuals Who Are Interested Trustees and Officers of the Trust |   |   |
|---|---|---|
| Name and Birthdate  | Trust Position(s);<br>Trustee Since   | Main Occupations and Other Directorships and Affiliations   |
| <b>Charles R. Schwab</b> <sup>2</sup><br>7/29/37                  | Chairman, Trustee:<br>Family of Funds, 1989;<br>Investments, 1991;<br>Capital Trust, 1993;<br>Annuity Portfolios, 1994. | Chair, CEO, Director, The Charles Schwab Corp., Charles Schwab & Co., Inc.; Chair, Director, Charles Schwab Investment Management, Inc.; Chair, Charles Schwab Holdings (UK); CEO, Director, Charles Schwab Holdings, Inc.; Chair, CEO Schwab (SIS) Holdings, Inc. I, Schwab International Holdings, Inc.; Director, Charles Schwab Bank, N.A., U.S. Trust, United States Trust Co. of New York, Siebel Systems (software), Xsign, Inc. (electronic payment systems), TrustMark, Inc., All Kinds of Minds (education); Trustee, Stanford University. <i>Until 5/04:</i> Director, The Gap, Inc. (clothing retailer). <i>Until 5/03:</i> Co-CEO, The Charles Schwab Corp. <i>Until 3/02:</i> Director, Audiobase, Inc. (Internet audio solutions). <i>Until 5/02:</i> Director, Vodaphone AirTouch PLC (telecommunications). <i>Until 7/01:</i> Director, The Charles Schwab Trust Co. |

<sup>1</sup> The Schwab Funds retirement policy requires that independent trustees elected after January 1, 2000 retire at age 72 or after twenty years of service as a trustee, whichever comes first. Independent trustees elected prior to January 1, 2000 will retire on the following schedule: Messrs. Holmes and Dorward will retire on December 31, 2007, and Messrs. Stephens and Wilsey will retire on December 31, 2010.

<sup>2</sup> In addition to his position with the investment adviser and the distributor, Mr. Schwab also owns stock of The Charles Schwab Corporation.

## Individuals Who Are Officers of the Trust but Not Trustees

| Name and Birthdate                  | Trust Office(s) Held                                       | Main Occupations and Other Directorships and Affiliations   |
|-------------------------------------|--|---|
| <b>Evelyn Dilsaver</b><br>5/4/55    | President, CEO<br>(all trusts).                            | EVP, President, Director, Charles Schwab Investment Management, Inc. <i>Until 7/04</i> : SVP for Development and Distribution, Asset Management Products and Services Enterprise. <i>Until 6/03</i> : EVP, CFO, Chief Administrative Officer, U.S. Trust.   |
| <b>Stephen B. Ward</b><br>4/5/55    | SVP, Chief Investment<br>Officer (all trusts).             | SVP, Chief Investment Officer, Director, Charles Schwab Investment Management, Inc.; Chief Investment Officer, The Charles Schwab Trust Co.   |
| <b>Kimon Daifotis</b><br>7/10/59    | SVP, Chief Investment<br>Officer (all trusts).             | <i>Since 9/04</i> : Chief Investment Officer, Fixed Income, Charles Schwab Investment Management, Inc. <i>Since 6/04</i> : SVP, Charles Schwab Investment Management, Inc. <i>Until 6/04</i> : VP, Charles Schwab Investment Management, Inc.   |
| <b>Jeffrey Mortimer</b><br>9/29/63  | SVP, Chief Investment<br>Officer (all trusts).             | <i>Since 5/04</i> : SVP, Chief Investment Officer, Equities, Charles Schwab Investment Management, Inc. <i>Since 6/04</i> : VP, Chief Investment Officer, Laudus Trust, Laudus Variable Insurance Trust. <i>Until 5/04</i> : VP, Charles Schwab Investment Management, Inc.   |
| <b>Randall Fillmore</b><br>11/11/60 | Chief Compliance<br>Officer (all trusts).                  | <i>Since 9/04</i> : SVP, Institutional Compliance and Chief Compliance Officer, Charles Schwab Investment Management, Inc. <i>Until 9/04</i> : VP, Charles Schwab & Co., Charles Schwab Investment Management, Inc. <i>Until 2002</i> : VP of Internal Audit, Charles Schwab & Co., Inc.; Chief Compliance Officer, Laudus Trust, Laudus Variable Insurance Trust. <i>Prior to 2000</i> : PricewaterhouseCoopers. |
| <b>Koji E. Felton</b><br>3/13/61    | Secretary (all trusts).                                    | SVP, Chief Counsel, Assistant Corporate Secretary, Charles Schwab Investment Management, Inc. <i>Until 6/98</i> : Branch Chief in Enforcement, U.S. Securities and Exchange Commission, San Francisco.  |
| <b>George Pereira</b><br>6/9/64     | Treasurer, Principal<br>Financial Officer<br>(all trusts). | <i>Since 11/04</i> : SVP, CFO, Charles Schwab Investment Management, Inc. <i>Until 11/04</i> : SVP, Financial Reporting, Charles Schwab & Co., Inc. <i>Until 12/99</i> : Chief Financial Officer, Commerzbank Capital Markets. <i>Until 9/99</i> : Managing Director at the New York Stock Exchange.  |

## Individuals Who Are Independent Trustees

| Name and Birthdate                   | Trustee Since  | Main Occupations and Other Directorships and Affiliations  |
|--------------------------------------|--|--|
| <b>Mariann Byerwalter</b><br>8/13/60 | 2000 (all trusts).   | Chair, JDN Corp. Advisory LLC; Trustee, Stanford University, America First Cos., Omaha, NE (venture capital/fund management), Redwood Trust, Inc. (mortgage finance), Stanford Hospitals and Clinics, SRI International (research), PMI Group, Inc. (mortgage insurance), Lucile Packard Children's Hospital. <i>Since 2/05:</i> Director, Pacific Life Insurance Company. <i>Since 2004:</i> Laudus Trust, Laudus Variable Insurance Trust. <i>2001:</i> Special Assistant to the President, Stanford University.         |
| <b>Donald F. Dorward</b><br>9/23/31  | Family of Funds, 1989; Investments, 1991; Capital Trust, 1993; Annuity Portfolios, 1994. | CEO, Dorward & Associates (corporate management, marketing and communications consulting). <i>Until 1999:</i> EVP, Managing Director, Grey Advertising. <i>Until 1996:</i> President, CEO, Allen & Dorward Advertising.  |
| <b>William A. Hasler</b><br>11/22/41 | 2000 (all trusts).   | Dean Emeritus, Haas School of Business, University of California, Berkeley; Director, Aphton Corp. (bio-pharmaceuticals); Non-Executive Chair, Solelectron Corp. (manufacturing), Mission West Properties (commercial real estate), Stratex Networks (network equipment), TOUSA (home building); Public Governor, Member, executive committee, Pacific Stock & Options Exchange. <i>Since 2004:</i> Trustee, Laudus Trust, Laudus Variable Insurance Trust. <i>Until 2/04:</i> Co-CEO, Aphton Corp. (bio-pharmaceuticals). |
| <b>Robert G. Holmes</b><br>5/15/31   | Family of Funds, 1989; Investments, 1991; Capital Trust, 1993; Annuity Portfolios, 1994. | Chair, CEO, Director, Semloh Financial, Inc. (international financial services and investment advisory firm).  |
| <b>Gerald B. Smith</b><br>9/28/50    | 2000 (all trusts).   | Chair, CEO, Founder, Smith Graham & Co. (investment advisors); Trustee, Cooper Industries (electrical products, tools and hardware); Chairman, audit committee, Northern Border Partners, L.P. (energy).   |
| <b>Donald R. Stephens</b><br>6/28/38 | Family of Funds, 1989; Investments, 1991; Capital Trust, 1993; Annuity Portfolios, 1994. | Managing Partner, D.R. Stephens & Co. (investments). <i>Until 1996:</i> Chair, CEO, North American Trust (real estate investment trust).   |
| <b>Michael W. Wilsey</b><br>8/18/43  | Family of Funds, 1989; Investments, 1991; Capital Trust, 1993; Annuity Portfolios, 1994. | Chair, CEO, Wilsey Bennett, Inc. (real estate investment and management, and other investments).   |

# Glossary

**Alternative Minimum Tax (AMT)** A federal income tax designed to limit the extent to which high-income taxpayers (including individuals, estates, trusts and corporations) can benefit from certain deductions and exemptions. For example, some types of income that are exempt from regular federal income tax are not exempt from the AMT.

**asset allocation** The practice of dividing a portfolio among different asset classes, with each asset class assigned a particular percentage.

**asset-backed securities** Bond or other debt securities that represent ownership in a pool of debt obligations such as credit card debt.

**asset class** A group of securities with similar structure and basic characteristics. Stocks, bonds and cash are the three main examples of asset classes.

**average rate** The average rate of interest paid annually by the fixed-income securities in a fund or portfolio.

**bond** A security representing a loan from the investor to the issuer. A bond typically pays interest at a fixed rate (the “coupon rate”) until a specified date (the “maturity date”), at which time the issuer returns the money borrowed (“principal” or “face value”) to the bondholder. Because of their structure, bonds are sometimes called “fixed income securities” or “debt securities.”

An individual bond is subject to the credit risk of the issuer. Changes in interest rates can affect a bond’s market value prior to call or maturity. There is no guarantee that a bond’s yield to call or maturity will provide a positive return over the rate of inflation.

**bond fund** A bond fund is subject to the same credit, interest rate, and inflation risks as bonds. In addition, a bond fund incurs ongoing fees and expenses. A bond fund’s net asset value will fluctuate with the price of the underlying bonds and the portfolio turnover activity; return of principal is not guaranteed.

**call** An early repayment of a bond’s principal by the issuer, usually done because the issuer is able to refinance its bond debt at a lower rate.

**call protection** A term used in reference to a bond that cannot be called by the issuer before maturity, or at least for many years from the present date. A bond that offers call protection can more reliably be expected to provide a given yield over a given number of years than a bond that could be called (assuming both bonds are of the same credit quality).

**capital gain, capital loss** The difference between the amount paid for an investment and its value at a later time. If the investment has been sold, the capital gain or loss is considered a realized gain or loss. If the investment is still held, the gain or loss is still “on paper” and is considered unrealized.

**certificate of participation** A municipal bond that is repaid from an annual budget appropriation rather than being backed by the full faith and credit of the issuer.

**coupon, coupon rate** The annual rate of interest paid until maturity by the issuer of a debt security.

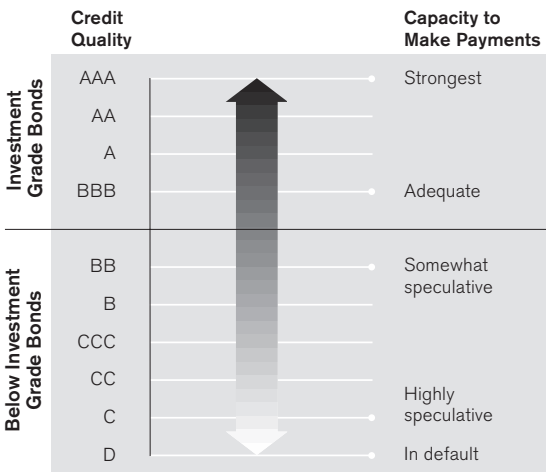
**credit quality** The capacity of an issuer to make its interest and principal payments. See chart below.

**credit risk** The risk that a bond issuer may be unable to pay interest or principal to its bondholders.

**discount rate** The implied rate on a debt security that does not pay interest but is bought at a discount and redeemed at face value when it matures.

## Credit Ratings

Most major bond issuers arrange with a recognized independent rating organization, such as Standard & Poor’s (S&P) or Moody’s Investors Service, to rate the credit-worthiness of their bonds. The spectrum of these ratings is divided into two major categories: investment grade and below investment grade (sometimes called “junk bonds”). Bonds rated below investment grade range from those that are considered to have some vulnerability to default to those that appear on the brink of default or are in default.



**dividend** Money from earnings that is distributed to shareholders as a given amount per share.

**duration** A measure of a bond's sensitivity to interest rates. Calculations of duration generally take into account the investment's yield, interest payments, maturity date and call features. Like maturity, duration is expressed in years, but is more accurate than maturity in determining the effect of interest rate movements on a bond investment's price. The duration of a portfolio equals the market value weighted average of the duration of the bonds held in the portfolio.

**expense ratio** The amount that is taken from a mutual fund's assets each year to cover the fund's operating expenses. An expense ratio of 0.50% means that a fund's expenses amount to half of one percent of its average net assets a year.

**general obligation bonds** Municipal bonds that are secured by the issuer's full faith and credit, which typically is backed by the power of the issuer to levy taxes.

**interest** Payments to bondholders (usually made twice a year) as compensation for loaning the bond principal to the issuer.

**interest rate risk** The risk that a bond's value will fluctuate if market interest rates change or are expected to change. Bond prices tend to move in the opposite direction of interest rates: when interest rates rise, bond prices tend to fall.

**market risk** Those elements of risk that are common to all securities in an asset class, and therefore cannot be significantly reduced by diversification within the asset class. Also known as "systematic risk."

**maturity** The date a bond is scheduled to be "retired" and its principal amount returned to the bondholder.

**mortgage-backed securities** Bond or other debt securities that represent ownership in a pool of mortgage loans.

**muni, municipal bonds, municipal securities** Debt securities issued by a state, its counties, municipalities, authorities and other subdivisions, or the territories and possessions of the United States and the District of Columbia, including their subdivisions, agencies and instrumentalities and corporations. These securities may be issued to obtain money for various public purposes, including the construction of a wide range of public facilities such as airports, bridges, highways, housing, hospitals, mass transportation, public utilities, schools, streets, and water and sewer works.

**net asset value (NAV)** The value of one share of a mutual fund. NAV is calculated by taking the fund's total assets, subtracting liabilities, and dividing by the number of shares outstanding.

**outstanding shares, shares outstanding** When speaking of a company or mutual fund, indicates all shares currently held by investors.

**prepayment risk** The risk that a mortgage-backed security may be paid off early, typically because interest rates have fallen and the homeowners who hold the underlying mortgages have refinanced those mortgages at lower rates. In this type of situation, the investor who held the mortgage-backed security will usually have to settle for a lower rate when reinvesting the principal.

**restricted securities** Securities that are subject to contractual restrictions on resale and may be sold only to "qualified institutional buyers" under Securities Act Rule 144A. These securities are often purchased in private placement transactions.

**revenue bonds** Municipal bonds that are issued to finance public works projects and are secured by revenue generated by the project (such as water and sewer fees) rather than the full faith and credit of the issuer.

**section 4(2)/144A securities** Securities exempt from registration under Section 4(2) of the Securities Act of 1933. These securities may be sold only to qualified institutional buyers under Securities Act Rule 144A.

**taxable-equivalent yield** The yield an investor would need to get from a taxable investment in order to match the yield paid by a given tax-exempt investment, once the effect of all applicable taxes is taken into account. For example, if your tax rate were 25%, a tax-exempt investment paying 4.5% would have a taxable-equivalent yield for you of 6.0% ( $4.5\% \div [1 - 0.25\%] = 6.0\%$ ).

**total return** The percentage that an investor would have earned or lost on an investment in the fund assuming dividends and distributions were reinvested.

**weighted average** For mutual funds, an average that gives the same weight to each security as the security represents in the fund's portfolio.

**weighted average maturity** For mutual funds, the maturity of all the bonds in its portfolio, calculated as a weighted average. As a rule, the longer a fund's weighted average maturity, the greater its interest rate risk.

**yield** The income paid out by an investment, expressed as a percentage of the investment's market value.

**yield to maturity** The annualized rate of return a bondholder could expect if the bond were held to maturity. In addition to interest payments, yield to maturity also factors in any difference between a bond's current price and its principal amount, or face value.

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Englewood, CO  
80155-3812

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REG13481-08