

2021 Third Quarter Schwab Equity Ratings® (SER) Performance Commentary
Volatile quarter ends with U.S. stocks clinging to small gains

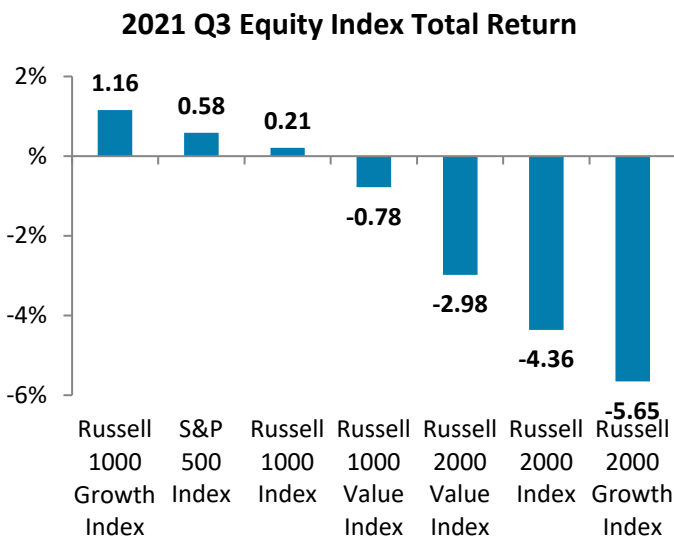
By Adam Lynch, Sr. Quantitative Analyst

MARKET ENVIRONMENT

U.S. equity markets started the third quarter well after this summer’s strong earnings season. However, growth and inflation concerns crept into the picture in September when the Fed stated that QE tapering will be announced at the November meeting and will finish in mid-2022.¹ This news resulted in a September sell-off that left the S&P 500 up just over 50 bps for the quarter.

In economic news, revised GDP growth and increased inflation dominated the headlines. Real GDP growth was revised downward from 7% to 5.9%, while inflation increased to 4.2% (a 30-year high) from the Fed’s previous estimate of 3.4%.² The unemployment rate dropped to 5.2%, a pandemic-era low, and consumer spending ticked up as potential supply chain concerns entered into the discussion.³

The chart below summarizes how all of this activity played out in U.S. equity index returns for the quarter:



Source: Schwab Center for Financial Research. Past performance is no guarantee of future results.

In terms of investment style, growth stocks once again outperformed, at least in large cap. This can be seen by

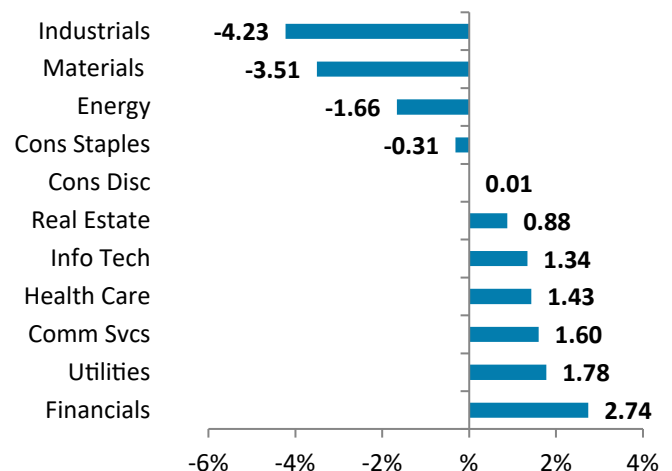
comparing the returns of the Russell 1000 Growth Index to the Russell 1000 Value Index.

Large cap stocks as a whole did much better than their small cap peers for the second quarter in a row. Last quarter the Russell 1000 outperformed the Russell 2000 by 4.25%. This quarter’s spread was even wider at 4.57%. Much like the past couple of years, the best stocks to hold tended to be those defined as large cap growth.

During quarters with increased volatility and major economic news we often observe interesting sector level data. Last quarter was no exception. The financial sector did the best, as most of these firms will benefit from rising interest rates. Industrial stocks were down the most as companies like FedEx and UPS gave back some of the gains they’ve made off of increased demand for order delivery due to the pandemic.

This chart helps summarize the S&P 500 sector performance for Q3 2021:

2021 Q3 S&P 500 Sector Total Return



Source: Schwab Center for Financial Research. Past performance is no guarantee of future results.

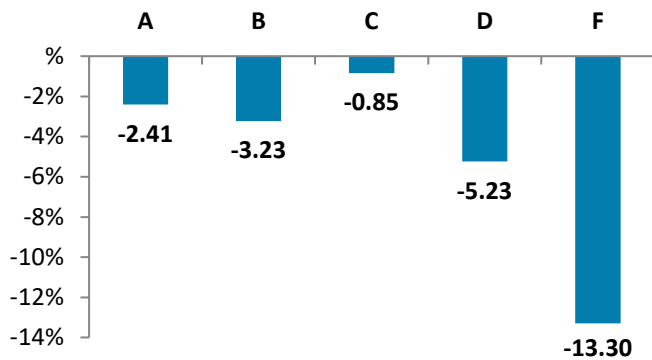
SCHWAB EQUITY RATINGS PERFORMANCE

In general, the Schwab Equity Ratings model performed well during what was mostly a flat to down market for

most equity indices.

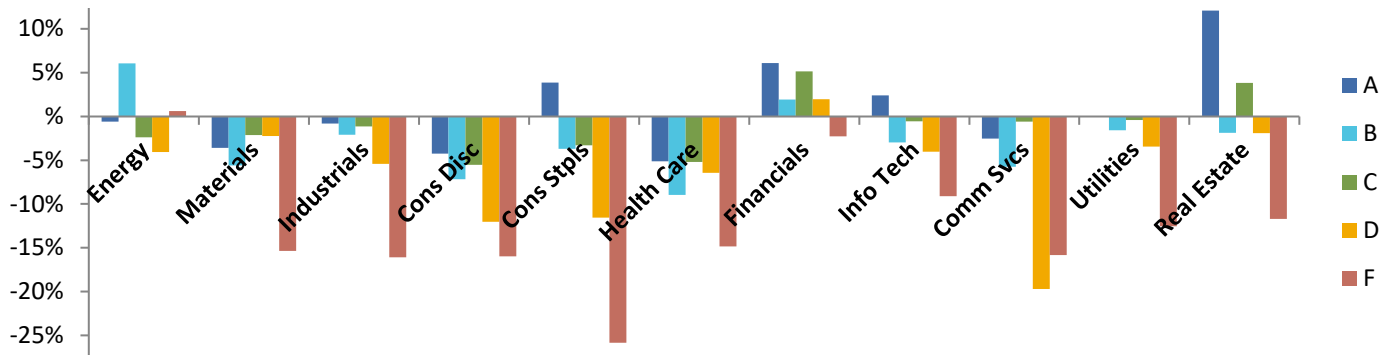
To calculate quarterly SER performance we use the cohorts formed on 6/30/2021 and track their performance through 9/30/2021. This chart summarizes each cohort's performance during the quarter:

2021 Q3 Schwab Equity Rating (SER) Total Return



Source: Schwab Center for Financial Research

While each cohort experienced negative returns this quarter, the stocks with a general advice guidance of “buy” (A or B-rated SER) outperformed those with a guidance of “sell” (D or F-rated SER). The “buy rated” stocks averaged -2.82% while the “sell rated” stocks were down -9.27%, leading to a spread of 6.45%.



Source: Schwab Center for Financial Research

The chart below illustrates how the SER model performed within each of the economic sectors. A-rated stocks performed best in groups like Consumer Staples, Financials, and Real Estate.

F-rated stocks were down in every sector but Energy this quarter with the hardest hit group being F-rated Consumer Staples stocks, down more than -25%.

Since inception in May 2002, Schwab Equity Rating performance has been noteworthy. On average, A-rated stocks have outperformed Bs, Bs have outperformed Cs, Cs have outperformed Ds, and Ds have outperformed Fs on a 52-week buy-and-hold basis.

Analyzing SER performance since inception through September, 2021, A-rated stocks are up 17.32% annually while F-rated stocks are up only 8.76%. Compared to the average rated stock, A-rated stocks have outperformed them by 2.77% annually. Over the same time period, F-rated stocks have lagged the average rated stock by a margin of -5.79% annually, reinforcing the Ratings' usefulness as a sell discipline.⁴

While past performance doesn't ensure future results and performance will inevitably vary over shorter evaluation periods, Schwab Equity Ratings' long-term track record suggests that they can be a useful tool for helping investors and traders decide which stocks to buy and which to sell/avoid.⁵

1. “Quarterly Markets Review - Q3 2021”. schroders.com. Schroders Global Asset Management. October 2021. Web. 11 November 2021.
2. “Quarterly Markets Review - Q3 2021”. schroders.com. Schroders Global Asset Management. October 2021. Web. 11 November 2021.
3. “World Markets Review - 3rd Quarter 2021”. capitalgroup.com. Capital Group. October 2021. Web. 11 November 2021.
4. For calculation methodology and model details please see the Schwab Equity Ratings Performance page on www.schwab.com.
5. Schwab Equity Ratings® and the general buy/hold/sell guidance are not personal recommendations for any particular investor or client and do not take into account the financial, investment, or other objectives or needs of, and may not be suitable for, any particular investor or client. Investors and clients should consider Schwab Equity Ratings as only a single factor in making their investment decision while taking into account the current market environment.

§ Indexes are unmanaged, do not incur management fees, costs and expenses (or “transaction fees or other related expenses”), and cannot be invested in directly. For more information on indexes please see www.schwab.com/indexdefinitions.

Investing involves risk including loss of principal. Diversification strategies do not ensure a profit and do not protect against losses in a declining market. Supporting documentation for any claims or statistical information is available upon request.

All corporate names shown above are for illustration purposes only and are not a recommendation, offer to sell, or solicitation to buy any security.

The policy analysis provided by the Charles Schwab & Co., Inc., does not constitute and should not be interpreted as an endorsement of any political party.

©2021 Charles Schwab & Co., Inc. All rights reserved. Member SIPC. (1221-1F1N)

