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# **Windhaven Investment Management<sup>®</sup>, a Division of Charles Schwab Investment Advisory, Inc.**

**Windhaven<sup>®</sup> Strategies Disclosure Brochure**

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This brochure provides information about the qualifications and business practices of Charles Schwab Investment Advisory, Inc. ("CSIA" or "Adviser") as an adviser for the above mentioned strategies. If you have any questions about the contents of this brochure, please contact us at the phone number above. The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission ("SEC") or by any state securities authority. CSIA's description of itself in this brochure as a registered investment adviser with the SEC does not imply a certain level of skill or training on the part of CSIA or its representatives.

Additional information about CSIA is also available on the SEC's website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).

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## Advisory Business

Charles Schwab Investment Advisory, Inc. ("CSIA") is a wholly owned subsidiary of The Charles Schwab Corporation ("CSCorp"), a Delaware corporation that is publicly traded and listed on the New York Stock Exchange. CSIA is an affiliate of Charles Schwab & Co., Inc. ("Schwab"). In early 2018, ThomasPartners, Inc. and Windhaven Investment Management, Inc. merged into, and became divisions of, CSIA. In anticipation of this merger, on March 30, 2018, CSIA incorporated the existing Windhaven portfolio management team to manage the assets and assumed fiduciary responsibility for the Windhaven® Strategies formerly managed by this affiliated investment adviser. CSIA has been registered as an investment adviser since November 5, 2009. Windhaven Investment Management, Inc. was founded in 2010 when CSCorp purchased the assets and intellectual property of Windward Investment Management, Inc., which had been registered as an investment adviser since April 2000 (and registered as Windward Capital, Inc. since October 1994). ThomasPartners, Inc. was purchased by CSCorp in December 2012. Prior to this acquisition, ThomasPartners, Inc. traced its roots back to July 1970 under other names, including Shorey-Huntington; during a change in control in 2004, the firm adopted the ThomasPartners name.

This brochure relates to the portfolio management services that Windhaven Investment Management® ("Windhaven"), a division of CSIA, provides for the Windhaven Strategies. CSIA also manages portfolios for several other strategies or programs, including: Schwab Managed Portfolios™ ("SMP"), Schwab Intelligent Portfolios® ("SIP"), and ThomasPartners® Strategies (collectively, "Strategies" or "Programs"). Windhaven utilizes a proprietary process and model to help guide investment decisions and seeks to manage portfolio risk. The investment approach is the result of extensive independent research into the economic, fundamental, and behavioral factors that impact the global capital markets. The strategies are broadly diversified across asset classes. Understanding and modeling risk is a research priority. The Windhaven Portfolio Management Team believes it is important to look at both returns and the risk taken to achieve those returns. Assets in the Windhaven Strategies are primarily invested in exchange-traded funds ("ETFs").

Clients may impose reasonable restrictions on the management of their account(s) subject to approval by CSIA. See the "Investment Discretion" section of this brochure for details on potential investment restrictions.

Clients in the Windhaven Strategies include those with whom CSIA has a direct contractual relationship through our investment advisory agreement ("Direct Clients"), those who have enrolled in asset-based wrap fee and similar programs offered through broker-dealers ("Wrap Fee Programs"), and clients where CSIA acts as a sub-adviser.

The Wrap Fee Programs in which the Windhaven Strategies are made available include the Managed Account Access® and Managed Account Connection® programs ("the Managed Account Programs") sponsored by Schwab. Information relating to CSIA's participation in Wrap Fee Programs is included in the "Other Financial Industry Activities and Affiliations" section of this document. CSIA receives compensation from the program sponsor for the investment management services it provides.

CSIA offers several types of separately managed account strategies and manages \$70,583,747,656 on a discretionary basis as of 12/31/2018. CSIA also manages \$5,224,382 on a non-discretionary basis as of 12/31/2018.

## Fees and Compensation

Pursuant to an agreement between CSIA and Schwab, Schwab pays all costs and expenses incurred by CSIA in connection with Windhaven Strategies offered through the Managed Accounts Programs sponsored by Schwab and other services provided by CSIA to Schwab, plus an additional amount based on a fixed percentage of such costs and expenses. Schwab also provides CSIA with human resources, legal,

compliance, and other administrative and technological support services. The portion of the costs and expenses paid by Schwab for the work done by CSIA may be adjusted from time to time as more or fewer resources are required.

Windhaven, as a division of CSIA, participates as a portfolio manager in the Managed Account Programs offered by Schwab. More specific information about the Managed Account Programs and the fees paid by clients who participate in the program appears in Schwab's Disclosure Brochure for those programs, which is provided to program clients directly by Schwab. CSIA does not enter into agreements directly with Managed Account Program clients and so does not receive direct compensation from or negotiate fees with them.

## Direct Client Fees

For Direct Client accounts managed by Windhaven, CSIA will charge an annual investment management fee ("Fee") on a quarterly basis as follows: 1% of assets on the first \$5 million; 0.85% of assets on the next \$5 million; 0.75% of assets on the next \$15 million; 0.60% of assets on the next \$25 million; and 0.50% of assets on amounts over \$50 million. Unless the Fee is paid directly by the client, the client's custodian will deduct the Fee from the client's account for payment to CSIA.

Exceptions to the fee schedule above are made at CSIA's discretion. Management fees are discounted for Schwab employees. Fees for Wrap Fee Programs or other programs and relationships in which CSIA acts as an adviser or sub-adviser can differ from those above.

Direct Client accounts may be combined for Fee breakpoint purposes as requested by the client and subject to approval by CSIA. Individual Retirement Accounts ("IRAs"), Roth IRAs and Education IRAs, as well as Simplified Employee Pension IRAs ("SEP-IRAs"), Savings Incentive Match Plan for Employees IRAs ("SIMPLE IRAs"), and other personal retirement accounts generally may be aggregated for this purpose. However, other retirement plan accounts subject to the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), may not be combined for fee breakpoint purposes unless they have identical account registrations. The accounts that may be aggregated are subject to negotiation (except ERISA accounts) and must be requested by the client for CSIA's approval.

For those Direct Clients who are not custodied at Schwab, CSIA primarily uses Schwab for pricing when valuing client assets for Fee calculation purposes. If Schwab does not provide a price, then pricing from another custodian will be used. For Direct Clients custodied at Schwab, Schwab is responsible for the valuation and Fee-related calculations.

For Direct Client accounts not custodied at Schwab, CSIA will charge the Fee in arrears, after the end of each quarter, by applying the annual fee to account balances on the last day of the preceding quarter and then dividing by four. In case of cash flows into or out of these accounts which would result in at least a \$100 fee adjustment, the fee will be prorated. For Direct Client accounts custodied at Schwab, Schwab will calculate and charge the Fee in arrears at the end of each quarter by multiplying the daily value of the assets in the account for each calendar day in the quarter by the applicable daily percentage rate and then adding together the fee for each calendar day in the quarter.

If the investment advisory agreement between those Direct Clients not custodied at Schwab and CSIA is terminated, CSIA's compensation will be calculated on a pro-rata basis for the last quarter as provided above using the value of the portfolio assets as of the date of termination.

## Additional Costs

In addition to the Fee described above, clients may incur additional costs, which include fees charged by the client's custodian for account maintenance, and may also include transaction fees, commissions, mark-ups and mark-downs, or brokerage fees ("Brokerage Fee") on the purchase and sale of securities in their accounts. Such costs will be paid directly from clients' accounts to the broker-dealer who completes the purchase or sale. For those clients that have selected Schwab as their custodian, Schwab will waive all of its trading commissions on those accounts managed by CSIA. Please note that Schwab's waiver does not

extend to any other non-Schwab Brokerage Fees. Information relating to CSIA's brokerage practices is included in the "Brokerage Practices" section of this document.

ETFs and mutual funds held in the Windhaven® Strategies are subject to operating expenses and fees as set forth in the prospectuses of the funds. These fees and expenses are paid by the funds but ultimately are borne by clients as fund shareholders, and are in addition to the Fee. Clients pay the operating expense ratio ("OER") of ETFs used in the portfolios, which affects the performance of Windhaven Strategies accounts. CSIA may also provide access to certain ETFs, mutual funds, or classes of funds that a client might normally not be qualified to purchase. If an account leaves, these investments may be liquidated or exchanged for the share class corresponding to the size of the client's individual investment in the fund.

### **Compensation Earned By CSIA Affiliates**

Schwab and its affiliates may receive an investment management fee for managing an affiliated ETF or mutual fund, or other forms of compensation in connection with the operation and/or sale of shares of affiliated or unaffiliated ETFs or mutual funds, or cash to the extent permitted by applicable law. The fee arrangements are available in the applicable fund's prospectus.

If a client's account(s) is custodied at Schwab, cash in the account(s) may be invested in: (1) a money market fund that is managed or distributed by a Schwab affiliate, including funds sponsored by Charles Schwab Investment Management, Inc. ("CSIM"); (2) a sweep vehicle sponsored by Schwab Bank; or (3) a Schwab One® product (collectively, "Schwab Cash Vehicles"). While CSIA does not earn additional compensation from such cash or mutual fund investments, Schwab and its other affiliates do. This presents a conflict of interest. The CSIA Fees will be adjusted relative to the Schwab Cash Vehicle for retirement accounts, including IRAs and accounts subject to ERISA. CSIA reserves the right to change the manner in which it makes accommodations, to the extent permitted by applicable law. More information about Schwab Cash Vehicles may be found in the client's brokerage account agreement(s).

These conflicts of interest are mitigated by the fact that the investment decision-making process employed by the Windhaven Portfolio Management Team is independent of and separate from Schwab, Schwab Bank, and CSIM.

### **Performance-Based Fees and Side-by-Side Management**

CSIA does not receive or charge any performance-based fees.

### **Types of Clients**

Clients of Windhaven Strategies primarily include individuals, trusts, estates, charitable organizations, retirement plans, pension and profit-sharing plans, state or municipal government entities and other corporations, business entities, or investment advisers.

The minimum investment required to open an account in a Windhaven Strategy is at least \$100,000 per account. If the market value of a client account falls below this specified minimum due to withdrawal of assets from the account, clients may be required to deposit additional money or securities to bring the account up to the required minimum, and CSIA reserves the right to discontinue management of the account. Exceptions to this policy are made at CSIA's discretion.

Clients who invest in the Windhaven Strategies through the Managed Account Programs, or for programs sponsored by other brokers ("Broker/Custodian-Related Programs"), or other arrangements by which CSIA acts as sub-adviser to clients' accounts may be subject to a different minimum.

### **Methods of Analysis, Investment Strategies, and Risk of Loss**

The Windhaven Strategies seek capital appreciation over full market cycles while generally maintaining global diversification. Each strategy seeks to achieve its investment objective by obtaining exposure to a wide variety of asset classes, including but not limited to U.S. and international stocks, fixed income securities, real estate, currencies, and hard assets. The Windhaven Strategies primarily use ETFs to gain exposure to desired allocations. Each strategy is dynamically managed, striving to take advantage of global capital market opportunities while focusing on downside risk management by changing allocations in response to the Windhaven Portfolio Management and research teams' views and market conditions.

CSIA receives a broad range of research from a wide variety of sources that includes Schwab-affiliated entities, other brokers, and independent research providers, including issuers and trading partners. CSIA may use written reports prepared by recognized analysts who are specialists in the industry and may use computer-based models to assist in portfolio management. CSIA may also use statistical and other information published by third-party data providers, industry, and government, information gathered at meetings of professionals within the industry, and its own research of investment trends.

To construct the Windhaven Strategies, CSIA employs a proprietary quantitative model combined with macroeconomic research and a disciplined review process to guide investment decisions and manage risk. In selecting ETFs for the strategies, CSIA has implemented a disciplined review process.

CSIA creates diversified portfolios that primarily consist of ETFs in a single account for several Programs, or Portfolios such as Schwab Managed Portfolios™ – ETF, Windhaven Strategies, and Schwab Intelligent Portfolios®. In addition, CSIA also provides portfolio management for ThomasPartners® Strategies, which invests primarily in dividend-paying stocks and fixed income investments. Each Program or Portfolio maintains a cash component which may be invested in Schwab Cash Vehicles, a money market fund, an ETF, or similar cash instruments. The guidelines for asset allocations for each Program or Portfolio differ from the others. There may be times when clients in different Programs or Portfolios are investing in the same ETF; however, each Program or Portfolio has a separate portfolio management team making investing decisions.

### **Risk of Loss**

There are inherent risks to investing in CSIA's Windhaven Strategies, including but not limited to:

#### **Management Risks**

CSIA applies its investment techniques and risk analyses in making investment decisions or recommendations for its clients, but there can be no guarantee that they will produce the desired results. In addition, there is no guarantee that a strategy based on historical information will produce the desired results in the future and, if market dynamics change, the effectiveness of the strategy may be limited. Each strategy runs the risk that investment techniques will fail to produce the desired results. There also can be no assurance that all of the key personnel will continue to be associated with the firm for any length of time.

#### **Investment Risks**

Investments in securities, including ETFs and mutual funds and the securities that they in turn invest in involve various risks, including those summarized below. In addition, each ETF and mutual fund has its own investment style, which may involve risks different from those described below. Clients and prospective clients should be aware that investing in securities involves risk of loss that clients should be prepared to bear.

## Model Risks

The Windhaven® Strategies use quantitative analyses and/or models. Any imperfections, limitations, or inaccuracies in its analyses and/or models could affect its ability to implement strategies. By necessity, these tools make simplifying assumptions that may limit their effectiveness. Models that appear to explain prior market data can fail to predict future market events. Further, the data used in models may be inaccurate and/or it may not include the most current information available.

## ETF General Risks

ETFs in which the strategies may invest involve certain inherent risks generally associated with investments in a portfolio of underlying securities, including the risk that the general level of the underlying security prices may decline, thereby adversely affecting the value of each unit of the ETF. Moreover, an ETF may not fully replicate the performance of its benchmark index because of the temporary unavailability of certain securities in the secondary market or discrepancies between the ETF and the benchmark index with respect to the weighting of securities or the number of securities held. Investing in ETFs carries the risk of capital loss. ETFs are not guaranteed or insured by the FDIC or any other government agency. You can lose money investing in ETFs.

ETFs in which the strategies invest have their own fees and expenses as set forth in the ETF prospectuses. These fees and expenses lower investment returns. Although ETFs themselves are generally classified as equities, the underlying holdings of ETFs can include a variety of asset classes, including but not limited to equities, bonds, foreign currencies, physical commodities, and derivatives. A full disclosure of the specific risks of ETFs is located in the respective prospectus of each fund.

ETFs may have exposure to derivative instruments, such as futures contracts, forward contracts, options, and swaps. There is a risk that a derivative may not perform as expected. The main risk with derivatives is that some types can amplify a gain or loss, potentially earning or losing substantially more money than the actual cost of the derivative; or that the counterparty may fail to honor its contract terms, causing a loss for the ETF. Use of these instruments may also involve certain costs and risks such as liquidity risk, interest rate risk, market risk, credit risk, management risk, and the risk that an ETF could not close out a position when it would be most advantageous to do so.

## Mutual Fund Risks

Mutual fund managers may base investment decisions for funds on historical information. There is no guarantee that a strategy based on historical information will produce the desired results in the future. In addition, if market dynamics change, the effectiveness of that kind of strategy may be limited. Either of these risks may cause the investment strategy of a particular fund to underperform its benchmark or similar funds. Mutual funds in which the strategies invest have their own fees and expenses as set forth in the fund prospectuses. These fees and expenses lower investment returns.

Mutual funds may have exposure to derivative instruments, such as futures contracts, forward contracts, options, and swaps. There is a risk that a derivative may not perform as expected. The main risk of derivatives is that some types of derivatives can amplify a gain or loss, potentially earning or losing substantially more money than the actual cost of the derivative, or that the counterparty may fail to honor its contract terms, causing a loss for the fund. Use of these instruments may also involve certain costs and risks such as liquidity risk, interest rate risk, market risk, credit risk, management risk, and the risk that a fund could not close out a position when it would be most advantageous to do so.

The value of mutual funds can be impacted by the movement of large positions in and out of a particular fund. Clients may collectively account for a large portion of the assets in certain mutual funds. A decision by CSIA to buy or sell some or all of a particular fund where Program/Strategy clients hold a significant portion of that fund may negatively impact the value of that fund.

## Market/Systemic Risks

Equity, fixed income, and other global capital markets rise and fall daily. The performance of client investments is, to varying degrees, tied to these markets. When markets fall, the value of a client's investments will fluctuate, which means a client could lose money.

## Asset Allocation/Strategy/Diversification Risks

Asset allocation decisions may result in more portfolio concentration in a certain asset class or classes, which could reduce overall return if the concentrated assets underperform expectations. The more aggressive the strategy selected, the more likely the portfolio will contain larger weights in riskier asset classes, such as equities. The asset classes in which the strategies seek investment exposure can perform differently from each other at any given time (as well as over the long term), so the strategy will be affected by its allocation among the various asset classes. Depending on market conditions there may be times where diversified strategies perform worse than less diversified strategies.

## Geographic Concentration Risk

Portfolios concentrated in any one geographic region can be more susceptible to that region's political and economic risk. For example, a portfolio that is concentrated in the United States will be more susceptible to the United States' political and economic risk, as compared to a more globally diversified portfolio.

## Trading/Liquidity Risks

A particular investment may be difficult to purchase or sell or may become difficult to sell after being purchased for a client account. CSIA may be unable to sell securities on behalf of a client at an advantageous time and/or price due to then-existing trading market conditions.

## Large Investment Risks

Clients may collectively account for a large portion of the assets in certain ETFs or mutual funds. A decision by CSIA to buy or sell some or all of a particular ETF or mutual fund where clients hold a significant portion of such may negatively impact the value of that security.

## Counterparty Risks

There may be a risk of an executing broker failing to deliver securities, especially due to the large volume of step-out transactions for the Windhaven and ThomasPartners® Strategies. This may result in a loss to the client. CSIA will attempt to mitigate trading counterparty risk through its broker selection program included in "Brokerage Practices."

ETFs may have some "product" or "structural" risk associated with underlying derivatives, as they will sometimes provide market exposure through indirect means, like futures, options, and forward contracts.

## Custodian Risks

Schwab, or the custodian chosen by the client, is a Securities Investor Protection Corporation ("SIPC") member brokerage firm and maintains SIPC protection. SIPC offers protection of up to \$500,000, including a \$250,000 limit for cash, if a member brokerage firm fails. SIPC covers most securities such as stocks, bonds, ETFs, and mutual funds, but does not protect against market loss.

## Tax Risks

Windhaven Strategies are not designed to address specific tax objectives. Ongoing investment income, capital gains, capital losses, and miscellaneous deductions for some ETFs, including, but not limited to, certain commodity and currency ETFs, are reported annually on the Schedule K-1, and when certain commodity ETFs are sold in a taxable account, proceeds will be reported on Form 1099-B. For those limited ETFs (e.g., commodity and currency), the Schedule K-1 is mailed separately to clients each year and needs to be included in the clients' income tax return. In cases where the entity generating the Schedule K-1 files for a tax extension beyond April 15, clients may receive their Schedule K-1 after the due date for their income tax return. Individual taxpayers who do not request a filing extension may need to file an amended federal and/or state tax return if they receive their Schedule

K-1 after filing their original return. Also, gains and losses associated with some commodities may be taxed differently than standard short-term and long-term capital gains and losses. Clients should consult a professional tax advisor for help with their unique situations.

## **Underlying Securities Risk**

### **Equity-Related Risks**

#### **General Risks**

The prices of equity securities, including the value of ETFs or mutual funds that invest in them, will rise and fall. These price movements may result from factors affecting individual companies, industries, or the securities market as a whole. Individual companies may report poor results or be negatively affected by industry and/or economic trends and developments. The prices of securities issued by such companies may suffer a decline in response. In addition, the equity market tends to move in cycles, which may cause stock prices to fall over short or extended periods of time.

#### **Large- and Mid-Cap Risks**

Large- and/or mid-cap U.S. stocks, along with mutual funds and ETFs that focus on large- and/or mid-cap segments of the U.S. stock market, bear the risk that they tend to go in and out of favor based on market and economic conditions. However, stocks of mid-cap companies tend to be more volatile than those of large-cap companies because mid-cap companies tend to be more susceptible to adverse business or economic events than larger, more established companies. During a period when large- and/or mid-cap U.S. stocks fall behind other types of investments—bonds or small-cap stocks, for instance—the performance of the portion of the investment strategies invested in large- and/or mid-cap stocks may lag the performance of these other investments.

#### **Small-Cap and International Risks**

Historically, small-cap and international stocks have been riskier than large- and mid-cap U.S. stocks (also see “Foreign Investment–Related Risks” section below for additional information). During a period when small-cap and/or international stocks fall behind other types of investments—large- and mid-cap U.S. stocks, for instance—the performance of the portion of the investment strategies invested in small-cap or international stocks may lag the performance of these other investments.

### **Fixed Income–Related Risks**

#### **General Risks**

Bond markets rise and fall daily, and fixed income investments, which generally also include instruments with variable or floating rates (including cash and cash-like investments), are subject to various risks. As with any investment whose performance is tied to bond markets, the value of a fixed income investment, ETF, or mutual fund will fluctuate, which means that the client could lose money.

#### **Interest Rate Risks**

When interest rates rise, bond prices usually fall, and with them the value of an ETF or mutual fund holding the bonds. A decline in interest rates generally causes bond prices to rise, and with them potentially the value of a bond fund or ETF, but could also hurt the performance of an ETF or mutual fund by lowering its yield (which could increase reinvestment risk). The longer the duration of the investments held by an ETF or mutual fund, the more sensitive to interest rate movements its value is likely to be.

#### **Credit Risks**

A decline in the credit quality of a fixed income investment, whether real or perceived, could cause the value of a fixed income security, ETF, or mutual fund to fall. The security, ETF, or mutual fund could lose value if the issuer or guarantor of an investment fails to make timely principal or interest payments or otherwise honor its obligations. The emphasis of a fixed income strategy on relatively higher credit quality and

preservation of capital also could cause a security, ETF, or mutual fund to underperform certain other types of bond investments, particularly those that take greater maturity and credit risks.

#### **High Yield Risks**

Investments in ETFs or mutual funds that hold high yield securities and unrated securities of similar credit quality (sometimes called junk bonds) are subject to greater levels of credit and liquidity risks. High yield securities and the ETFs or mutual funds that invest in them may be considered speculative.

#### **Government Securities Risks**

Many U.S. government securities are not backed by the full faith and credit of the United States government, which means they are neither issued nor guaranteed by the U.S. Treasury. Certain issuers of securities, such as the Federal Home Loan Banks (“FHLB”), maintain limited lines of credit with the U.S. Treasury. Securities issued by other issuers, such as the Federal Farm Credit Banks Funding Corporation (“FFCB”), are supported solely by the credit of the issuer. There can be no assurance that the U.S. government will provide financial support to securities of its agencies and instrumentalities if it is not obligated to do so under law.

#### **Bank Loans**

Investments in ETFs or mutual funds that hold bank loans are typically below investment grade credit quality and may be subject to more credit risk, including the risk of nonpayment of principal or interest. Most bank loans are floating rate, whose interest rates are tied to LIBOR or another short-term reference rate, so substantial increases in interest rates may make it more difficult for issuers to service their debt and cause an increase in loan defaults. Bank loans are typically secured by collateral posted by the issuer, or guarantees of its affiliates, the value of which may decline and be insufficient to cover repayment of the loan. Many loans are relatively illiquid or are subject to restrictions on resales, have delayed settlement periods, and may be difficult to value, which could have an adverse impact on the ability of the ETF or mutual fund to sell loans at an advantageous time and/or price. Loans are also subject to maturity extension risk and prepayment risk.

#### **State and Regional Risks**

To the extent that a security, ETF, or mutual fund invests in securities from a given state or geographic region, its value and performance could be affected by local, state, and regional factors, including erosion of the tax base and changes in the economic climate. National governmental actions, such as the elimination of tax-exempt status, also could affect performance. In addition, an ETF or mutual fund may be more sensitive to adverse economic, business, or political developments if a substantial portion of it is invested in municipal securities that are financing similar projects.

#### **Foreign Risks**

Investments in ETFs or mutual funds that hold securities of foreign issuers or securities with credit or liquidity enhancements provided by foreign entities may involve certain risks such as adverse changes in foreign economic, political, regulatory, and other conditions; differing accounting, auditing, financial reporting, and legal standards and practices; differing securities market structures; and higher transaction costs. In addition, sovereign risk, or the risk that a government may become unwilling or unable to meet its loan obligations or guarantees, could increase the credit risk of financial institutions connected to that particular country.

### **Foreign Investment–Related Risks**

#### **General Risks**

Investments in securities of foreign issuers or ETFs or mutual funds that hold securities of foreign issuers may involve certain risks that are greater than those associated with investments in securities of U.S. issuers. These include risks of adverse changes in foreign economic, political, regulatory, and other conditions; changes in currency exchange

rates or exchange control regulations (including limitations on currency movements and exchanges); differing accounting, auditing, financial reporting, foreign taxes, and legal standards and practices; differing securities market structures; differing trading and settlement practices; ownership restrictions; and higher transaction costs.

### **Emerging Markets Risks**

These and other risks (e.g., nationalization, expropriation, or other confiscation of assets of foreign issuers) are greater for those securities, ETFs, or mutual funds investing in companies tied economically to emerging countries, the economies of which tend to be more volatile than the economies of developed countries.

### **Frontier Markets Risks**

The risks associated with investing in securities, ETFs, or mutual funds that hold foreign or emerging markets generally are magnified in frontier markets, also known as “next emerging” markets. Some frontier markets may operate in politically unstable regions of the world and may be subject to additional geopolitical/disruption-of-markets risks.

### **Geopolitical/Disruption-of-Markets Risks**

Geopolitical events may adversely affect global economies and markets and thereby decrease the value of and/or the ease of trading those securities, ETFs, or mutual funds invested in those affected markets. Those events as well as other changes in foreign and domestic economic and political conditions could adversely affect the value of the strategy’s investments.

### **Currency Risks**

Fluctuations in exchange rates may adversely affect the value of ETFs or mutual funds that hold foreign currency holdings and investments denominated in foreign currencies.

### **Risks Related to Other Asset Classes**

#### **Commodities Risks**

Commodities involve unique risks that may be distinct from those that affect stocks and bonds, including but not limited to worldwide supply and demand factors, weather conditions, currency movements, and international government policies regarding commodity reserves and choice of currency for commodity pricing. Commodities investments may also involve unique risks inherent to investing in derivatives which may include basis, roll, liquidity, and regulatory risks. A detailed explanation of the risks is available in the prospectus of the respective commodity fund. Commodity pools may be subject to different regulatory requirements than traditional funds governed by the Investment Company Act of 1940.

#### **Hard Assets Risks**

The production and distribution of hard assets, such as precious metals, oil and gas, real estate, and/or agricultural commodities may be affected by geopolitical and environmental factors and are cyclical in nature. During periods of economic or financial instability, hard asset securities and other instruments may be subject to broad price fluctuations, reflecting volatility of energy and basic materials prices and possible instability of supply of various hard assets. Hard asset securities, hard asset companies, and other instruments may also experience greater price fluctuations than the relevant hard asset. Therefore, the return on hard asset securities may deviate from that of the hard asset itself.

#### **Real Estate Risks**

Real estate-related investments (and the ETFs or mutual funds that hold them) may be adversely affected by factors affecting the real estate industry, which may include changes in interest rates and social and economic trends. Real Estate Investment Trusts (“REITs”) may also

be subject to the risk of fluctuations in income from underlying real estate assets, poor performance by the REIT’s manager, prepayments and defaults by borrowers, adverse changes in tax laws, and, with respect to U.S. REITs, their failure to qualify for the special tax treatment granted to REITs under the Internal Revenue Code of 1986 and/or to maintain exempt status under the Investment Company Act of 1940.

### **Limitations of Disclosure**

The foregoing list of risks does not purport to be a complete enumeration or explanation of the risks involved in Windhaven Strategies. As the strategies develop and change over time, clients and investors may be subject to additional and different risk factors. No assurance can be made that profits will be achieved or that substantial losses will not be incurred.

### **Disciplinary Information**

CSIA (including historically Windhaven Investment Management, Inc. and ThomasPartners, Inc.) and its (their) employees have not been involved in any legal or disciplinary events in the past 10 years that would be material to a client’s evaluation of the company or its personnel.

### **Other Financial Industry Activities and Affiliations**

As a wholly owned subsidiary of CSCorp, CSIA leverages the resources of CSCorp and Schwab, such as personnel, including but not limited to its Chief Compliance Officer (“CCO”), Chief Legal Officer, legal and compliance support, sales, marketing, technology, operations, finance, human resources, and risk management personnel. These relationships or arrangements may create the potential for conflicts of interest to arise. These potential conflicts of interest are governed by various policies adopted by CSIA. For example, CSIA has adopted policies and procedures reasonably designed to protect against the misuse of information (and mitigate potential conflicts of interest) whether amongst Schwab-affiliated entities or entities or individuals outside of Schwab. Other wholly owned subsidiaries of CSCorp are engaged in investment advisory, brokerage, trust, custody, or banking services.

CSIM provides advisory and administrative services to certain proprietary mutual funds and ETFs marketed under the Schwab Funds®, Schwab ETFs™ names and under the Laudus® name, which may be recommended to clients. If a client’s account is custodied at Schwab, money market funds for which CSIM receives investment advisory fees may be used in client accounts. For more information about CSIM fund expenses, investment management, and sweep features associated with a client’s money market fund, please review the prospectus, which can be found at [schwab.com/prospectus](http://schwab.com/prospectus).

CSIA serves as an investment manager on the Windhaven® Strategies available in the Managed Account Programs sponsored by Schwab and other programs sponsored by other firms. The Schwab Managed Account Programs include, but are not limited to, the following Schwab wrap fee programs: (i) Charles Schwab & Co., Inc. – Managed Account Access® and (ii) Charles Schwab & Co., Inc. – Managed Account Connection®. CSIA receives from the program sponsor a fee for the investment management services it provides for the Windhaven Strategies. Each program sponsor has prepared a brochure which contains detailed information about its Wrap Fee Program, including the wrap fee charged. Copies of each brochure are available from the program sponsor upon request.

Schwab effects securities transactions for clients in the Windhaven Strategies on an agency basis. Windhaven Strategy Wrap Fee Program clients should note that over time only a small portion of transactions, specifically Maintenance Trades discussed below, are executed for their accounts through the program sponsor. Information related to Maintenance Trades, step-out trades, transactions, and other costs that are in addition to a client’s “wrap” fee is included in the “Brokerage Practices” section of this document.

## **Code of Ethics, Participation or Interest in Client Transactions, and Personal Trading**

CSIA has adopted a written Code of Ethics (the “Code”) pursuant to Rule 204A-1 under the Investment Advisers Act of 1940 (“Advisers Act”). The Code reflects the fiduciary duty CSIA owes to its clients to avoid activities, interests, and relationships that run contrary to the best interests of CSIA’s clients. All Access Persons (employees and other individuals deemed appropriate by the CCO) are required to place clients’ interests ahead of their own, engage in personal investing that is in compliance with the Code, and avoid taking advantage of CSIA’s position as Adviser. Access Persons are prohibited from using information for personal profit or the profit of others and from disclosing non-public information to anyone except certain designated employees of CSIA and Schwab.

The Code places restrictions on Access Persons making personal investments in securities traded on behalf of clients, in initial public offerings, and in private placements. Access Persons may not engage in deceptive conduct in connection with the purchase or sale of securities for client accounts and are required to: (1) pre-clear certain personal securities transactions; (2) report certain personal securities transactions on a quarterly basis; and (3) provide a detailed summary of certain holdings (both initially and annually) that the Access Person has a direct or indirect beneficial interest in. The Code and its requirements are subject to change as necessary to remain current with regulatory requirements and internal business policies and procedures. A copy of CSIA’s Code is available upon request by calling the number located on the front of this brochure.

### **Participation or Interest in Client Transactions**

CSIA has a conflict of interest in selecting Schwab ETFs™ and mutual funds for other Strategies or Programs, which pay compensation to CSIM. CSIA also has a conflict of interest because it selects ETFs and mutual funds that it holds in other client accounts CSIA manages in other Schwab programs. Other affiliates of CSIA, as well as other divisions within CSIA, may buy or sell the same securities for client accounts. These are all inherent conflicts of interest within and among CSIA, Schwab, and its affiliates. CSIA mitigates these conflicts of interest through its policies and procedures and by the fact that the investment decision-making processes of CSIA portfolio management teams, including those of its Windhaven® and ThomasPartners® divisions, are separate and independent from each other and from Schwab and its other affiliated portfolio managers.

### **Brokerage Practices**

For the Windhaven Strategies, CSIA’s principal objective in executing client trades is to obtain best execution and to aggregate and allocate trades to achieve fair and equitable treatment of its clients. CSIA has adopted policies and procedures that are designed so that the trading practices do not unfairly or systematically favor one client or group of clients or strategies over another and that, over time, accounts are treated equitably.

### **Selection of Brokers and Best Execution**

For the Windhaven division, CSIA seeks to obtain the best execution for clients’ portfolio transactions and will evaluate the quality and cost of services received from broker-dealers/custodians on a periodic and systematic basis. Factors evaluated include execution price, Brokerage Fees, promptness and reliability of execution, accuracy of trades, ability to place trades in difficult markets, ability to source liquidity, and confidentiality. In seeking to meet its best execution goal, CSIA considers whether the transaction represents the best qualitative and quantitative execution, which may not be solely determined by the lowest brokerage fee available. Brokerage Fees are generally considered to be transaction fees, commissions, or mark-ups and mark-downs on the purchase and sale of securities. CSIA does not consider the receipt of client referrals when selecting or evaluating broker-dealers used for client transactions.

### **Soft Dollars**

CSIA does not participate in or actively seek out soft dollar arrangements. Due to its affiliation with Schwab, or participation in certain other Broker/Custodian-Related Programs, and/or other brokers with whom CSIA may trade, CSIA may receive certain benefits that it would not otherwise receive if it did not have an established relationship with these companies. These benefits can include trading, custody, reporting, research, technology, software, and related services that assist the firm in managing and administering client accounts. CSIA is not obligated to direct client transactions to broker-dealers that provide research information.

### **Trading Process**

Trade orders for different strategies (e.g., SMP, SIP, Windhaven Strategies, and ThomasPartners Strategies) are generated by different portfolio management teams, may be on different systems, and may utilize one or more trading strategies (e.g., price at the time of order arrival, market closing price, volume weighted average price over some specified period). Certain trading strategies place relatively greater emphasis on timing, others on speed of execution, while others place greater emphasis on reducing market impact cost. As a result, the speed of trade order fulfillment and the prices achieved for the same security may vary in different programs or strategies. Certain strategies, which may include accounts in programs with different fee structures, may trade in advance of other strategies or may be completed more quickly, and, as a result, may achieve different execution on the same or similar securities. In addition, market, regulatory, and/or country limitations (especially in the case of emerging markets) may contribute to differences in security prices.

For the Windhaven Strategies, CSIA typically performs maintenance trades and strategy trades. Maintenance trades reflect individual activity in a client account such as initial contributions, additional account contributions, or raising cash for withdrawal (“Maintenance Trades”). Strategy trades impact nearly all client accounts within a strategy and are directed by the Windhaven Portfolio Management Team (“Strategy Trades”).

### **Trade Aggregation**

CSIA will not aggregate trades unless it believes that aggregation is consistent with its duty to seek best execution for affected clients in the aggregate and consistent with the terms of the client’s investment advisory agreement.

For Windhaven Strategy accounts, most Maintenance Trades are aggregated as part of one or more blocks. CSIA may aggregate securities sales or purchases across investment strategies, including Windhaven, ThomasPartners, SMP, or SIP. CSIA may decide to either send the blocks to the client’s custodian for execution or step-out the block to an executing broker as described further below. The method of execution for Maintenance Trades will depend on a variety of factors and will be at the discretion of the CSIA Trading Team in seeking best execution. Nearly all Strategy Trades are aggregated as part of a block and sent to an executing broker-dealer that accommodates step-out trading. If trades are not aggregated, clients may pay prices for the transactions that are different from what they may have paid had the trades been aggregated. When aggregating, CSIA may, consistent with its policies and procedures and fiduciary duties, include proprietary and/or employee accounts in an aggregated order. CSIA may exclude from aggregation those client accounts that have relevant restrictions or client activity (e.g., pending withdrawals). In addition, certain securities in client accounts may at times be executed through aggregation, but may not be aggregated at CSIA’s discretion (e.g., individual bonds).

### **“Step-Out” Trades**

For the Windhaven Strategies, CSIA places a significant amount of trades with selected broker-dealers other than the program sponsor or client selected broker-dealer/custodians to the extent that a “step-out”

trade will, in our opinion, achieve best execution in aggregate over time. This includes both Maintenance Trades and Strategy Trades. Certain program sponsors and directed brokers may have restrictions on accommodating step-out trades which affect execution quality.

### **Program Fees**

For Wrap Fee Program and Broker/Custodial Program clients, the fee does not cover Brokerage Fees charged by the step-out brokers, which are fees that are in addition to their wrap fees. This is because clients participating in Wrap Fee Programs pay a single, all-inclusive fee to cover any Brokerage Fees on trades executed by the sponsor, but does not cover Brokerage Fees charged by other broker-dealers. For step-out trades, Brokerage Fees are included in the price of the security and may not be shown separately on a confirmation or statement. The wrap fee or all-inclusive fee described above will not be reduced or offset by these Brokerage Fees. Instead, any additional Brokerage Fees will reduce the overall return of a Wrap Program Client's account.

Regardless of the embedded Brokerage Fees, it is the responsibility of CSIA to determine whether the program sponsor or the step-out broker can provide best overall execution of any given trade. In addition, Schwab receives remuneration such as liquidity or order flow rebates from a market or firm to which some orders are routed, but its trading practices are designed to achieve best execution.

### **Trade Rotation**

CSIA has a trade rotation process for Maintenance Trades that it uses among client accounts within a single program or across programs (e.g., within or across the SMP Program, the SIP Program, Windhaven® Strategies, or ThomasPartners® Strategies) to prevent any client from being systematically disadvantaged. For Strategy Trades, if more than one program (e.g., the SMP Program and the Windhaven Strategies) wants to trade securities in the same direction that are similar or the same, the CSIA Trading Team will conduct an analysis and then escalate the findings for further instructions on how to proceed with the trades. Trades done on the same day or on different days are not guaranteed to receive the same trading price. CSIA will review its rotation procedures at least annually to confirm that they are adequate to prevent any client from being systematically disadvantaged.

### **Trade Allocation**

Trade allocation procedures are designed to provide that trade allocations are timely, that no set of trade allocations is accomplished to the unfair advantage of one client or group of clients over another, and that over time client accounts are treated equitably, even though a specific trade may have the effect of benefiting one account or group of accounts over another when viewed in isolation.

Trading orders that can be only partially filled are generally allocated on a pro rata basis, or allocated on some other basis consistent with the goal of giving all clients equitable opportunities over time. CSIA may elect to execute trades in a single aggregated trade over multiple days due to volume, liquidity, or other factors. This could include an aggregated trade that is executed over multiple days, where at the end of each day, whatever portion of the trade has been executed is allocated to client accounts, or it could include an aggregated trade that is executed over multiple days, where the full order is held and not allocated to client accounts until fully executed on the final day. Client accounts will receive the average price for those aggregated trades allocated to their account(s), whether at the end of each day of the trade or when the trade is fully completed. There may be some variations in allocations based on account size and security price due to full share allocation methodology. In some cases, the CSIA Trading Team may execute a trade order at the same time it is executing a different trade order for the same security, with the same or a different broker, to meet account or strategy-specific requirements, in which case the two trades may be treated as distinct trades and may not be subject to pro rata allocation.

When opportunities are limited (collectively, "limited opportunities"), CSIA will generally consider the needs of clients across programs. When

it is not practicable to allocate an opportunity across all eligible accounts, CSIA uses various methods, to give all accounts using the same trading strategy equitable opportunities for allocation over time. This may result in a limited opportunity being allocated to only some of the eligible accounts.

### **Schwab Affiliation**

Schwab, an affiliate of CSIA, is a registered broker-dealer that effects securities transactions for its brokerage customers. Schwab may act as a broker-dealer in transactions in a client's account. For the Windhaven Strategies, whether or not a client has selected Schwab as custodian, CSIA may execute some or all portfolio transactions through Schwab and/or Schwab's designated market makers (together, the "Affiliated Firm") when feasible and to the extent consistent with best execution practices. Although the Affiliated Firm will not charge Brokerage Fees in connection with transactions in a client's account custodied with the Affiliated Firm, there may be other costs or expenses associated with the use of the Affiliated Firm. This may create a potential conflict of interest, because Schwab may have referred the client to CSIA for the Windhaven Strategies; because Schwab is an affiliate of CSIA; and because of the arrangements Schwab has with its designated market makers.

### **Trade Errors**

CSIA maintains policies and procedures that address the identification and correction of errors. On those occasions when such an error does occur, CSIA will use reasonable efforts to identify and resolve errors as promptly as possible. CSIA will address and resolve errors on a case-by-case basis, in its discretion, based on the facts and circumstances. CSIA is not obligated to follow any single method of resolving errors but will seek to treat all clients fairly in the resolution of trade errors.

### **Review of Accounts**

Direct Client accounts are typically reviewed on at least an annual basis. The reviews are performed by Relationship Managers and/or Client Service team members and generally focus on the client's personal financial situation, liquidity needs, and comfort with risk level; a review of account restrictions; an overview of the client's current portfolio; and any questions the client may have on their accounts and strategies. For clients who do not sign a CSIA investment advisory agreement for the Windhaven Strategies, account reviews would typically be performed by personnel of the sub-adviser or Wrap Fee Program sponsor. Reviews of accounts custodied at Schwab may be assisted by Schwab personnel.

Direct Clients generally receive quarterly written reports, which include the client's investment positions and performance of their Windhaven Strategies account(s), and quarterly newsletter.

### **Client Referrals and Other Compensation**

CSIA may recommend that Windhaven Strategies clients establish brokerage accounts with Schwab, an affiliate registered broker-dealer, to maintain custody of clients' assets and to effect trades for their accounts. Schwab provides CSIA, its affiliate, with access to its institutional trading and operations services, which are typically not available to Schwab clients. Schwab's services include research, brokerage, custody, and access to mutual funds and other investments that are otherwise available only to institutional investors or would require a significantly higher minimum initial investment. Schwab also makes available to CSIA other products and services that benefit CSIA but may not benefit clients' accounts. Some of these other products and services assist CSIA in managing and administering clients' accounts. These include software and other technology that provide access to client account data (such as trade confirmations and account statements); facilitate trade execution (and allocation of aggregated trade orders for multiple client accounts); provide research, pricing information, and other market data; facilitate payment of CSIA's Fees from its

clients' accounts; and assist with back-office support, recordkeeping, and client reporting. Many of these services generally may be used to service all or a substantial number of Windhaven® Strategies client accounts, including accounts not maintained at Schwab. Schwab may also provide CSIA with other services intended to help CSIA manage and further develop its business. These services may include consulting, publications and presentations on practice management, information technology, business succession, regulatory compliance, and marketing. In addition, Schwab may make available, arrange, and/or pay for these types of services to CSIA by independent third parties. Schwab may discount or waive fees it would otherwise charge for some of these services or pay all or a part of the fees of a third party providing these services to CSIA.

### Other Broker/Custodian-Related Programs

For the ThomasPartners® Strategies, CSIA participates in a number of Broker/Custodian-Related Programs sponsored by unaffiliated firms. These Broker/Custodian-Related Programs and their affiliates provide CSIA with certain economic benefits and access to products and services not typically available to retail clients as a result of CSIA's participation in their programs. Some of the products and services made available by these custodians through their program benefit program clients; some products and services may benefit CSIA but not the clients. These products or services may assist CSIA in managing and administering client accounts, including accounts not maintained at the custodian. As part of its fiduciary duties to clients, CSIA strives at all times to put the interests of its clients first.

### Client Referrals from Solicitors

CSIA may contract with its independent solicitors and affiliate, Schwab (and/or Schwab affiliates), to obtain new Windhaven Strategies clients. There is currently one arrangement where a terminated solicitor is paid an ongoing fee for client referrals. No new clients can be referred under this terminated solicitation arrangement. Client fees are generally not higher than our standard Windhaven Strategies fees because of payments to a solicitor.

### Custody

For those clients that have selected Schwab as custodian for their Windhaven Strategy account, Schwab, on at least a quarterly basis, will send client account statements detailing account positions and activities during the preceding period.

A portion of client accounts invested in the Windhaven Strategies are held in custody by unaffiliated broker-dealers or banks. These unaffiliated broker-dealers or banks will also send client account statements on at least a quarterly basis.

Clients should carefully review these statements, and should compare these statements to any account information provided by CSIA, as the information provided in our quarterly reports for Direct Clients invested in a Windhaven Strategy may vary based on accounting procedures, reporting dates, or valuation methodologies.

Clients may elect to custody their accounts at any custodian of their choosing, subject to the acceptance of CSIA. However, the selection of a custodian may or may not put a client at a disadvantage for getting best execution for their trades.

### Investment Discretion

When clients choose the Windhaven Strategies, they sign the custodian's applicable new account paperwork giving CSIA authorization to make trades in their account. This investment management discretion is limited to the purchase and sale of securities and investment of cash, and does not include discretion for distributions of cash or securities (except for limited grants of authority to facilitate withdrawal of money and direct payments to third parties according to clients' instructions). Clients may impose reasonable restrictions on the management of their account.

Investments will not exceed the client's funds in the account and a margin balance will not be maintained, unless allowed by CSIA.

### Voting Client Securities

CSIA has adopted written proxy voting policies and procedures (the "Policy"). For proxies voted by CSIA on behalf of each client who delegates voting authority to CSIA ("Delegating Clients"), procedures may be changed as necessary to comply with regulatory requirements and internal policies and procedures and are designed to maximize the economic benefit to Delegating Clients. CSIA has retained a third-party vendor to manage this process and to vote the proxies. CSIA reviews the vendor's voting guidelines no less than annually to determine consistency in the Policy and with CSIA's fiduciary duty to Delegating Clients.

For proxy issues deemed by Windhaven portfolio management to raise significant concerns and which relate to those securities that are managed through the Windhaven Strategies, CSIA reviews the analysis and recommendation of the vendor. Examples of factors that could cause a matter to raise significant concerns include, but are not limited to: issues whose outcome have the potential to materially affect the issuer (ETF/fund) or issuer's sponsor/index provider, and matters which involve broad public policy developments which may materially affect the issuer (ETF/fund). After evaluating all such recommendations, CSIA decides how to vote the shares and will instruct the vendor to vote consistent with its decisions.

To address any potential conflicts of interest, CSIA votes proxies of affiliated mutual funds, ETFs, and Schwab stock in the same proportion as the vote of all other shareholders of the mutual fund, ETF, or stock (i.e., "echo vote"), unless otherwise required by law. When required by law, CSIA also "echo votes" proxies of unaffiliated mutual funds, ETFs or stock.

Windhaven Strategies clients can obtain a copy of the Policy and information about how CSIA has voted their securities in a particular proxy vote by calling (415) 667-1910. The information will be provided at no charge.

Delegating clients may not direct voting in a particular solicitation. Clients wishing to retain the ability to vote proxies must submit a separate form to their custodian.

### Financial Information

CSIA does not require prepayment of fees, and therefore is not required to provide a balance sheet for its most recent fiscal year. CSIA (and historically also Windhaven Investment Management, Inc. and ThomasPartners, Inc.) has never filed for bankruptcy and is not aware of any financial condition that is expected to affect its ability to manage client accounts.





**March 28, 2019**

# **Summary of Material Changes to the Charles Schwab Investment Advisory, Inc. Windhaven® Strategies Disclosure Brochure (Form ADV Part 2A) Since March 30, 2018**

There have been no material changes to the CSIA Windhaven Strategies Disclosure Brochure since March 30, 2018.