

*charles* SCHWAB

Money Market

**Schwab Money  
Market Portfolio™**

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*Money Market*

Semiannual report for the period ended June 30, 2006

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 1-888-311-4887 for a prospectus. Please read the prospectus carefully before you invest.

**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 website at [www.schwab.com/schwabfunds](http://www.schwab.com/schwabfunds), the SEC's website at [www.sec.gov](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 website at [www.schwab.com/schwabfunds](http://www.schwab.com/schwabfunds) or the SEC's website at [www.sec.gov](http://www.sec.gov).

# Management's Discussion for the six months ended June 30, 2006



**Karen Wiggan**, a vice president of the investment adviser and senior portfolio manager, is responsible for the overall management of the portfolio. She joined the firm in 1987 and has worked in fixed income portfolio management since 1991.

## The Investment Environment and the Fund

After a volatile six months in the domestic markets, equity and fixed income funds ended the period with mixed returns. Several key issues dominated market discussions throughout the period, including slowing economic growth, inflation fears, U.S. Federal Reserve (the Fed) interest rate increases, and volatile crude oil prices.

The markets remained in a steady growth mode over the first quarter of 2006 and ended the period on a positive note. Volatility was up during the second quarter of the year, but remained lower than its historical norm. During the six-month report period, oil prices hit new record highs and the Fed continued to raise short-term interest rates to curb inflationary pressures, boosting its Fed Funds target rate four consecutive times during the six-month period and bringing the benchmark rate up to 5.25%. This was the 17th rate hike over the past two years.

Rising sharply in the second half of the report period, crude oil prices peaked in April at around \$75 per barrel while domestic gasoline prices were above \$3 a gallon. In recent months, crude oil prices climbed back in response to declining crude inventories and geopolitical concerns. Despite the volatility in energy prices, gains in productivity have remained strong and corporate earnings continue to rise. Reasonable valuations, a solid earnings season, and expectations that monetary policy tightening will soon come to an end, helped support the markets. Additionally, job and income growth remained positive, though they slowed during the report period. Moderate inflationary expectations and large foreign capital inflows helped to contain increases in long-term interest rates.

As noted above, the Fed continued its tightening cycle throughout the period, raising its Fed Funds target 0.25% at each of its four meetings. At the end of the six-month report period, the benchmark rate was up to 5.25%. As the Fed raised rates, the yield curve flattened and had brief periods of inversion. Historically, economic slowdowns or recessions have followed the inversion of the yield curve. Nonetheless, higher short-term rates succeeded in moving money fund yields higher, making them a more attractive investment vehicle. Following a strong start to 2006, economic growth has moderated over the past six months.

Rising interest rates have led to volatility in the equities markets and have weighed down bond returns. Meanwhile, money market funds enticed investors as the rise in short-term interest rates offered yields that have not been seen in years. The mixed messages that arose from the slowing economy and rising inflation have left investors puzzled about the direction of the Fed policy. The June 29 Federal Open Market Committee (FOMC) policy statement did little to alleviate uncertainty, as the Fed acknowledged slower growth while expressing concern about inflation risks.

**In this market environment, our strategy was to position the fund for a continued rise in interest rates.** The fund continued to maintain a shorter weighted average maturity (WAM) by focusing on shorter-term discount notes. Keeping the WAM short provided the flexibility to adapt and respond to the changes in rising money market rates. During the six-month reporting period, the supply of agency discount notes continued to decline. This was due to a reduced demand for short-term funding from the various government sponsored enterprises (GSEs).

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.

## Performance and Portfolio Facts as of 6/30/06

### Seven-Day Yields<sup>1</sup>

The seven-day yields are calculated using standard SEC formulas. The effective yield includes the effect of reinvesting daily dividends. Please remember that money market fund yields fluctuate.

<b>Seven-Day Yield</b>	4.66%
<b>Seven-Day Effective Yield</b>	4.77%

**The performance data quoted represents past performance. Past performance does not guarantee future results. Current performance may be lower or higher than performance data quoted. To obtain more current performance information, please visit [www.schwab.com/schwabfunds](http://www.schwab.com/schwabfunds).**

### Statistics

Money funds must maintain a dollar-weighted average maturity of no longer than 90 days, and cannot invest in any security whose effective maturity is longer than 397 days (approximately 13 months).

<b>Weighted Average Maturity</b>	41 days
<b>Credit Quality of Holdings</b> % of portfolio	100% Tier 1

**An investment in a money fund is neither insured nor guaranteed by the Federal Deposit Insurance Corporation (FDIC) or any other government agency. Although money funds seek to preserve the value of your investment at \$1 per share, it is possible to lose money by investing in a money fund.**

Portfolio holdings may have changed since the report date.

<sup>1</sup> Portfolio yields do not reflect the additional fees and expenses imposed by the insurance company under the variable insurance product contract. If those contract fees and expenses were included, the yields would be less than those shown. Please refer to the variable insurance product prospectus for a complete listing of these expenses.

# Portfolio Expenses (unaudited)

## 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 January 1, 2006 and held through June 30, 2006.

**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 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 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> (Annualized)	Beginning Account Value at 1/1/06	Ending Account Value (Net of Expenses) at 6/30/06	Expenses Paid During Period <sup>2</sup> 1/1/06–6/30/06
<b>Schwab Money Market Portfolio</b>				
Actual Return	0.46%	\$1,000	\$1,021.01	\$2.31
Hypothetical 5% Return	0.46%	\$1,000	\$1,022.51	\$2.31

<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 the portfolio 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 Money Market Portfolio

## Financial Statements

### Financial Highlights

	1/1/06– 6/30/06*	1/1/05– 12/31/05	1/1/04– 12/31/04	1/1/03– 12/31/03	1/1/02– 12/31/02	1/1/01– 12/31/01
<b>Per-share data (\$)</b>						
Net asset value at beginning of period	1.00	1.00	1.00	1.00	1.00	1.00
Income from investment operations:						
Net investment income	0.02	0.03	0.01	0.01	0.01	0.04
Less distributions:						
Dividends from net investment income	(0.02)	(0.03)	(0.01)	(0.01)	(0.01)	(0.04)
Net asset value at end of period	1.00	1.00	1.00	1.00	1.00	1.00
Total return (%)	2.10 <sup>1</sup>	2.75	0.90	0.74	1.31	3.72
<b>Ratios/supplemental data (%)</b>						
Ratios to average net assets:						
Net operating expenses	0.46 <sup>2</sup>	0.47	0.46	0.44	0.48	0.49
Gross operating expenses	0.47 <sup>2</sup>	0.47	0.46	0.44	0.48	0.50
Net investment income	4.20 <sup>2</sup>	2.74	0.89	0.75	1.31	3.55
Net assets, end of period (\$ x 1,000,000)	161	133	116	141	215	204

\* Unaudited.

<sup>1</sup> Not annualized.

<sup>2</sup> Annualized.

**Portfolio Holdings** as of June 30, 2006 (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 Form N-Q is available on the SEC's website at [www.sec.gov](http://www.sec.gov) and may be viewed 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 also available by visiting Schwab's website at [www.schwab.com/schwabfunds](http://www.schwab.com/schwabfunds).

For fixed rate obligations, the rate shown is the effective yield at the time of purchase, except for U.S. Treasury notes, for which the rate shown is the interest rate (the rate established when the obligation was issued). For variable-rate obligations, the rate shown is the rate as of the report date and the maturity date shown is the next interest rate change date.

Holdings by Category	Cost (\$x1,000)	Value (\$x1,000)
<b>93.4% Federal Agency Securities</b>	150,447	150,447
<b>6.9% Other Investments</b>	11,080	11,080
<b>100.3% Total Investments</b>	<b>161,527</b>	<b>161,527</b>
<b>(0.3)% Other Assets and Liabilities</b>		(496)
<b>100.0% Net Assets</b>		<b>161,031</b>

Issuer Rate, Maturity Date	Face Amount (\$ x 1,000)	Value (\$ x 1,000)
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<b>Federal Agency Securities</b>	<b>93.4% of net assets</b>
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**Discount Notes 93.4%****Fannie Mae**

4.86%, 07/05/06	2,000	1,999
5.00%, 07/12/06	3,000	2,995
4.93%, 07/17/06	1,240	1,237
4.97%, 07/19/06	1,774	1,770
4.98%, 07/19/06	2,000	1,995
4.96%, 07/26/06	1,000	997
4.99%, 07/26/06	1,900	1,893
4.99%, 07/26/06	1,000	997
5.21%, 07/26/06	1,000	996
5.00%, 08/02/06	1,178	1,173
5.01%, 08/02/06	1,071	1,066
5.08%, 08/16/06	1,000	994
5.27%, 08/16/06	6,190	6,149
5.25%, 08/21/06	2,970	2,948
5.30%, 08/23/06	4,000	3,969
5.16%, 09/01/06	1,670	1,655
5.17%, 09/06/06	2,000	1,981
5.33%, 09/13/06	2,900	2,869
5.35%, 09/13/06	1,000	989

**Federal Farm Credit Bank**

4.98%, 07/05/06	3,000	2,998
5.08%, 07/14/06	4,000	3,993
5.17%, 07/25/06	3,000	2,990
4.96%, 07/26/06	2,000	1,993
5.17%, 07/26/06	5,000	4,982
5.18%, 07/28/06	1,548	1,542
4.89%, 08/07/06	1,185	1,179
4.99%, 08/11/06	1,000	994
5.33%, 10/16/06	1,000	984

**Federal Home Loan Bank**

4.97%, 07/07/06	2,000	1,998
4.90%, 07/14/06	3,512	3,506
4.91%, 07/14/06	2,500	2,496
4.92%, 07/19/06	2,000	1,995
4.95%, 07/19/06	1,000	998
4.98%, 07/19/06	1,060	1,057
5.25%, 08/02/06	1,075	1,070
5.01%, 08/04/06	3,000	2,986
5.26%, 08/16/06	1,118	1,111
5.24%, 08/18/06	2,000	1,986
5.26%, 08/25/06	1,500	1,488
5.16%, 09/08/06	5,000	4,951
5.17%, 09/13/06	2,000	1,979

**Portfolio Holdings** (Unaudited) continued

Issuer Rate, Maturity Date	Face Amount (\$ x 1,000)	Value (\$ x 1,000)
5.23%, 09/13/06	5,000	4,947
5.27%, 09/15/06	4,768	4,716
<b>Freddie Mac</b>		
4.86%, 07/03/06	1,129	1,129
5.00%, 07/11/06	1,000	999
4.95%, 07/18/06	1,000	998
4.88%, 07/25/06	1,355	1,351
4.90%, 07/25/06	2,000	1,994
4.97%, 07/25/06	2,216	2,209
5.21%, 07/31/06	1,900	1,892
4.94%, 08/04/06	1,095	1,090
4.95%, 08/04/06	1,070	1,065
5.23%, 08/08/06	2,700	2,685
5.25%, 08/08/06	1,000	995
5.27%, 08/22/06	1,000	992
5.27%, 08/30/06	1,123	1,113
5.29%, 09/05/06	6,445	6,383
5.30%, 09/05/06	1,565	1,550
5.33%, 09/05/06	3,000	2,971
5.23%, 09/18/06	1,067	1,055
5.33%, 09/19/06	2,550	2,520
5.22%, 11/14/06	2,000	1,961
<b>Tennessee Valley Authority</b>		
4.94%, 07/06/06	3,000	2,998
5.03%, 07/20/06	3,000	2,992
5.18%, 08/03/06	4,000	3,981
5.25%, 09/14/06	6,000	5,935
5.25%, 09/14/06	2,000	1,978
		<b>150,447</b>

Issuer Rate, Maturity Date	Maturity Amount (\$ x 1,000)	Value (\$ x 1,000)
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Other Investments 6.9% of net assets

**Repurchase Agreements 6.9%****Credit Suisse First Boston L.L.C.**

Tri-Party Repurchase Agreement Collateralized by U.S. Treasury Securities with a value of \$11,305 4.50%, issued 06/30/06, due 07/03/06	11,084	11,080
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**End of Investments.**

At 06/30/06, the cost of the fund's investments was \$161,527.



Statement of

**Assets and Liabilities**

As of June 30, 2006; unaudited. All numbers x 1,000 except NAV.

**Assets**

Investments, at cost and value	\$150,447
Repurchase agreements, at cost and value	11,080
Receivables:	
Fund shares sold	668
Interest	+
	1
<b>Total assets</b>	<b>162,196</b>

**Liabilities**

Payables:	
Dividends to shareholders	301
Fund shares redeemed	824
Investment adviser and administrator fees	5
Trustees' fees	3
Accrued expenses	+
	32
<b>Total liabilities</b>	<b>1,165</b>

**Net Assets**

<b>Total assets</b>	162,196
<b>Total liabilities</b>	-
	1,165
<b>Net assets</b>	<b>\$161,031</b>

**Net Assets by Source**

Capital received from investors	161,044
Net realized capital losses	(13)

**Net Asset Value (NAV)**

<b>Net Assets</b>	÷	<b>Shares Outstanding</b>	=	<b>NAV</b>
\$161,031		161,078		\$1.00

## Statement of

**Operations**

For January 1, 2006 through June 30, 2006; unaudited. All numbers x 1,000.

**Investment Income**

Interest	<b>\$3,126</b>
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**Expenses**

Investment adviser and administrator fees	255
Trustees' fees	11
Custodian fees	7
Portfolio accounting fees	10
Professional fees	4
Shareholder reports	23
Other expenses	+
	2
Total expenses	312
Custody credits	-
	1
<b>Net expenses</b>	<b>311</b>

**Increase in Net Assets from Operations**

<b>Total investment income</b>	3,126
<b>Net expenses</b>	-
	311
<b>Net investment income</b>	<b>2,815</b>
<b>Increase in net assets from operations</b>	<b>\$2,815</b>

Statements of

**Changes in Net Assets**

For the current and prior report periods. All numbers x 1,000.

Figures for current period are unaudited.

**Operations**

	1/1/06-6/30/06	1/1/05-12/31/05
Net investment income	\$2,815	\$3,417
<b>Increase in net assets from operations</b>	<b>2,815</b>	<b>3,417</b>
<b>Distributions Paid</b>		
Dividends from net investment income	2,815	3,417
<b>Transactions in Fund Shares*</b>		
Shares sold	153,488	150,665
Shares reinvested	2,526	3,417
Shares redeemed	+ (128,029)	(137,096)
<b>Net transactions in fund shares</b>	<b>27,985</b>	<b>16,986</b>
<b>Net Assets</b>		
Beginning of period	133,046	116,060
Total increase	+ 27,985	16,986
<b>End of period</b>	<b>\$161,031</b>	<b>\$133,046</b>

\* Transactions took place at \$1.00 per share; figures for share quantities are the same as for dollars.

## Financial Notes, unaudited.

Unless stated, all dollar amounts are x 1,000.

### 1. Business Structure of the Fund

Schwab Money Market Portfolio is a series of Schwab Annuity Portfolios, 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 list below shows all the funds in the trust including the fund in this report, which is highlighted:

#### **Schwab Annuity Portfolios**

Organized January 21, 1994

Schwab Money Market Portfolio

Schwab MarketTrack Growth Portfolio II

Schwab S&P 500 Index Portfolio

Schwab Money Market Portfolio offers one share class. Shares are bought and sold at \$1.00 per share. Each share has a par value of 1/1,000 of a cent, and the trustees may issue as many shares as necessary.

The fund is intended as an investment vehicle for variable annuity contracts and variable life insurance policies to be offered by separate accounts of participating life insurance companies and for pension and retirement plans qualified under the Internal Revenue Code of 1986, as amended.

### 2. Significant Accounting Policies

The following is a summary of the significant accounting policies the fund uses in its operations and in the preparation of financial statements:

#### **(a) Security Valuation:**

The fund values the securities in its portfolio at amortized cost, which approximates market value.

#### **(b) Portfolio Investments:**

**Delayed-Delivery:** The fund may buy securities on a delayed-delivery basis. In these transactions, the 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, the fund could end up paying more for the security than its market value at the time of settlement. The fund has set aside sufficient securities as collateral for those securities bought on a delayed-delivery basis.

**Repurchase Agreements:** The fund may enter into repurchase agreements. In a repurchase agreement, the fund buys a security from another party (usually a financial institution) with the agreement that it be sold back in the future. The date, price and other conditions are all specified when the agreement is created. Any repurchase agreements with due dates later than seven days from issue dates may be subject to seven day put features for liquidity purposes.

## Financial Notes, unaudited (continued).

Unless stated, all dollar amounts are x 1,000.

### 2. Significant Accounting Policies (continued)

The fund's repurchase agreements will be fully collateralized by U.S. government securities. All collateral is held by the fund's custodian (or, with tri-party agreements, the agent's bank) and is monitored daily to ensure that its market value is at least equal to the repurchase price under the agreement.

#### (c) Security Transactions:

Security transactions are recorded as of the date the order to buy or sell the security is executed. Realized gains and losses from security transactions are based on the identified costs of the securities involved.

#### (d) Income, Expenses and Distributions:

Interest income is recorded as it accrues. If the fund buys a debt security at a discount (that is, for less than face value) or a premium (more than face value), it amortizes the discount or premium from the current date 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.

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

The fund declares dividends every day it is open for business. These dividends, which are equal to a fund's net investment income for that day, are paid out to the insurance company separate accounts once a month. The fund may make distributions from any net realized capital gains once a year.

The fund maintains its own account for purposes of holding assets and accounting, and is considered a separate entity for tax purposes. Within its account, the fund also keeps certain assets in segregated accounts, as may be required by securities law.

#### (e) Borrowing:

The fund may borrow money from banks and custodians. The fund may obtain temporary bank loans through the trust to which the fund belongs to use for meeting shareholder redemptions or for extraordinary or emergency purposes. The trust has 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 fund pays interest on the amounts it borrows at rates that are negotiated periodically. There was no borrowing for the fund during the period.

#### (f) Accounting Estimates:

The accounting policies described in this report 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.

#### (g) Indemnification:

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

## Financial Notes, unaudited (continued).

Unless stated, all dollar amounts are x 1,000.

### 3. Affiliates and Affiliated Transactions

Charles Schwab Investment Management, Inc. (CSIM or the investment adviser), a wholly owned subsidiary of The Charles Schwab Corporation, serves as the fund's investment adviser and administrator pursuant to an Investment Advisory and Administration Agreement (Advisory Agreement) between it and the trust. Charles Schwab & Co., Inc. ("Schwab") is an affiliate of the investment adviser and is the trust's shareholder services agent and transfer agent.

For its advisory and administrative services to the fund, the investment adviser is entitled to receive an annual fee payable monthly based on the fund's average daily net assets described as follows:

<u>Average daily net assets</u>	
First \$1 billion	0.38%
Over \$1 billion	0.35%
Over \$10 billion	0.32%
Over \$20 billion	0.30%
Over \$40 billion	0.27%

Schwab does not charge the fund for transfer agent and shareholder services fees.

Although these agreements specify certain fees for these services, CSIM and Schwab have made additional agreements with the fund to limit the total expenses charged, excluding interest, taxes and certain non-routine expenses to 0.50% through April 29, 2007.

The fund 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. For the period ended June 30, 2006, the fund had no security transactions with other Schwab Funds.

Pursuant to an exemptive order issued by the SEC, the fund 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. There was no interfund borrowing or lending activity for the fund during the period.

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 the fund's Statement of Operations.

### 4. Federal Income Taxes

The fund intends to meet federal income and excise tax requirements for regulated investment companies. Accordingly, the fund distributes substantially all of its net investment income and realized net capital gains (if any) to the participating insurance company separate accounts each year. As long as the fund meets the tax requirements, it is not required to pay federal income tax. As of December 31, 2005, the fund had no undistributed earnings on a tax basis.

## Financial Notes, unaudited (continued).

Unless stated, all dollar amounts are x 1,000.

### 4. Federal Income Taxes (continued)

As of December 31, 2005, the fund had capital loss carry forwards available to offset future net capital gains before the expiration date:

<u>Expire</u>	
2006	\$3
2007	9
2008	1
<b>Total</b>	<b><u>\$13</u></b>

The tax-basis components of distributions for the fiscal year ended December 31, 2005 were:

From ordinary income	\$3,417
From long-term capital gains	—
From return of capital	—

The permanent book and tax basis differences may result in reclassifications between capital account and other accounts as required. The adjustments will have no impact on net assets or the results of operations. As of December 31, 2005, the fund made the following reclassifications:

Capital received from investors	(\$1)
Net realized capital losses	\$1

# Investment Advisory Agreement Approval

The Investment Company Act of 1940 (the “1940 Act”) requires that initial approval of, as well as the continuation of, a fund’s investment advisory agreement must be specifically approved (1) by the vote of the trustees or by a vote of the shareholders of the fund, and (2) by the vote of a majority of the trustees who are not parties to the investment advisory agreement or “interested persons” of any party (the “Independent Trustees”), cast in person at a meeting called for the purpose of voting on such approval. In connection with such approvals, the fund’s trustees must request and evaluate, and the investment adviser is required to furnish, such information as may be reasonably necessary to evaluate the terms of the advisory agreement. In addition, the Securities and Exchange Commission (the “SEC”) takes the position that, as part of their fiduciary duties with respect to fund fees, fund boards are required to evaluate the material factors applicable to a decision to approve an investment advisory agreement.

Consistent with these responsibilities, the Board of Trustees (the “Board”) calls and holds one or more meetings each year that are dedicated, in whole or in part, to considering whether to renew the investment advisory agreement between Schwab Annuity Portfolios (the “Trust”) and CSIM (the “Agreement”) with respect to existing funds in the Trust, including the Schwab Money Market Portfolio, and to review certain other agreements pursuant to which CSIM provides investment advisory services to certain other registered investment companies. In preparation for the meeting(s), the Board requests and reviews a wide variety of materials provided by CSIM, including information about CSIM’s affiliates, personnel and operations. The Board also receives extensive data provided by third parties. This information is in addition to the detailed information about the funds that the Board reviews during the course of each year, including information that relates to fund operations and fund performance. The trustees also receive a memorandum from fund counsel regarding the respon-

sibilities of trustees for the approval of investment advisory contracts. In addition, the Independent Trustees receive advice from independent counsel to the Independent Trustees, meet in executive session outside the presence of fund management and participate in question and answer sessions with representatives of CSIM.

The Board, including a majority of the Independent Trustees, considered information specifically relating to the continuance of the Agreement at meetings held on May 2, 2006, May 24, 2006 and June 12, 2006, and approved the renewal of the Agreement for an additional one year term at the meeting held on June 12, 2006. The Board’s approval of the Agreement was based on consideration and evaluation of a variety of specific factors discussed at these meetings and at prior meetings, including:

1. the nature, extent and quality of the services provided to the funds under the Agreement, including the resources of CSIM and its affiliates dedicated to the funds;
2. each fund’s investment performance and how it compared to that of certain other comparable mutual funds;
3. each fund’s expenses and how those expenses compared to those of certain other comparable mutual funds;
4. the profitability of CSIM and its affiliates, including Charles Schwab & Co., Inc. (“Schwab”), with respect to each fund, including both direct and indirect benefits accruing to CSIM and its affiliates; and
5. the extent to which economies of scale would be realized as the funds grow and whether fee levels in the Agreement reflect those economies of scale for the benefit of fund investors.



**Nature, Extent and Quality of Services.** The Board considered the nature, extent and quality of the services provided by CSIM to the funds and the resources of CSIM and its affiliates dedicated to the funds. In this regard, the trustees evaluated, among other things, CSIM's personnel, experience, track record and compliance program. The trustees considered the role of unaffiliated insurance companies in the distribution of the funds. The information considered by the trustees included specific information concerning changes in the nature, extent and quality of services provided by CSIM since the trustees had last considered approval of the Agreement. The trustees also considered Schwab's excellent reputation as a full service brokerage firm and its overall financial condition, and how this affects the success of the funds. Following such evaluation, the Board concluded, within the context of its full deliberations, that the nature, extent and quality of services provided by CSIM to the funds and the resources of CSIM and its affiliates dedicated to the funds supported renewal of the Agreement.

**Fund Performance.** The Board considered fund performance in determining whether to renew the Agreement. Specifically, the trustees considered each fund's performance relative to a peer group of other mutual funds and appropriate indices/benchmarks, in light of total return, yield, when applicable, and market trends. As part of this review, the trustees considered the composition of the peer group, selection criteria and the reputation of the third party who prepared the peer group analysis. In evaluating the performance of each fund, the trustees considered both risk and shareholder risk expectations for such fund and the appropriateness of the benchmark used to compare the performance of each fund. The trustees further considered the level of fund performance in the context of its review of fund expenses and adviser profitability discussed below. Following such evaluation the Board concluded, within the context of its full deliberations, that the performance of the funds supported renewal of the Agreement.

**Fund Expenses.** With respect to the funds' expenses, the trustees considered the rate of compensation called for by the Agreement, and each fund's net operating expense ratio, in each case, in comparison to those of other comparable mutual funds, such peer groups and comparisons having been selected and calculated by an independent third party. The trustees considered the effects of CSIM's and Schwab's historical practice of voluntarily waiving management and other fees to prevent total fund expenses from exceeding a specified cap. The trustees also considered fees charged by CSIM to other mutual funds and to other types of accounts, such as wrap accounts and offshore funds, but, with respect to such other types of accounts, accorded less weight to such comparisons due to the different legal, regulatory, compliance and operating features of mutual funds as compared to these other types of accounts, and the unique insurance dedicated distribution arrangements of the funds as compared to other funds managed by CSIM. Following such evaluation, the Board concluded, within the context of its full deliberations, that the expenses of the funds are reasonable and supported renewal of the Agreement.

**Profitability.** With regard to profitability, the trustees considered the compensation flowing to CSIM and its affiliates, directly or indirectly. In this connection, the trustees reviewed management's profitability analyses, together with certain commentary thereon from an independent accounting firm. The trustees also considered any other benefits derived by CSIM from its relationship with the funds, such as whether, by virtue of its management of the Funds, CSIM obtains investment information or other research resources that aid it in providing advisory services to other clients. The trustees considered whether the varied levels of compensation and profitability under the Agreement and other service agreements were reasonable and justified in light of the quality of all services rendered to each fund by CSIM and its affiliates. The Board also con-

sidered information relating to changes to CSIM's cost structure, including cost savings, technology investments and increased operating efficiencies and how these changes affected CSIM's profitability under the Agreement. Based on this evaluation, the Board concluded, within the context of its full deliberations, that the profitability of CSIM is reasonable and supported renewal of the Agreement.

**Economies of Scale.** The trustees considered the existence of any economies of scale and whether those are passed along to a fund's shareholders through a graduated investment advisory fee schedule or other means, including any fee waivers by CSIM and its affiliates. In this regard, and consistent with their consideration of fund expenses, the trustees considered that CSIM and Schwab have previously committed resources to minimize the effects on shareholders of diseconomies of scale during periods when fund assets were relatively small through their contractual expense waivers. For example, such diseconomies of scale may particularly affect newer funds or funds with investment strategies that are from time to time out of favor, but shareholders may benefit from the continued availability of such funds at subsidized expense levels. The trustees also considered CSIM's agreement to contractual investment advisory fee schedules that include lower fees at higher graduated asset levels. The Board also considered certain commitments by CSIM and Schwab that are designed to pass along potential economies of scale to fund shareholders. Specifically, the Board considered CSIM and Schwab's commitments, which may be changed only with Board approval: (i) to reduce contractual advisory fees or add breakpoints for certain funds, and (ii) to implement, by means of expense limitation agreement, reductions in net

overall expenses for certain funds. Based on this evaluation, and in consideration of the commitments made by CSIM and Schwab as discussed above, the Board concluded, within the context of its full deliberations, that the funds obtain reasonable benefit from economies of scale.

In the course of their deliberations, the trustees did not identify any particular information or factor that was all-important or controlling. Based on the trustees' deliberation and their evaluation of the information described above, the Board, including all of the Independent Trustees, unanimously approved the continuation of the Agreement and concluded that the compensation under the Agreement is fair and reasonable in light of such services and expenses and such other matters as the trustees have considered to be relevant in the exercise of their reasonable judgment.

# Trustees and Officers

The tables below give information about the trustees and officers for The Schwab Annuity Portfolios, which includes the fund covered in this report. The “Fund Complex” includes The Charles Schwab Family of Funds, Schwab Investments, Schwab Capital Trust, Schwab Annuity Portfolios, Laudus Trust, Laudus Variable Insurance Trust, Excelsior Funds, Inc., Excelsior Tax-Exempt Funds, Inc., and Excelsior Funds Trust. As of June 30, 2006, the Fund Complex included 98 funds.

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.

## Independent Trustees

Name, Year of Birth, and Position(s) with the Trust; (Term of Office, and Length of Time Served <sup>1</sup> )	Principal Occupations During the Past Five Years	Number of Portfolios in Fund Complex Overseen by the Trustee	Other Directorships
<b>Mariann Byerwalter</b> 1960 Trustee (Trustee of The Schwab Annuity Portfolios since 2000.)	Chairman of JDN Corporate Advisory LLC. <i>From 1996 to 2001</i> , Vice President for Business Affairs and Chief Financial Officer of Stanford University, and <i>in 2001</i> , Special Advisor to the President of Stanford University.	98	<i>Board 1</i> —Director, Redwood Trust, Inc. <i>Board 2</i> —Director, PMI Group, Inc.
<b>Donald F. Dorward</b> 1931 Trustee (Trustee of The Schwab Annuity Portfolios since 1989.)	Chief Executive Officer, Dorward & Associates (corporate management, marketing and communications consulting firm). <i>From 1996-1999</i> , Executive Vice President and Managing Director, Grey Advertising. <i>Prior to 1996</i> , President and Chief Executive Officer, Allen & Dorward Advertising.	57	None.
<b>William A. Hasler</b> 1941 Trustee (Trustee of The Schwab Annuity Portfolios since 2000.)	Retired. Dean Emeritus, Haas School of Business, University of California, Berkeley. <i>Until February 2004</i> , Co-Chief Executive Officer, Apton Corp. (bio-pharmaceuticals). <i>Prior to August 1998</i> , Dean of the Haas School of Business, University of California, Berkeley (higher education).	98	<i>Board 1</i> —Director, Apton Corp. <i>Board 2</i> —Director, Mission West Properties <i>Board 3</i> —Director, TOUSA <i>Board 4</i> —Director, Stratex Networks <i>Board 5</i> —Director, Genitope Corp. <i>Board 6</i> —Director & Non-Executive Chairman, Solectron Corp. <i>Board 7</i> —Director, Ditech Communications Corp.

**Independent Trustees** continued

Name, Year of Birth, and Position(s) with the Trust; (Term of Office, and Length of Time Served')	Principal Occupations During the Past Five Years	Number of Portfolios in Fund Complex Overseen by the Trustee	Other Directorships
<p><b>Robert G. Holmes</b> 1931 Trustee (Trustee of The Schwab Annuity Portfolios since 1989.)</p>	<p>Chairman, Chief Executive Officer and Director, Semloh Financial, Inc. (international financial services and investment advisory firm).</p>	57	None.
<p><b>Gerald B. Smith</b> 1950 Trustee (Trustee of The Schwab Annuity Portfolios since 2000.)</p>	<p>Chairman and Chief Executive Officer and founder of Smith Graham &amp; Co. (investment advisors).</p>	57	<p><i>Board 1</i>—Board of Cooper Industries <i>Board 2</i>—Chairman of the Audit Committee of Northern Border Partners, M.L.P.</p>
<p><b>Donald R. Stephens</b> 1938 Trustee (Trustee of The Schwab Annuity Portfolios since 1989.)</p>	<p>Managing Partner, D.R. Stephens &amp; Company (investments). Prior to 1996, Chairman and Chief Executive Officer of North American Trust (real estate investment trust).</p>	57	None.
<p><b>Michael W. Wilsey</b> 1943 Trustee (Trustee of The Schwab Annuity Portfolios since 1989.)</p>	<p>Chairman and Chief Executive Officer, Wilsey Bennett, Inc. (real estate investment and management, and other investments).</p>	57	None.

## Interested Trustees

Name, Year of Birth, and Position(s) with the Trust; (Term of Office, and Length of Time Served <sup>1</sup> )	Principal Occupations During the Past Five Years	Number of Portfolios in Fund Complex Overseen by the Trustee	Other Directorships
<p><b>Charles R. Schwab</b><sup>2</sup> 1937 Chairman and Trustee (Chairman and Trustee of The Schwab Annuity Portfolios since 1989.)</p>	<p>Chairman, Chief Executive Officer and Director, The Charles Schwab Corporation, Charles Schwab &amp; Co., Inc.; Chairman and Director, Charles Schwab Investment Management, Inc., Charles Schwab Bank, N. A.; Chairman and Chief Executive Officer, Schwab (SIS) Holdings Inc. I, Schwab International Holdings, Inc.; Chief Executive Officer and Director, Schwab Holdings, Inc.; Director, U.S. Trust Company, N. A., U.S. Trust Corporation, United States Trust Company of New York. <i>Until May 2003</i>, Co-Chief Executive Officer, The Charles Schwab Corporation.</p>	57	None.
<p><b>Randall W. Merk</b><sup>2</sup> 1954 Trustee (Trustee of The Schwab Annuity Portfolios since 2005.)</p>	<p>Executive Vice President and President, Schwab Financial Products, Charles Schwab &amp; Co., Inc.; Director, Charles Schwab Asset Management (Ireland) Limited and Charles Schwab Worldwide Funds PLC. <i>From September 2002 to July 2004</i>, Chief Executive Officer and President, Charles Schwab Investment Management, Inc. and Executive Vice President, Charles Schwab &amp; Co., Inc. <i>Prior to September 2002</i>, President and Chief Investment Officer, American Century Investment Management, and Director, American Century Companies, Inc.</p>	98	None.

## Officers of the Trust

Name, Year of Birth, and Position(s) with the Trust; (Term of Office, and Length of Time Served <sup>3</sup> )	Principal Occupations During the Past Five Years
<p><b>Evelyn Dilsaver</b> 1955 President and Chief Executive Officer (Officer of The Schwab Annuity Portfolios since 2004.)</p>	<p>President, Chief Executive Officer, and Director, Charles Schwab Investment Management, Inc.; Executive Vice President, Charles Schwab &amp; Co., Inc; President and Chief Executive Officer, Laudus Trust and Laudus Variable Insurance Trust; President, Excelsior Funds Inc., Excelsior Tax-Exempt Funds, Inc., and Excelsior Funds Trust; President, Mutual Fund Division, UST Advisers, Inc. <i>From June 2003 to July 2004</i>, Senior Vice President, Asset Management Products and Services, Charles Schwab &amp; Co., Inc. <i>Prior to June 2003</i>, Executive Vice President, Chief Financial Officer, and Chief Administrative Officer, U.S. Trust, a subsidiary of The Charles Schwab Corporation.</p>
<p><b>Stephen B. Ward</b> 1955 Senior Vice President and Chief Investment Officer (Officer of The Schwab Annuity Portfolios since 1991.)</p>	<p>Director, Senior Vice President and Chief Investment Officer, Charles Schwab Investment Management, Inc.; Chief Investment Officer, The Charles Schwab Trust Company.</p>
<p><b>George Pereira</b> 1964 Treasurer and Principal Financial Officer (Officer of The Schwab Annuity Portfolios since 2004.)</p>	<p>Senior Vice President and Chief Financial Officer, Charles Schwab Investment Management, Inc.; Chief Financial Officer, Laudus Trust and Laudus Variable Insurance Trust; Chief Financial Officer and Chief Accounting Officer, Excelsior Funds Inc., Excelsior Tax-Exempt Funds, Inc., and Excelsior Funds Trust; Chief Financial Officer, Mutual Fund Division, UST Advisers, Inc. Director, Charles Schwab Worldwide Fund, PLC and Charles Schwab Asset Management (Ireland) Limited. <i>From December 1999 to November 2004</i>, Sr. Vice President, Financial Reporting, Charles Schwab &amp; Co., Inc.</p>
<p><b>Kimon Daifotis</b> 1959 Senior Vice President and Chief Investment Officer—Fixed Income (Officer of The Schwab Annuity Portfolios since 2004.)</p>	<p>Senior Vice President and Chief Investment Officer—Fixed Income, Charles Schwab Investment Management, Inc. <i>Prior to 2004</i>, Vice President and Sr. Portfolio Manager, Charles Schwab Investment Management, Inc.</p>
<p><b>Jeffrey Mortimer</b> 1963 Senior Vice President and Chief Investment Officer—Equities (Officer of The Schwab Annuity Portfolios since 2004.)</p>	<p>Senior Vice President and Chief Investment Officer—Equities, Charles Schwab Investment Management, Inc.; Vice President and Chief Investment Officer, Laudus Trust and Laudus Variable Insurance Trust. <i>Prior to 2004</i>, Vice President and Sr. Portfolio Manager, Charles Schwab Investment Management, Inc.</p>

**Officers of the Trust** continued

Name, Year of Birth, and Position(s) with the Trust; (Term of Office, and Length of Time Served <sup>3</sup> )	Principal Occupations During the Past Five Years
<p><b>Randall Fillmore</b> 1960 Chief Compliance Officer and AML Officer (Officer of The Schwab Annuity Portfolios since 2002.)</p>	<p>Senior Vice President and Chief Compliance Officer, Charles Schwab Investment Management, Inc.; Senior Vice President Charles Schwab &amp; Co., Inc.; Chief Compliance Officer, Laudus Trust and Laudus Variable Insurance Trust; Chief Compliance Officer, Excelsior Funds Inc., Excelsior Tax-Exempt Funds, Inc., and Excelsior Funds Trust. <i>From 2002 to 2003</i>, Vice President, Charles Schwab &amp; Co., Inc., and Charles Schwab Investment Management, Inc. <i>From 2000 to 2002</i>, Vice President, Internal Audit, Charles Schwab &amp; Co., Inc.</p>
<p><b>Koji E. Felton</b> 1961 Secretary and Chief Legal Officer (Officer of The Schwab Annuity Portfolios since 1998.)</p>	<p>Senior Vice President, Chief Counsel and Corporate Secretary, Charles Schwab Investment Management, Inc.; Senior Vice President and Deputy General Counsel, Charles Schwab &amp; Co., Inc.; Chief Legal Officer, Laudus Trust and Laudus Variable Insurance Trust; Chief Legal Officer, Excelsior Funds Inc., Excelsior Tax-Exempt Funds, Inc., and Excelsior Funds Trust. <i>Prior to June 1998</i>, Branch Chief in Enforcement at U.S. Securities and Exchange Commission in San Francisco.</p>

<sup>1</sup> Trustees remain in office until they resign, retire or are removed by shareholder vote. 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 their employment with the investment adviser and the distributor, Messrs. Schwab and Merk also own stock of The Charles Schwab Corporation. Mr. Schwab and Mr. Merk are Interested Trustees because they are employees of Schwab and/or the adviser.

<sup>3</sup> The President, Treasurer and Secretary hold office until their respective successors are chosen and qualified or until he or she sooner dies, resigns, is removed or becomes disqualified. Each other officer serves at the pleasure of the Board.

*charles* SCHWAB

Large-Cap Blend

**Schwab MarketTrack  
Growth Portfolio II™**

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*Balanced*

Semiannual report for the period ended June 30, 2006



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 1-888-311-4887 for a prospectus. Please read the prospectus carefully before you invest.

**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 website at [www.schwab.com/schwabfunds](http://www.schwab.com/schwabfunds), the SEC's website at [www.sec.gov](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 website at [www.schwab.com/schwabfunds](http://www.schwab.com/schwabfunds) or the SEC's website at [www.sec.gov](http://www.sec.gov).

The industry/sector classification of the fund's portfolio holdings uses the Global Industry Classification Standard (GICS) which was developed by and is the exclusive property of Morgan Stanley Capital International Inc. and Standard & Poor's. GICS is a service mark of MSCI and S&P and has been licensed for use by Charles Schwab & Co., Inc.

# Management's Discussion for the six months ended June 30, 2006



**Larry Mano**, a vice president and senior portfolio manager of the investment adviser, is responsible for the overall management of the portfolio. Prior to joining the firm in 1998, he worked for 20 years in equity management.



**Tom Brown**, an associate portfolio manager of the investment adviser, is a day-to-day manager of the equity portions of the portfolio. He joined Schwab in 1995, became a trader in 1999, and was named to his current position in 2004.

## The Investment Environment and the Fund

After a volatile six months in the domestic markets, equity and fixed income funds ended the period with mixed returns. Several key issues dominated market discussions throughout the period, including slowing economic growth, inflation fears, U.S. Federal Reserve (the Fed) interest rate increases, and volatile crude oil prices.

The markets remained in a steady growth mode over the first quarter of 2006 and ended the period on a positive note. Volatility was up during the second quarter of the year, but remained lower than its historical norm. During the six-month report period, oil prices hit new record highs and the Fed continued to raise short-term interest rates to curb inflationary pressures, boosting its Fed Funds target rate four consecutive times during the six-month period and bringing the benchmark rate up to 5.25%. This was the 17th rate hike over the past two years.

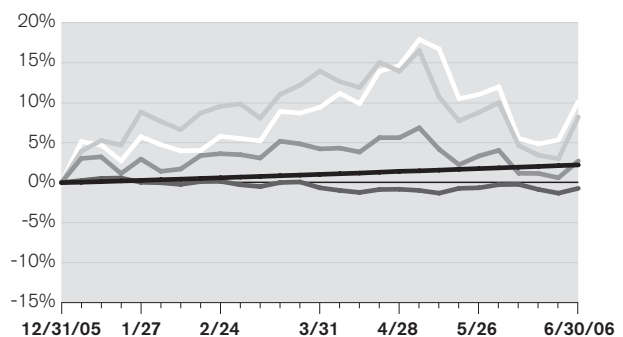
Rising sharply in the second half of the report period, crude oil prices peaked in April at around \$75 per barrel while domestic gasoline prices were above \$3 a gallon. In recent months, crude oil prices climbed back in response to declining crude inventories and geopolitical concerns. Despite the volatility in energy prices, gains in productivity have remained strong and corporate earnings continue to rise. Reasonable valuations, a solid earnings season, and expectations that monetary policy tightening will soon come to an end, helped support the markets. Additionally, job and income growth remained positive, though they slowed during the report period. Moderate inflationary expectations and large foreign capital inflows helped to contain increases in long-term interest rates.

As noted above, the Fed continued its tightening cycle throughout the period, raising its Fed Funds target 0.25% at each of its four meetings. As the Fed raised rates, the yield curve flattened and had brief periods

### Asset Class Performance Comparison % returns during the report period

This graph compares the performance of various asset classes during the report period. Final performance figures for the period are in the key below.

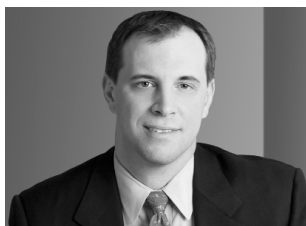
- 2.21% **Three-Month U.S. Treasury Bills (T-Bills)**: measures short-term U.S. Treasury obligations
- -0.72% **Lehman Brothers U.S. Aggregate Bond Index**: measures the U.S. bond market
- 2.71% **S&P 500® Index**: measures U.S. large-cap stocks
- 8.21% **Russell 2000® Index**: measures U.S. small-cap stocks
- 10.16% **MSCI EAFE® Index**: measures (in U.S. dollars) large-cap stocks in Europe, Australasia and the Far East



These figures 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. Remember that past performance is not an indication of future results.

Data source: Charles Schwab & Co., Inc.

Source of Sector Classification: S&P and MSCI.



**Matthew Hastings, CFA**, a vice president and senior portfolio manager of the investment adviser, has day-to-day responsibility for the co-management of the bond and cash portions of the portfolio. He joined the firm in 1999 and has worked in fixed-income and asset management since 1996.



**Steven Hung**, a director and portfolio manager of the investment adviser, has day-to-day responsibility for the co-management for the bond and cash portions of the portfolio. He joined the firm in 1998 and has worked in fixed-income asset management since 1999.

of inversion. Historically, economic slowdowns or recessions have followed the inversion of the yield curve. Following a strong start to 2006, economic growth has moderated over the past six months.

Despite rising interest rates and soaring energy prices, the S&P 500 Index<sup>1</sup> posted gains of 2.71% for the six-month period ending June 30, 2006 while the Russell 2000 Index also displayed a positive return of 8.21%. As improving fundamentals and attractive valuations have strengthened investor interest in emerging markets, the MSCI EAFE (Morgan Stanley Capital International, Inc. Europe, Australasia, and Far East) Index also had an impressive return of 10.16% for the six-month period.

Although performance of the bond markets was sluggish, as measured by the Lehman Brothers U.S. Aggregate Bond Index, which was down 0.72% for the six-month period, these types of results are not unusual. When the economy is strong and job growth is robust, investors normally expect to see more inflation, which generally leads to higher interest rates and lower bond prices.

Rising interest rates have led to volatility in the equities markets and have weighed down bond returns. Meanwhile, money market funds enticed investors as the rise in short-term interest rates offered yields that have not been seen in years. The mixed messages that arose from the slowing economy and rising inflation have left investors puzzled about the direction of the Fed policy. The June 29 Federal Open Market Committee (FOMC) policy statement did little to alleviate uncertainty, as the Fed acknowledged slower growth while expressing concern about inflation risks.

**The Schwab MarketTrack Growth Portfolio II** incorporates a mix of different asset classes. Accordingly, its returns over a given period will reflect a blend of the returns of those asset classes, and will depend on their relative weightings within the portfolio. By spreading its exposure over various asset classes, The MarketTrack Growth Portfolio II is designed to provide more stable returns while seeking to reduce risk over various market cycles.

The portfolio was up 4.38% for the six-month period, compared to a 4.14% return for its benchmark, the Growth Composite Index. The portfolio has an 80% target stock allocation that is divided amongst large-cap, small-cap, and international stocks. The 20% target allocation to fixed income, which includes 5% cash, is designed to reduce volatility and risk over the long term. In this report period, due to the volatility in the equity markets, the fund benefited from its allocation to larger-capitalization stocks and the fixed income portion of the portfolio.

Past performance does not indicate future results.

Source of Sector Classification: S&P and MSCI.

Small company stocks are subject to greater volatility than other asset categories. Foreign securities can involve risks such as political and economic instability and currency risk.

All portfolio 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. The portfolio's share price and principal values change and when you sell your shares they may be worth more or less than what you paid for them.

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.

Portfolio returns do not reflect the additional fees and expenses imposed by the insurance company under the variable insurance product contract.

Portfolio expenses have been partially absorbed by CSIM and Schwab. Without these reductions, the portfolio's returns would have been lower.

<sup>1</sup> Standard & Poor's®, S&P®, S&P 500®, Standard & Poor's 500® and 500® are trademarks of The McGraw-Hill Companies, Inc. and have been licensed for use by the fund. The fund is not sponsored, endorsed, sold or promoted by Standard & Poor's, and Standard & Poor's makes no representation regarding the advisability of investing in the fund.

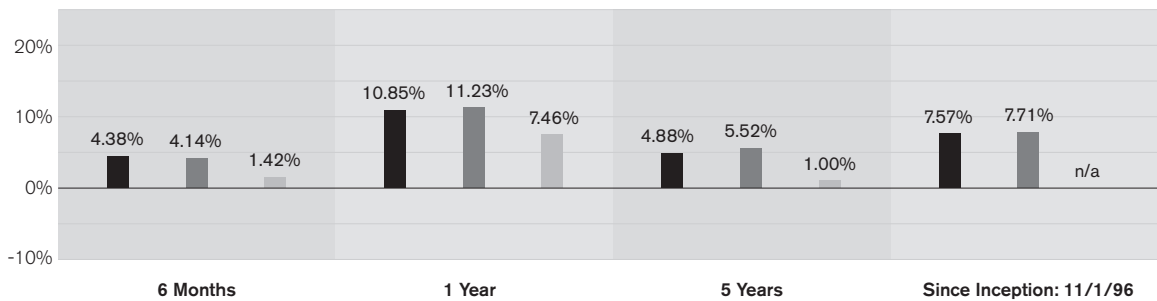
# Schwab MarketTrack Growth Portfolio II

Performance as of 6/30/06

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

This chart compares performance of the portfolio with a benchmark and the portfolio's Morningstar category.

- Portfolio
- Benchmark: Growth Composite Index
- Fund Category: Morningstar Large-Cap Blend

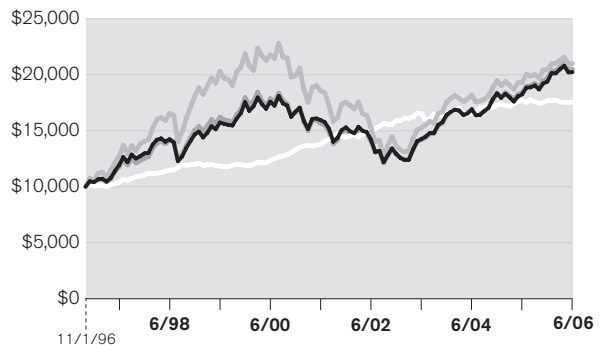


The performance data quoted represents past performance. Past performance does not guarantee future results. Investment returns and principal value will fluctuate so that an investor's shares may be worth more or less than their original cost. Current performance may be lower or higher than performance 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>1,2</sup>

This graph shows performance since inception of a hypothetical \$10,000 investment in the portfolio, compared with a similar investment in a benchmark and two additional indices.

- \$20,239 Portfolio
- \$20,495 Growth Composite Index
- \$20,991 S&P 500® Index
- \$17,560 Lehman Brothers U.S. Aggregate Bond Index



All portfolio 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. The portfolio's share price and principal values change, and when you sell your shares, they may be worth more or less than what you paid for them. Past performance does not indicate future results. Performance results less than one year are not annualized.

<sup>1</sup> Portfolio expenses have been partially absorbed by CSIM and Schwab. Without these reductions, the portfolio's returns would have been lower. Portfolio returns do not reflect the additional fees and expenses imposed by the insurance company under the variable insurance product contract. If those contract fees and expenses were included, the returns would be less than those shown. Please refer to the variable insurance product prospectus for a complete listing of these expenses.

<sup>2</sup> The Growth Composite Index is based on a comparable portfolio asset allocation and calculated using the following portion allocations: 60% Dow Jones Wilshire 5000 Composite Index<sup>SM</sup>, 20% MSCI EAFE<sup>®</sup> Index, 15% Lehman Brothers U.S. Aggregate Bond Index, and 5% Morningstar 3-Month T-Bill Index.

## Portfolio Facts as of 6/30/06

Style Assessment<sup>1</sup>

## Statistics

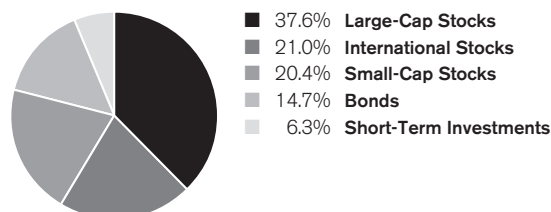
Number of Holdings	507
Weighted Average Market Cap (\$ x 1,000,000)	\$60,516
Price/Earnings Ratio (P/E)	19.0
Price/Book Ratio (P/B)	2.6
Portfolio Turnover Rate <sup>2</sup>	32%

Top Holdings<sup>3</sup>

Security	% of Net Assets
① Schwab Institutional Select* S&P 500 Fund	23.8%
② Schwab International Index Fund*, Select Shares*	21.1%
③ Schwab Small-Cap Index Fund*, Select Shares	20.5%
④ Schwab Total Bond Market Fund™	14.8%
⑤ Schwab Value Advantage Money Fund*, Select Shares	0.7%
⑥ Exxon Mobil Corp.	0.5%
⑦ General Electric Co.	0.4%
⑧ Citigroup, Inc.	0.3%
⑨ Bank of America Corp.	0.3%
⑩ Microsoft Corp.	0.3%
<b>Total</b>	<b>82.7%</b>

## Asset Class Weightings % of Investments

This chart shows the portfolio's asset class composition as of the report date.



Portfolio holdings may have changed since the report date.

Source of Sector Classification: S&P and MSCI.

<sup>1</sup> Source: Morningstar, Inc. This style assessment is the result of evaluating the stock portion of the portfolio based on a ten-factor model for value and growth characteristics. The portfolio's market capitalization placement is determined by the geometric mean of its holdings' market capitalizations. The assessment reflects the portfolio as of 6/30/06, which may have changed since then, and is not a precise indication of risk or performance—past, present, or future.

<sup>2</sup> Not annualized.

<sup>3</sup> This list is not a recommendation of any security by the investment adviser.

# Portfolio Expenses (unaudited)

## 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 January 1, 2006 and held through June 30, 2006.

**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 ÷ \$1,000 = 8.6), then multiply the result by the number given for your fund 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 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> (Annualized)	Beginning Account Value at 1/1/06	Ending Account Value (Net of Expenses) at 6/30/06	Expenses Paid During Period <sup>2</sup> 1/1/06–6/30/06
<b>Schwab MarketTrack Growth Portfolio II</b>				
Actual Return	0.50%	\$1,000	\$1,043.79	\$2.53
Hypothetical 5% Return	0.50%	\$1,000	\$1,022.32	\$2.51

<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 the portfolio 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 MarketTrack Growth Portfolio II

## Financial Statements

### Financial Highlights

	1/1/06– 6/30/06*	1/1/05– 12/31/05	1/1/04– 12/31/04	1/1/03– 12/31/03	1/1/02– 12/31/02	1/1/01– 12/31/01
<b>Per-Share Data (\$)</b>						
Net asset value at beginning of period	15.53	14.87	13.49	10.75	12.99	14.81
Income or loss from investment operations:						
Net investment income	0.08	0.24	0.21	0.16	0.17	0.18
Net realized and unrealized gains or losses	0.60	0.62	1.35	2.74	(2.17)	(1.43)
Total income or loss from investment operations	0.68	0.86	1.56	2.90	(2.00)	(1.25)
Less distributions:						
Dividends from net investment income	–	(0.20)	(0.18)	(0.16)	(0.20)	(0.35)
Distributions from net realized gains	–	–	–	–	(0.04)	(0.22)
Total distributions	–	(0.20)	(0.18)	(0.16)	(0.24)	(0.57)
Net asset value at end of period	16.21	15.53	14.87	13.49	10.75	12.99
Total return (%)	4.38 <sup>2</sup>	5.77	11.58	26.97	(15.44)	(8.40)
<b>Ratios/Supplemental Data (%)</b>						
Ratios to average net assets:						
Net operating expenses <sup>1</sup>	0.50 <sup>3</sup>	0.48	0.50	0.50	0.50	0.50
Gross operating expenses <sup>1</sup>	0.70 <sup>3</sup>	0.68	0.69	0.87	1.00	0.82
Net investment income	0.98 <sup>3</sup>	1.66	1.52	1.70	1.59	1.67
Portfolio turnover rate	32	5	8	10	30	13
Net assets, end of period (\$ x 1,000,000)	39	37	34	30	20	22

\* Unaudited.

<sup>1</sup> The expense incurred by underlying funds in which the portfolio invests are not included in this ratio. The income received by the portfolio from underlying funds is reduced by those expenses.

<sup>2</sup> Not annualized.

<sup>3</sup> Annualized.

**Portfolio Holdings** as of June 30, 2006 (Unaudited)

This section shows all the securities in the fund's portfolio by industry classification 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 Form N-Q is available on the SEC's website at www.sec.gov and may be viewed 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 also available by visiting Schwab's website at www.schwab.com/schwabfunds.

<b>Holdings by Category</b>	<b>Cost</b> (\$x1,000)	<b>Value</b> (\$x1,000)
<b>14.0% Common Stock</b>	3,048	5,471
<b>80.7% Other Investment Companies</b>	27,041	31,515
<b>5.6% Short-Term Investments</b>	2,155	2,155
<b>0.1% U.S. Government Securities</b>	45	45
<b>100.4% Total Investments</b>	<b>32,289</b>	<b>39,186</b>
<b>(0.4)% Other Assets and Liabilities</b>		(148)
<b>100.0% Net Assets</b>		<b>39,038</b>

<b>Security</b>	<b>Number of Shares</b>	<b>Value</b> (\$ x 1,000)
<b>Common Stock</b>	<b>14.0% of net assets</b>	

**Automobiles & Components 0.1%**

Cooper Tire & Rubber Co.	30	—
Ford Motor Co.	882	6
General Motors Corp.	266	8
Harley-Davidson, Inc.	127	7
Johnson Controls, Inc.	90	8
The Goodyear Tire & Rubber Co. *	84	1
		<b>30</b>

**Banks 1.1%**

AmSouth Bancorp	163	4
Bank of America Corp.	2,196	106
BB&T Corp.	253	11
Comerica, Inc.	78	4
Compass Bancshares, Inc.	59	3
Countrywide Financial Corp.	285	11
Fannie Mae	457	22
Fifth Third Bancorp	262	10
First Horizon National Corp.	60	2
Freddie Mac	326	19
Golden West Financial Corp.	122	9
Huntington Bancshares, Inc.	118	3

<b>Security</b>	<b>Number of Shares</b>	<b>Value</b> (\$ x 1,000)
KeyCorp	191	7
M&T Bank Corp.	37	4
Marshall & Ilsley Corp.	106	5
MGIC Investment Corp.	42	3
National City Corp.	260	9
North Fork Bancorp, Inc.	226	7
PNC Financial Services Group, Inc.	138	10
Regions Financial Corp.	215	7
Sovereign Bancorp, Inc.	176	4
SunTrust Banks, Inc.	175	13
Synovus Financial Corp.	149	4
U.S. Bancorp	851	26
Wachovia Corp.	766	41
Washington Mutual, Inc.	469	21
Wells Fargo & Co.	791	53
Zions Bancorp	50	4
		<b>422</b>

**Capital Goods 1.3%**

3M Co.	357	29
American Power Conversion Corp.	72	1
American Standard Cos., Inc.	85	4
Caterpillar, Inc.	317	24
Cooper Industries Ltd., Class A	44	4
Cummins, Inc.	22	3
Danaher Corp.	112	7
Deere & Co.	113	9
Dover Corp.	97	5
Eaton Corp.	71	5
Emerson Electric Co.	194	16
Fluor Corp.	42	4
General Dynamics Corp.	189	12
General Electric Co.	4,931	163
Goodrich Corp.	59	2
Honeywell International, Inc.	393	16
Illinois Tool Works, Inc.	196	9
Ingersoll-Rand Co., Class A	154	7
ITT Industries, Inc.	88	4
L-3 Communications Holdings, Inc.	58	4
Lockheed Martin Corp.	169	12
Masco Corp.	196	6
Navistar International Corp. *	30	1
Northrop Grumman Corp.	165	11
Paccar, Inc.	81	7
Pall Corp.	60	2
Parker Hannifin Corp.	56	4



**Portfolio Holdings** (Unaudited) continued

Security	Number of Shares	Value (\$ x 1,000)	Security	Number of Shares	Value (\$ x 1,000)
Raytheon Co.	212	9	<b>Consumer Services 0.2%</b>		
Rockwell Automation, Inc.	83	6	Apollo Group, Inc., Class A *	67	3
Rockwell Collins, Inc.	82	5	Carnival Corp.	204	9
Textron, Inc.	62	6	Darden Restaurants, Inc.	63	3
The Boeing Co.	377	31	Harrah's Entertainment, Inc.	88	6
Tyco International Ltd.	952	26	Hilton Hotels Corp.	155	4
United Technologies Corp.	479	30	International Game Technology	158	6
W.W. Grainger, Inc.	37	3	Marriott International, Inc., Class A	152	6
		<b>487</b>	McDonald's Corp.	593	20
<b>Commercial Services &amp; Supplies 0.1%</b>			Starbucks Corp. *	360	14
Allied Waste Industries, Inc. *	114	1	Starwood Hotels & Resorts Worldwide, Inc.	103	6
Avery Dennison Corp.	53	3	Wendy's International, Inc.	55	3
Cendant Corp.	477	8	YUM! Brands, Inc.	130	7
Cintas Corp.	66	3			<b>87</b>
Equifax, Inc.	62	2	<b>Diversified Financials 1.1%</b>		
H&R Block, Inc.	155	4	American Express Co.	584	31
Monster Worldwide, Inc. *	60	3	Ameriprise Financial, Inc.	118	5
Pitney Bowes, Inc.	108	5	Capital One Financial Corp.	142	12
R.R. Donnelley & Sons Co.	103	3	CIT Group, Inc.	95	5
Robert Half International, Inc.	82	3	Citigroup, Inc.	2,360	114
Waste Management, Inc.	260	9	E*TRADE Financial Corp. *	197	5
		<b>44</b>	Federated Investors, Inc., Class B	40	1
<b>Consumer Durables &amp; Apparel 0.2%</b>			Franklin Resources, Inc.	72	6
Brunswick Corp.	45	1	Janus Capital Group, Inc.	102	2
Centex Corp.	59	3	JPMorgan Chase & Co.	1,648	69
Coach, Inc. *	180	5	Legg Mason, Inc.	59	6
D.R. Horton, Inc.	128	3	Lehman Brothers Holdings, Inc.	350	23
Eastman Kodak Co.	134	3	Mellon Financial Corp.	197	7
Fortune Brands, Inc.	70	5	Merrill Lynch & Co., Inc.	434	30
Harman International Industries, Inc.	32	3	Moody's Corp.	116	6
Hasbro, Inc.	85	2	Morgan Stanley	507	32
Jones Apparel Group, Inc.	55	2	Northern Trust Corp.	87	5
KB Home	37	2	SLM Corp.	197	10
Leggett & Platt, Inc.	87	2	State Street Corp.	157	9
Lennar Corp., Class A	64	3	T. Rowe Price Group, Inc.	126	5
Liz Claiborne, Inc.	50	2	The Bank of New York Co., Inc.	64	12
Mattel, Inc.	182	3	The Bear Stearns Cos., Inc.	56	8
Newell Rubbermaid, Inc.	128	3	The Charles Schwab Corp. (a)	487	8
Nike, Inc., Class B	89	7	The Goldman Sachs Group, Inc.	206	31
Pulte Homes, Inc.	102	3			<b>442</b>
Snap-On, Inc.	27	1	<b>Energy 1.4%</b>		
The Black & Decker Corp.	36	3	Anadarko Petroleum Corp.	220	11
The Stanley Works	35	2	Apache Corp.	156	11
VF Corp.	42	3			
Whirlpool Corp.	36	3			
		<b>64</b>			

**Portfolio Holdings** (Unaudited) continued

<b>Security</b>	<b>Number of Shares</b>	<b>Value</b> (\$ x 1,000)	<b>Security</b>	<b>Number of Shares</b>	<b>Value</b> (\$ x 1,000)
Baker Hughes, Inc.	161	13	Coca-Cola Enterprises, Inc.	144	3
BJ Services Co.	154	6	ConAgra Foods, Inc.	245	5
Chesapeake Energy Corp.	176	5	Constellation Brands, Inc., Class A *	94	2
ChevronTexaco Corp.	1,052	65	Dean Foods Co. *	65	2
ConocoPhillips	779	51	General Mills, Inc.	168	9
Devon Energy Corp.	210	13	H.J. Heinz Co.	158	6
El Paso Corp.	310	5	Kellogg Co.	118	6
EOG Resources, Inc.	114	8	McCormick & Co., Inc.	63	2
Exxon Mobil Corp.	2,888	177	Molson Coors Brewing Co., Class B	25	2
Halliburton Co.	244	18	PepsiCo, Inc.	782	47
Hess Corp.	111	6	Reynolds American, Inc.	40	5
Kerr-McGee Corp.	108	7	Sara Lee Corp.	358	6
Kinder Morgan, Inc.	49	5	The Coca-Cola Co.	973	42
Marathon Oil Corp.	173	14	The Hershey Co.	84	5
Murphy Oil Corp.	79	4	The Pepsi Bottling Group, Inc.	63	2
Nabors Industries, Ltd. *	149	5	Tyson Foods, Inc., Class A	99	1
National-Oilwell Varco, Inc. *	82	5	UST, Inc.	78	4
Noble Corp.	64	5	Wm. Wrigley Jr. Co., Class A	105	5
Occidental Petroleum Corp.	203	21			<b>262</b>
Rowan Cos., Inc.	52	2			
Schlumberger Ltd.	558	36			
Sunoco, Inc.	64	4			
Transocean, Inc. *	154	12			
Valero Energy Corp.	294	20			
Weatherford International, Ltd. *	166	8			
Williams Cos., Inc.	282	7			
XTO Energy, Inc.	171	8			
		<b>552</b>			
<b>Food &amp; Staples Retailing 0.3%</b>			<b>Health Care Equipment &amp; Services 0.6%</b>		
Costco Wholesale Corp.	223	13	Aetna, Inc.	268	11
CVS Corp.	385	12	AmerisourceBergen Corp.	98	4
Safeway, Inc.	212	5	Bausch & Lomb, Inc.	26	1
Supervalu, Inc.	96	3	Baxter International, Inc.	305	11
Sysco Corp.	293	9	Becton Dickinson & Co.	118	7
The Kroger Co.	343	8	Biomet, Inc.	118	4
Wal-Mart Stores, Inc.	1,181	57	Boston Scientific Corp. *	544	9
Walgreen Co.	477	21	C.R. Bard, Inc.	50	4
Whole Foods Market, Inc.	66	4	Cardinal Health, Inc.	199	13
Winn-Dixie Stores, Inc. *	100	—	Caremark Rx, Inc.	212	11
		<b>132</b>	CIGNA Corp.	58	6
			Coventry Health Care, Inc. *	75	4
			Express Scripts, Inc. *	70	5
			HCA, Inc.	194	8
			Health Management Associates, Inc., Class A	114	2
			Hospira, Inc. *	77	3
			Humana, Inc. *	78	4
			IMS Health, Inc.	95	2
			Laboratory Corp. of America Holdings *	60	4
Altria Group, Inc.	986	72	Manor Care, Inc.	38	2
Anheuser-Busch Cos., Inc.	366	17	McKesson Corp.	144	7
Archer-Daniels-Midland Co.	309	13	Medco Health Solutions, Inc. *	145	8
Brown-Forman Corp., Class B	40	3	Medtronic, Inc.	570	27
Campbell Soup Co.	88	3			

**Portfolio Holdings** (Unaudited) continued

Security	Number of Shares	Value (\$ x 1,000)	Security	Number of Shares	Value (\$ x 1,000)
Patterson Cos., Inc. *	66	2			
Quest Diagnostics	76	4			
St. Jude Medical, Inc. *	173	6			
Stryker Corp.	139	6			
Tenet Healthcare Corp. *	223	1			
UnitedHealth Group, Inc.	640	29			
WellPoint, Inc. *	311	23			
Zimmer Holdings, Inc. *	118	7			
		<b>235</b>			
<b>Household &amp; Personal Products 0.3%</b>			<b>Materials 0.4%</b>		
Alberto-Culver Co., Class B	36	2	Air Products & Chemicals, Inc.	106	7
Avon Products, Inc.	213	7	Alcoa, Inc.	411	13
Clorox Co.	72	4	Allegheny Technologies, Inc.	40	3
Colgate-Palmolive Co.	242	15	Ashland, Inc.	34	2
Kimberly-Clark Corp.	218	13	Ball Corp.	50	2
Procter & Gamble Co.	1,555	87	Bemis Co.	50	2
The Estee Lauder Cos., Inc., Class A	57	2	E.I. du Pont de Nemours & Co.	434	18
		<b>130</b>	Eastman Chemical Co.	39	2
			Ecolab, Inc.	87	3
			Freeport-McMoran Copper & Gold, Inc., Class B	88	5
			Hercules, Inc. *	54	1
			International Flavors & Fragrances, Inc.	38	1
			International Paper Co.	233	8
			Louisiana-Pacific Corp.	51	1
			MeadWestvaco Corp.	86	2
			Monsanto Co.	127	11
			Newmont Mining Corp.	210	11
			Nucor Corp.	146	8
			Pactiv Corp. *	68	2
			Phelps Dodge Corp.	97	8
			PPG Industries, Inc.	79	5
			Praxair, Inc.	152	8
			Rohm & Haas Co.	69	3
			Sealed Air Corp.	39	2
			Sigma-Aldrich Corp.	39	3
			Temple-Inland, Inc.	53	2
			The Dow Chemical Co.	456	18
			United States Steel Corp.	52	4
			Vulcan Materials Co.	48	4
			Weyerhaeuser Co.	116	7
					<b>166</b>
			<b>Media 0.5%</b>		
			CBS Corp., Class B	995	27
			Clear Channel Communications, Inc.	244	7
			Comcast Corp., Class A *	1,010	33
			Dow Jones & Co., Inc.	28	1
			Gannett Co., Inc.	112	6
			Interpublic Group of Cos., Inc. *	204	2
			McGraw-Hill Cos., Inc.	173	9
			Meredith Corp.	20	1
			New York Times Co., Class A	74	2
			News Corp., Class A	1,134	22
			Omnicom Group, Inc.	84	7
			The E.W. Scripps Co., Class A	41	2
			The McClatchy Co., Class A	16	1
		<b>256</b>			

**Portfolio Holdings** (Unaudited) continued

Security	Number of Shares	Value (\$ x 1,000)
The Walt Disney Co.	911	27
Time Warner, Inc.	2,130	37
Tribune Co.	123	4
Univision Communications, Inc., Class A *	105	3
Viacom, Inc., Class B *	365	13
		<b>204</b>

**Pharmaceuticals & Biotechnology 1.1%**

Abbott Laboratories	728	32
Allergan, Inc.	71	8
Amgen, Inc. *	552	36
Applera Corp. - Applied Biosystems Group	87	3
Barr Pharmaceuticals, Inc. *	50	2
Biogen Idec, Inc. *	162	8
Bristol-Myers Squibb Co.	925	24
Eli Lilly & Co.	534	30
Fisher Scientific International, Inc. *	59	4
Forest Laboratories, Inc. *	155	6
Genzyme Corp. *	122	7
Gilead Sciences, Inc. *	218	13
Johnson & Johnson	1,407	84
King Pharmaceuticals, Inc. *	115	2
MedImmune, Inc. *	120	3
Merck & Co., Inc.	1,033	38
Millipore Corp. *	25	2
Mylan Laboratories, Inc.	104	2
PerkinElmer, Inc.	62	1
Pfizer, Inc. (b)	3,480	82
Schering-Plough Corp.	701	13
Thermo Electron Corp. *	77	3
Waters Corp. *	49	2
Watson Pharmaceuticals, Inc. *	49	1
Wyeth	635	28
		<b>434</b>

**Real Estate 0.1%**

Apartment Investment & Management Co., Class A	46	2
Archstone-Smith Trust	100	5
Boston Properties, Inc.	43	4
Equity Office Properties Trust	174	6
Equity Residential	137	6
Kimco Realty Corp.	100	4
Plum Creek Timber Co., Inc.	88	3
ProLogis	115	6
Public Storage, Inc.	40	3

Security	Number of Shares	Value (\$ x 1,000)
Simon Property Group, Inc.	86	7
Vornado Realty Trust	57	6
		<b>52</b>

**Retailing 0.5%**

Amazon.com, Inc. *	146	6
AutoNation, Inc. *	70	2
AutoZone, Inc. *	27	2
Bed, Bath & Beyond, Inc. *	132	4
Best Buy Co., Inc.	192	11
Big Lots, Inc. *	88	2
Circuit City Stores, Inc.	73	2
Dillard's, Inc.	30	1
Dollar General Corp.	150	2
eBay, Inc. *	544	16
Family Dollar Stores, Inc.	74	2
Federated Department Stores, Inc.	256	9
Genuine Parts Co.	81	3
Home Depot, Inc.	1,004	36
J.C. Penney Co., Inc.	109	7
Kohl's Corp. *	164	10
Limited Brands, Inc.	165	4
Lowe's Cos., Inc.	368	22
Nordstrom, Inc.	103	4
Office Depot, Inc. *	139	5
OfficeMax, Inc.	34	1
RadioShack Corp.	11	—
Sears Holdings Corp. *	48	8
Staples, Inc.	343	8
Target Corp.	416	20
The Gap, Inc.	270	5
The Sherwin-Williams Co.	53	3
The TJX Cos., Inc.	217	5
Tiffany & Co.	68	2
		<b>202</b>

**Semiconductors & Semiconductor Equipment 0.4%**

Advanced Micro Devices, Inc. *	227	5
Altera Corp. *	171	3
Analog Devices, Inc.	174	5
Applied Materials, Inc.	749	12
Applied Micro Circuits Corp. *	221	1
Broadcom Corp., Class A *	208	6
Freescale Semiconductor, Inc., Class B *	195	6
Intel Corp.	2,782	53
KLA-Tencor Corp.	95	4
Linear Technology Corp.	144	5

**Portfolio Holdings** (Unaudited) continued

Security	Number of Shares	Value (\$ x 1,000)	Security	Number of Shares	Value (\$ x 1,000)
LSI Logic Corp. *	186	2	Cisco Systems, Inc. *	2,909	57
Maxim Integrated Products, Inc.	151	5	Comverse Technology, Inc. *	96	2
Micron Technology, Inc. *	318	5	Corning, Inc. *	731	18
National Semiconductor Corp. 159	4		Dell, Inc. *	1,113	27
Novellus Systems, Inc. *	64	1	EMC Corp. *	1,124	12
NVIDIA Corp. *	161	3	Gateway, Inc. *	200	1
PMC - Sierra, Inc. *	88	1	Hewlett-Packard Co.	1,337	43
Teradyne, Inc. *	94	1	International Business Machines Corp.	741	57
Texas Instruments, Inc.	756	23	Jabil Circuit, Inc.	83	2
Xilinx, Inc.	164	4	JDS Uniphase Corp. *	794	2
		<b>149</b>	Juniper Networks, Inc. *	200	3
			Lexmark International, Inc., Class A *	52	3
<b>Software &amp; Services 0.7%</b>			Lucent Technologies, Inc. *	2,113	5
Adobe Systems, Inc. *	283	9	Molex, Inc.	68	2
Affiliated Computer Services, Inc., Class A *	55	3	Motorola, Inc.	1,181	24
Autodesk, Inc. *	110	4	NCR Corp. *	87	3
Automatic Data Processing, Inc.	274	13	Network Appliance, Inc. *	178	6
BMC Software, Inc. *	101	2	QLogic Corp. *	76	1
CA, Inc.	215	5	Qualcomm, Inc.	783	31
Citrix Systems, Inc. *	85	3	SanDisk Corp. *	88	5
Computer Sciences Corp. *	89	4	Sanmina - SCI Corp. *	252	1
Compuware Corp. *	182	1	Solectron Corp. *	433	2
Convergys Corp. *	67	1	Sun Microsystems, Inc. *	1,636	7
Electronic Arts, Inc. *	143	6	Symbol Technologies, Inc.	120	1
Electronic Data Systems Corp.	243	6	Tektronix, Inc.	39	1
First Data Corp.	362	16	Tellabs, Inc. *	214	3
Fiserv, Inc. *	88	4	Xerox Corp. *	440	6
Google, Inc., Class A *	96	40			<b>359</b>
Intuit, Inc. *	83	5			
Microsoft Corp. (b)	4,203	98	<b>Telecommunication Services 0.5%</b>		
Novell, Inc. *	185	1	Alltel Corp.	183	12
Oracle Corp. *	1,783	26	AT&T Corp.	1,834	51
Parametric Technology Corp. *	53	1	BellSouth Corp.	849	31
Paychex, Inc.	159	6	CenturyTel, Inc.	55	2
Sabre Holdings Corp., Class A	63	1	Citizens Communications Co.	156	2
Symantec Corp. *	492	8	Embarq Corp *	70	3
Unisys Corp. *	162	1	Qwest Communications International, Inc. *	734	6
VeriSign, Inc. *	116	3	Sprint Nextel Corp.	1,404	28
Yahoo! Inc. *	597	20	Verizon Communications, Inc.	1,383	46
		<b>287</b>			<b>181</b>
			<b>Transportation 0.3%</b>		
<b>Technology Hardware &amp; Equipment 0.9%</b>			Burlington Northern Santa Fe Corp.	175	14
ADC Telecommunications, Inc. *	56	1	CSX Corp.	103	7
Agilent Technologies, Inc. *	202	6	Delta Air Lines, Inc. *	100	—
Andrew Corp. *	76	1	FedEx Corp.	143	17
Apple Computer, Inc. *	402	23	Norfolk Southern Corp.	195	10
Avaya, Inc. *	198	2	Ryder System, Inc.	29	2
CIENA Corp. *	276	1			

**Portfolio Holdings** (Unaudited) continued

Security	Number of Shares	Value (\$ x 1,000)
Southwest Airlines Co.	335	6
Union Pacific Corp.	125	12
United Parcel Service, Inc., Class B	515	42
		<u>110</u>

**Utilities 0.5%**

Allegheny Energy, Inc. *	78	3
Ameren Corp.	96	5
American Electric Power Co., Inc.	187	6
CenterPoint Energy, Inc.	147	2
CMS Energy Corp. *	105	1
Consolidated Edison, Inc.	117	5
Constellation Energy Group, Inc.	85	5
Dominion Resources, Inc.	164	12
DTE Energy Co.	85	3
Duke Energy Corp.	585	17
Dynegy, Inc., Class A *	143	1
Edison International	155	6
Entergy Corp.	98	7
Exelon Corp.	314	18
FirstEnergy Corp.	157	9
FPL Group, Inc.	190	8
KeySpan Corp.	83	3
Nicor, Inc.	32	1
NiSource, Inc.	130	3
Peoples Energy Corp.	19	1
PG&E Corp.	163	6
Pinnacle West Capital Corp.	47	2
PPL Corp.	179	6
Progress Energy, Inc.	120	5
Public Service Enterprise Group, Inc.	118	8
Sempra Energy	123	6
TECO Energy, Inc.	99	1
The AES Corp. *	310	6
The Southern Co.	349	11
TXU Corp.	217	13
Xcel Energy, Inc.	192	4

**184****Other Investment Companies 80.7% of net assets**

Schwab Institutional Select S&P 500 Fund, Select Shares (a)	920,990	9,274
Schwab International Index Fund, Select Shares (a),(b)	420,294	8,225
Schwab Small-Cap Index Fund, Select Shares (a)	325,458	7,990
Schwab Total Bond Market		

Security	Number of Shares	Value (\$ x 1,000)
Fund (a)	601,781	5,771
Schwab Value Advantage Money Fund, Select Shares (a)	254,860	255
		<u>31,515</u>

Security	Face Amount (\$ x 1,000)	Value (\$ x 1,000)
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**Short-Term Investments 5.6% of net assets**

Brown Brothers Harriman & Co. Cash Management Sweep	2,155	<b>2,155</b>
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Security Rate, Maturity Date	Face Amount (\$ x 1,000)	Value (\$ x 1,000)
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**U.S. Government Securities 0.1% of net assets**

U.S. Treasury Bill 4.71%, 09/14/06	45	<b>45</b>
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**End of Investments.**

At 06/30/2006, the tax basis cost of the fund's investments was \$32,596 and the unrealized appreciation and depreciation were \$7,083 and (\$493), respectively, with a net unrealized appreciation of \$6,590.

In addition to the above, the fund held the following at 06/30/2006. All numbers are x1,000 except number of futures contracts.

	Number of Contracts	Contract Value	Unrealized Gains
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**Futures Contract 1.0% of net assets**

S & P Mini 500 Index Future, Long Expires 09/15/06	6	384	<b>9</b>
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\* Non-income producing security.

(a) Issuer is affiliated with the fund's adviser.

(b) All or a portion of this security is held as collateral for open futures contracts.

Statement of

**Assets and Liabilities**

As of June 30, 2006; unaudited. All numbers x 1,000 except NAV.

**Assets**

Investments in affiliated underlying funds, at value (cost \$27,041)	\$31,515
Investments, at value (cost \$5,248)	7,671
Receivables:	
Fund shares sold	36
Dividends	+
	32
<b>Total assets</b>	<b>39,254</b>

**Liabilities**

Payables:	
Fund shares redeemed	175
Investments bought	27
Due to brokers for futures	1
Investment adviser and administrator fees	1
Accrued expenses	+
	12
<b>Total liabilities</b>	<b>216</b>

**Net Assets**

Total assets	39,254
Total liabilities	-
	216
<b>Net assets</b>	<b>\$39,038</b>

**Net Assets by Source**

Capital received from investors	31,319
Net investment income not yet distributed	761
Net realized capital gains	52
Net unrealized capital gains	6,906

**Net Asset Value (NAV)**

<b>Net Assets</b>	+	<b>Shares Outstanding</b>	=	<b>NAV</b>
\$39,038		2,409		\$16.21

## Statement of

**Operations**

For January 1, 2006 through June 30, 2006; unaudited. All numbers x 1,000.

**Investment Income**

Dividends received from affiliated underlying funds	\$132
Dividends	136
Interest	+ 12
<b>Total investment income</b>	<b>\$280</b>

**Net Realized Gains and Losses**

Net realized losses on sales of affiliated issuers	(5)
Net realized gains received from affiliated underlying funds	36
Net realized gains on investments	929
Net realized losses on futures contracts	+ (31)
<b>Net realized gains</b>	<b>929</b>

**Net Unrealized Gains and Losses**

Net unrealized losses on investments	(401)
Net unrealized gains on affiliated funds	822
Net unrealized gains on futures contracts	+ 9
<b>Net unrealized gains</b>	<b>430</b>

**Expenses**

Investment adviser and administrator fees	84
Trustees' fees	8
Custodian fees	3
Portfolio accounting fees	8
Professional fees	15
Registration fees	1
Shareholder reports	11
Other expenses	+ 2
Total expenses	132
Expense reduction	- 37
<b>Net expenses</b>	<b>95</b>

**Increase in Net Assets from Operations**

<b>Total investment income</b>	280
<b>Net expenses</b>	- 95
<b>Net investment income</b>	<b>185</b>
<b>Net realized gains</b>	929
<b>Net unrealized gains</b>	+ 430
<b>Increase in net assets from operations</b>	<b>\$1,544</b>



Statements of

**Changes in Net Assets**

For the current and prior report periods. All numbers x 1,000.

Figures for current period are unaudited.

**Operations**

	1/1/06-6/30/06	1/1/05-12/31/05
Net investment income	\$185	\$576
Net realized gains	929	156
Net unrealized gains	+	1,255
<b>Increase in net assets from operations</b>	<b>1,544</b>	<b>1,987</b>

**Distributions Paid**

Dividends from net investment income	—	466
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**Transactions in Fund Shares**

	1/1/06-6/30/06		1/1/05-12/31/05	
	SHARES	VALUE	SHARES	VALUE
Shares sold	316	\$5,152	339	\$5,081
Shares reinvested	—	—	29	466
Shares redeemed	+	(273)	(278)	(4,162)
<b>Net transactions in fund shares</b>	<b>43</b>	<b>\$745</b>	<b>90</b>	<b>\$1,385</b>

**Shares Outstanding and Net Assets**

	1/1/06-6/30/06		1/1/05-12/31/05	
	SHARES	NET ASSETS	SHARES	NET ASSETS
Beginning of period	2,366	\$36,749	2,276	\$33,843
Total increase	+	43	90	2,906
<b>End of period</b>	<b>2,409</b>	<b>\$39,038</b>	<b>2,366</b>	<b>\$36,749</b>

Net investment income not yet distributed	\$761	\$576
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## Financial Notes, unaudited.

Unless stated, all dollar amounts are x 1,000.

### 1. Business Structure of the Fund

Schwab MarketTrack Growth Portfolio II is a series of Schwab Annuity Portfolios, 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 list below shows all the funds in the trust including the fund in this report, which is highlighted:

**Schwab Annuity Portfolios**  
Organized January 21, 1994

Schwab Money Market Portfolio  
**Schwab MarketTrack Growth Portfolio II**  
Schwab S&P 500 Index Portfolio

Schwab MarketTrack Growth Portfolio II 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 fund is intended as an investment vehicle for variable annuity contracts and variable life insurance policies to be offered by separate accounts of participating life insurance companies and for pension and retirement plans qualified under the Internal Revenue Code of 1986, as amended.

### 2. Significant Accounting Policies

The following is a summary of the significant accounting policies the fund uses in its operations and in the preparation of financial statements:

#### (a) Security Valuation:

The fund values the securities in its portfolio every business day. The fund uses the following policies to value various types of securities:

- **Securities traded on an exchange or over-the-counter:** valued at the closing value for the day, or, on days when no closing value has been reported, halfway between the most recent bid and asked quotes. Securities that are primarily traded on foreign exchanges are valued at the closing values of such securities on their respective exchanges with these values then translated into U.S. dollars at the current exchange rate.
- **Securities for which no quoted value is available or when a significant event has occurred between the time of the security's last close and the time the fund calculates net asset value:** 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 and the Pricing Committee. Some of the more common reasons that may necessitate that a security be valued at fair value include: the security's trading has been halted or suspended; the security has been de-listed from a national exchange; the security's primary trading market is temporarily closed at a time when under normal conditions it would be open; or the security's primary pricing source is not able or willing to provide a price.
- **Futures:** open contracts are valued at their settlement prices as of the close of their exchanges. When a fund closes out a futures 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.
- **Underlying funds:** valued at their respective net asset values as determined by those funds, in accordance with the Investment Company Act of 1940.

## Financial Notes, unaudited (continued).

Unless stated, all dollar amounts are x 1,000.

### 2. Significant Accounting Policies (continued)

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

#### (b) Portfolio Investments:

**Futures Contract:** The fund 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 the 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. The potential for losses associated with futures contracts may exceed amounts recorded in the Statement of Assets and Liabilities.

Because futures carry inherent risks, the 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. The fund records the change in market value of futures, and also the change in the amount of margin deposit required (“due to/from broker”).

#### (c) Security Transactions:

Security transactions are recorded as of the date the order to buy or sell the security is executed. Realized gains and losses from security transactions are based on the identified costs of the securities involved.

Assets and liabilities denominated in foreign currencies are reported in U.S. dollars. For assets and liabilities held on a given date, the dollar value is based on market exchange rates in effect on that date. Transactions involving foreign currencies, including purchases, sales, income receipts and expense payments, are calculated using exchange rates in effect on the transaction date.

For the period ended June 30, 2006, purchases and sales of securities (excluding short-term obligations) were as follows:

<u>Purchases</u>	<u>Sales/Maturities</u>
\$11,743	\$12,335

#### (d) Income, Expenses and Distributions:

Income from interest and the accretion of discount is recorded as it accrues. Dividends and distributions from portfolio securities and underlying funds are recorded on the date they are effective (the ex-dividend date), although the fund records certain foreign security dividends on the day it learns of the ex-dividend date.

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

The fund pays dividends from net investment income and makes distributions from net realized capital gains once a year.

The fund maintains its own account for purposes of holding assets and accounting, and is considered a separate entity for tax purposes. Within its account, the fund also keeps certain assets in segregated accounts, as may be required by securities law.

**Financial Notes**, unaudited (continued).

Unless stated, all dollar amounts are x 1,000.

**2. Significant Accounting Policies (continued)****(e) Borrowing:**

The fund may borrow money from banks and custodians. The fund may obtain temporary bank loans through the trust to which the fund belongs to use for meeting shareholder redemptions or for extraordinary or emergency purposes. The trust has 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 fund pays interest on the amounts it borrows at rates that are negotiated periodically.

	<b>Amount Outstanding at 6/30/06 (\$ x 1000)</b>	<b>Average Borrowing* (\$ x 1000)</b>	<b>Weighted Average Interest Rate* (%)</b>
Schwab MarketTrack Growth Portfolio II	—	329	5.24

\* Based on the number of days for which the borrowing is outstanding.

**(f) Accounting Estimates:**

The accounting policies described in this report 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.

**(g) Indemnification:**

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

**3. Affiliates and Affiliated Transactions**

Charles Schwab Investment Management, Inc. (CSIM or the investment adviser), a wholly owned subsidiary of The Charles Schwab Corporation, serves as the fund's investment adviser and administrator pursuant to an Investment Advisory and Administration Agreement (Advisory Agreement) between it and the trust. Charles Schwab & Co., Inc. ("Schwab") is an affiliate of the investment adviser and is the trust's shareholder services agent and transfer agent.

For its advisory and the administrative services to the fund, the investment adviser is entitled to receive an annual fee payable monthly based on the fund's average daily net assets described as follows:

<b><u>Average daily net assets</u></b>	
First \$500 million	0.44%
Over \$500 million	0.39%

Schwab does not charge the fund for transfer agent and shareholder services fees.

Although these agreements specify certain fees for these services, CSIM and Schwab have made additional agreements with the fund to limit the total expenses charged, excluding interest, taxes and certain non-routine expenses to 0.50% through April 29, 2007.

## Financial Notes, unaudited (continued).

Unless stated, all dollar amounts are x 1,000.

### 3. Affiliates and Affiliated Transactions (continued)

The fund may engage in certain transactions involving related parties. For instance, the fund may own shares of The Charles Schwab Corporation if that company is included in an index which the fund uses as part of an indexing strategy. Pursuant to an exemptive order issued by the SEC, the fund may invest in other related funds. As of June 30, 2006, the shares owned by the fund as a percentage of the total shares of the underlying funds is:

#### Schwab Equity Index Funds

Institutional Select S&P 500 Fund	0.6%
International Index Fund	0.5%
Small-Cap Index Fund	0.5%

#### Schwab Bond Funds

Total Bond Market Fund	0.5%
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#### Schwab Money Funds

Value Advantage Money Fund	less than 0.1%
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The fund 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. For the period ended June 30, 2006, the fund had no security transactions with other Schwab Funds.

Pursuant to an exemptive order issued by the SEC, the fund 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. There was no interfund borrowing or lending activity for the fund during the period.

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 the fund's Statement of Operations.

### 4. Federal Income Taxes

The fund intends to meet federal income and excise tax requirements for regulated investment companies. Accordingly, the fund distributes substantially all of its net investment income and realized net capital gains (if any) to the participating insurance company separate accounts 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 losses on wash sales. As long as the fund meets the tax requirements, it is not required to pay federal income tax.

As of December 31, 2005, the components of distributable earnings on a tax basis were as follows:

Ordinary income	\$576
Long-term capital gains	—

## Financial Notes, unaudited (continued).

Unless stated, all dollar amounts are x 1,000.

### 4. Federal Income Taxes (continued)

As of December 31, 2005, the fund had capital loss carry forwards available to offset future net capital gains before the expiration dates:

<u>Expire</u>	
2010	\$293
2011	200
2012	<u>103</u>
Total	<u><u>\$596</u></u>

The tax-basis components of distributions for the fiscal year ended December 31, 2005 were:

From ordinary income	\$466
From long-term capital gains	—
From return of capital	—

The permanent book and tax basis differences may result in reclassifications between capital account and other accounts as required. The adjustments will have no impact on net assets or the results of operations. As of December 31, 2005, the fund made the following reclassifications:

Capital received from investors	\$2
Net realized capital losses	(\$2)

# Investment Advisory Agreement Approval

The Investment Company Act of 1940 (the “1940 Act”) requires that initial approval of, as well as the continuation of, a fund’s investment advisory agreement must be specifically approved (1) by the vote of the trustees or by a vote of the shareholders of the fund, and (2) by the vote of a majority of the trustees who are not parties to the investment advisory agreement or “interested persons” of any party (the “Independent Trustees”), cast in person at a meeting called for the purpose of voting on such approval. In connection with such approvals, the fund’s trustees must request and evaluate, and the investment adviser is required to furnish, such information as may be reasonably necessary to evaluate the terms of the advisory agreement. In addition, the Securities and Exchange Commission (the “SEC”) takes the position that, as part of their fiduciary duties with respect to fund fees, fund boards are required to evaluate the material factors applicable to a decision to approve an investment advisory agreement.

Consistent with these responsibilities, the Board of Trustees (the “Board”) calls and holds one or more meetings each year that are dedicated, in whole or in part, to considering whether to renew the investment advisory agreement between Schwab Annuity Portfolios (the “Trust”) and CSIM (the “Agreement”) with respect to existing funds in the Trust, including the Schwab MarketTrack Growth Portfolio II, and to review certain other agreements pursuant to which CSIM provides investment advisory services to certain other registered investment companies. In preparation for the meeting(s), the Board requests and reviews a wide variety of materials provided by CSIM, including information about CSIM’s affiliates, personnel and operations. The Board also receives extensive data provided by third parties. This information is in addition to the detailed information about the funds that the Board reviews during the course of each year, including information that relates to fund operations and fund performance. The trustees also receive a memorandum from fund counsel regarding the

responsibilities of trustees for the approval of investment advisory contracts. In addition, the Independent Trustees receive advice from independent counsel to the Independent Trustees, meet in executive session outside the presence of fund management and participate in question and answer sessions with representatives of CSIM.

The Board, including a majority of the Independent Trustees, considered information specifically relating to the continuance of the Agreement at meetings held on May 2, 2006, May 24, 2006 and June 12, 2006, and approved the renewal of the Agreement for an additional one year term at the meeting held on June 12, 2006. The Board’s approval of the Agreement was based on consideration and evaluation of a variety of specific factors discussed at these meetings and at prior meetings, including:

1. the nature, extent and quality of the services provided to the funds under the Agreement, including the resources of CSIM and its affiliates dedicated to the funds;
2. each fund’s investment performance and how it compared to that of certain other comparable mutual funds;
3. each fund’s expenses and how those expenses compared to those of certain other comparable mutual funds;
4. the profitability of CSIM and its affiliates, including Charles Schwab & Co., Inc. (“Schwab”), with respect to each fund, including both direct and indirect benefits accruing to CSIM and its affiliates; and
5. the extent to which economies of scale would be realized as the funds grow and whether fee levels in the Agreement reflect those economies of scale for the benefit of fund investors.

**Nature, Extent and Quality of Services.** The Board considered the nature, extent and quality of the services provided by CSIM to the funds and the resources of CSIM and its affiliates dedicated to the funds. In this regard, the trustees evaluated, among other things, CSIM's personnel, experience, track record and compliance program. The trustees considered the role of unaffiliated insurance companies in the distribution of the funds. The information considered by the trustees included specific information concerning changes in the nature, extent and quality of services provided by CSIM since the trustees had last considered approval of the Agreement. The trustees also considered Schwab's excellent reputation as a full service brokerage firm and its overall financial condition, and how this affects the success of the funds. Following such evaluation, the Board concluded, within the context of its full deliberations, that the nature, extent and quality of services provided by CSIM to the funds and the resources of CSIM and its affiliates dedicated to the funds supported renewal of the Agreement.

**Fund Performance.** The Board considered fund performance in determining whether to renew the Agreement. Specifically, the trustees considered each fund's performance relative to a peer group of other mutual funds and appropriate indices/benchmarks, in light of total return, yield, when applicable, and market trends. As part of this review, the trustees considered the composition of the peer group, selection criteria and the reputation of the third party who prepared the peer group analysis. In evaluating the performance of each fund, the trustees considered both risk and shareholder risk expectations for such fund and the appropriateness of the benchmark used to compare the performance of each fund. The trustees further considered the level of fund performance in the context of its review of fund expenses and adviser profitability discussed below. Following such evaluation the Board concluded, within the con-

text of its full deliberations, that the performance of the funds supported renewal of the Agreement.

**Fund Expenses.** With respect to the funds' expenses, the trustees considered the rate of compensation called for by the Agreement, and each fund's net operating expense ratio, in each case, in comparison to those of other comparable mutual funds, such peer groups and comparisons having been selected and calculated by an independent third party. The trustees considered the effects of CSIM's and Schwab's historical practice of voluntarily waiving management and other fees to prevent total fund expenses from exceeding a specified cap. The trustees also considered fees charged by CSIM to other mutual funds and to other types of accounts, such as wrap accounts and offshore funds, but, with respect to such other types of accounts, accorded less weight to such comparisons due to the different legal, regulatory, compliance and operating features of mutual funds as compared to these other types of accounts, and the unique insurance dedicated distribution arrangements of the funds as compared to other funds managed by CSIM. Following such evaluation, the Board concluded, within the context of its full deliberations, that the expenses of the funds are reasonable and supported renewal of the Agreement.

**Profitability.** With regard to profitability, the trustees considered the compensation flowing to CSIM and its affiliates, directly or indirectly. In this connection, the trustees reviewed management's profitability analyses, together with certain commentary thereon from an independent accounting firm. The trustees also considered any other benefits derived by CSIM from its relationship with the funds, such as whether, by virtue of its management of the Funds, CSIM obtains investment information or other research resources that aid it in providing advisory services to other clients. The trustees considered whether the varied levels of compensation and profitability under



the Agreement and other service agreements were reasonable and justified in light of the quality of all services rendered to each fund by CSIM and its affiliates. The Board also considered information relating to changes to CSIM's cost structure, including cost savings, technology investments and increased operating efficiencies and how these changes affected CSIM's profitability under the Agreement. Based on this evaluation, the Board concluded, within the context of its full deliberations, that the profitability of CSIM is reasonable and supported renewal of the Agreement.

**Economies of Scale.** The trustees considered the existence of any economies of scale and whether those are passed along to a fund's shareholders through a graduated investment advisory fee schedule or other means, including any fee waivers by CSIM and its affiliates. In this regard, and consistent with their consideration of fund expenses, the trustees considered that CSIM and Schwab have previously committed resources to minimize the effects on shareholders of diseconomies of scale during periods when fund assets were relatively small through their contractual expense waivers. For example, such diseconomies of scale may particularly affect newer funds or funds with investment strategies that are from time to time out of favor, but shareholders may benefit from the continued availability of such funds at subsidized expense levels. The trustees also considered CSIM's agreement to contractual investment advisory fee schedules that include lower fees at higher graduated asset levels. The Board also considered certain commitments by CSIM and Schwab that are designed to pass along potential economies of scale to fund shareholders. Specifically, the Board considered CSIM and Schwab's commitments, which may be changed only with Board approval: (i) to reduce contractual advisory fees or add breakpoints for certain funds,

and (ii) to implement, by means of expense limitation agreement, reductions in net overall expenses for certain funds. Based on this evaluation, and in consideration of the commitments made by CSIM and Schwab as discussed above, the Board concluded, within the context of its full deliberations, that the funds obtain reasonable benefit from economies of scale.

In the course of their deliberations, the trustees did not identify any particular information or factor that was all-important or controlling. Based on the trustees' deliberation and their evaluation of the information described above, the Board, including all of the Independent Trustees, unanimously approved the continuation of the Agreement and concluded that the compensation under the Agreement is fair and reasonable in light of such services and expenses and such other matters as the trustees have considered to be relevant in the exercise of their reasonable judgment.

# Trustees and Officers

The tables below give information about the trustees and officers for The Schwab Annuity Portfolios, which includes the fund covered in this report. The “Fund Complex” includes The Charles Schwab Family of Funds, Schwab Investments, Schwab Capital Trust, Schwab Annuity Portfolios, Laudus Trust, Laudus Variable Insurance Trust, Excelsior Funds, Inc., Excelsior Tax-Exempt Funds, Inc., and Excelsior Funds Trust. As of June 30, 2006, the Fund Complex included 98 funds.

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.

## Independent Trustees

Name, Year of Birth, and Position(s) with the Trust; (Term of Office, and Length of Time Served <sup>1</sup> )	Principal Occupations During the Past Five Years	Number of Portfolios in Fund Complex Overseen by the Trustee	Other Directorships
<b>Mariann Byerwalter</b> 1960 Trustee (Trustee of The Schwab Annuity Portfolios since 2000.)	Chairman of JDN Corporate Advisory LLC. <i>From 1996 to 2001</i> , Vice President for Business Affairs and Chief Financial Officer of Stanford University, and <i>in 2001</i> , Special Advisor to the President of Stanford University.	98	<i>Board 1</i> —Director, Redwood Trust, Inc. <i>Board 2</i> —Director, PMI Group, Inc.
<b>Donald F. Dorward</b> 1931 Trustee (Trustee of The Schwab Annuity Portfolios since 1989.)	Chief Executive Officer, Dorward & Associates (corporate management, marketing and communications consulting firm). <i>From 1996-1999</i> , Executive Vice President and Managing Director, Grey Advertising. <i>Prior to 1996</i> , President and Chief Executive Officer, Allen & Dorward Advertising.	57	None.
<b>William A. Hasler</b> 1941 Trustee (Trustee of The Schwab Annuity Portfolios since 2000.)	Retired. Dean Emeritus, Haas School of Business, University of California, Berkeley. <i>Until February 2004</i> , Co-Chief Executive Officer, Apton Corp. (bio-pharmaceuticals). <i>Prior to August 1998</i> , Dean of the Haas School of Business, University of California, Berkeley (higher education).	98	<i>Board 1</i> —Director, Apton Corp. <i>Board 2</i> —Director, Mission West Properties <i>Board 3</i> —Director, TOUSA <i>Board 4</i> —Director, Stratex Networks <i>Board 5</i> —Director, Genitope Corp. <i>Board 6</i> —Director & Non-Executive Chairman, Solectron Corp. <i>Board 7</i> —Director, Ditech Communications Corp.

**Independent Trustees** continued

Name, Year of Birth, and Position(s) with the Trust; (Term of Office, and Length of Time Served')	Principal Occupations During the Past Five Years	Number of Portfolios in Fund Complex Overseen by the Trustee	Other Directorships
<p><b>Robert G. Holmes</b> 1931 Trustee (Trustee of The Schwab Annuity Portfolios since 1989.)</p>	<p>Chairman, Chief Executive Officer and Director, Semloh Financial, Inc. (international financial services and investment advisory firm).</p>	57	None.
<p><b>Gerald B. Smith</b> 1950 Trustee (Trustee of The Schwab Annuity Portfolios since 2000.)</p>	<p>Chairman and Chief Executive Officer and founder of Smith Graham &amp; Co. (investment advisors).</p>	57	<p><i>Board 1</i>—Board of Cooper Industries <i>Board 2</i>—Chairman of the Audit Committee of Northern Border Partners, M.L.P.</p>
<p><b>Donald R. Stephens</b> 1938 Trustee (Trustee of The Schwab Annuity Portfolios since 1989.)</p>	<p>Managing Partner, D.R. Stephens &amp; Company (investments). Prior to 1996, Chairman and Chief Executive Officer of North American Trust (real estate investment trust).</p>	57	None.
<p><b>Michael W. Wilsey</b> 1943 Trustee (Trustee of The Schwab Annuity Portfolios since 1989.)</p>	<p>Chairman and Chief Executive Officer, Wilsey Bennett, Inc. (real estate investment and management, and other investments).</p>	57	None.

## Interested Trustees

Name, Year of Birth, and Position(s) with the Trust; (Term of Office, and Length of Time Served <sup>1</sup> )	Principal Occupations During the Past Five Years	Number of Portfolios in Fund Complex Overseen by the Trustee	Other Directorships
<p><b>Charles R. Schwab</b><sup>2</sup> 1937 Chairman and Trustee (Chairman and Trustee of The Schwab Annuity Portfolios since 1989.)</p>	<p>Chairman, Chief Executive Officer and Director, The Charles Schwab Corporation, Charles Schwab &amp; Co., Inc.; Chairman and Director, Charles Schwab Investment Management, Inc., Charles Schwab Bank, N. A.; Chairman and Chief Executive Officer, Schwab (SIS) Holdings Inc. I, Schwab International Holdings, Inc.; Chief Executive Officer and Director, Schwab Holdings, Inc.; Director, U.S. Trust Company, N. A., U.S. Trust Corporation, United States Trust Company of New York. <i>Until May 2003</i>, Co-Chief Executive Officer, The Charles Schwab Corporation.</p>	57	None.
<p><b>Randall W. Merk</b><sup>2</sup> 1954 Trustee (Trustee of The Schwab Annuity Portfolios since 2005.)</p>	<p>Executive Vice President and President, Schwab Financial Products, Charles Schwab &amp; Co., Inc.; Director, Charles Schwab Asset Management (Ireland) Limited and Charles Schwab Worldwide Funds PLC. <i>From September 2002 to July 2004</i>, Chief Executive Officer and President, Charles Schwab Investment Management, Inc. and Executive Vice President, Charles Schwab &amp; Co., Inc. <i>Prior to September 2002</i>, President and Chief Investment Officer, American Century Investment Management, and Director, American Century Companies, Inc.</p>	98	None.

## Officers of the Trust

Name, Year of Birth, and Position(s) with the Trust; (Term of Office, and Length of Time Served <sup>3</sup> )	Principal Occupations During the Past Five Years
<p><b>Evelyn Dilsaver</b> 1955 President and Chief Executive Officer (Officer of The Schwab Annuity Portfolios since 2004.)</p>	<p>President, Chief Executive Officer, and Director, Charles Schwab Investment Management, Inc.; Executive Vice President, Charles Schwab &amp; Co., Inc; President and Chief Executive Officer, Laudus Trust and Laudus Variable Insurance Trust; President, Excelsior Funds Inc., Excelsior Tax-Exempt Funds, Inc., and Excelsior Funds Trust; President, Mutual Fund Division, UST Advisers, Inc. <i>From June 2003 to July 2004</i>, Senior Vice President, Asset Management Products and Services, Charles Schwab &amp; Co., Inc. <i>Prior to June 2003</i>, Executive Vice President, Chief Financial Officer, and Chief Administrative Officer, U.S. Trust, a subsidiary of The Charles Schwab Corporation.</p>
<p><b>Stephen B. Ward</b> 1955 Senior Vice President and Chief Investment Officer (Officer of The Schwab Annuity Portfolios since 1991.)</p>	<p>Director, Senior Vice President and Chief Investment Officer, Charles Schwab Investment Management, Inc.; Chief Investment Officer, The Charles Schwab Trust Company.</p>
<p><b>George Pereira</b> 1964 Treasurer and Principal Financial Officer (Officer of The Schwab Annuity Portfolios since 2004.)</p>	<p>Senior Vice President and Chief Financial Officer, Charles Schwab Investment Management, Inc.; Chief Financial Officer, Laudus Trust and Laudus Variable Insurance Trust; Chief Financial Officer and Chief Accounting Officer, Excelsior Funds Inc., Excelsior Tax-Exempt Funds, Inc., and Excelsior Funds Trust; Chief Financial Officer, Mutual Fund Division, UST Advisers, Inc. Director, Charles Schwab Worldwide Fund, PLC and Charles Schwab Asset Management (Ireland) Limited. <i>From December 1999 to November 2004</i>, Sr. Vice President, Financial Reporting, Charles Schwab &amp; Co., Inc.</p>
<p><b>Kimon Daifotis</b> 1959 Senior Vice President and Chief Investment Officer—Fixed Income (Officer of The Schwab Annuity Portfolios since 2004.)</p>	<p>Senior Vice President and Chief Investment Officer—Fixed Income, Charles Schwab Investment Management, Inc. <i>Prior to 2004</i>, Vice President and Sr. Portfolio Manager, Charles Schwab Investment Management, Inc.</p>
<p><b>Jeffrey Mortimer</b> 1963 Senior Vice President and Chief Investment Officer—Equities (Officer of The Schwab Annuity Portfolios since 2004.)</p>	<p>Senior Vice President and Chief Investment Officer—Equities, Charles Schwab Investment Management, Inc.; Vice President and Chief Investment Officer, Laudus Trust and Laudus Variable Insurance Trust. <i>Prior to 2004</i>, Vice President and Sr. Portfolio Manager, Charles Schwab Investment Management, Inc.</p>

## Officers of the Trust continued

Name, Year of Birth, and Position(s) with the Trust; (Term of Office, and Length of Time Served <sup>3</sup> )	Principal Occupations During the Past Five Years
<p><b>Randall Fillmore</b> 1960 Chief Compliance Officer and AML Officer (Officer of The Schwab Annuity Portfolios since 2002.)</p>	<p>Senior Vice President and Chief Compliance Officer, Charles Schwab Investment Management, Inc.; Senior Vice President Charles Schwab &amp; Co., Inc.; Chief Compliance Officer, Laudus Trust and Laudus Variable Insurance Trust; Chief Compliance Officer, Excelsior Funds Inc., Excelsior Tax-Exempt Funds, Inc., and Excelsior Funds Trust. <i>From 2002 to 2003</i>, Vice President, Charles Schwab &amp; Co., Inc., and Charles Schwab Investment Management, Inc. <i>From 2000 to 2002</i>, Vice President, Internal Audit, Charles Schwab &amp; Co., Inc.</p>
<p><b>Koji E. Felton</b> 1961 Secretary and Chief Legal Officer (Officer of The Schwab Annuity Portfolios since 1998.)</p>	<p>Senior Vice President, Chief Counsel and Corporate Secretary, Charles Schwab Investment Management, Inc.; Senior Vice President and Deputy General Counsel, Charles Schwab &amp; Co., Inc.; Chief Legal Officer, Laudus Trust and Laudus Variable Insurance Trust; Chief Legal Officer, Excelsior Funds Inc., Excelsior Tax-Exempt Funds, Inc., and Excelsior Funds Trust. <i>Prior to June 1998</i>, Branch Chief in Enforcement at U.S. Securities and Exchange Commission in San Francisco.</p>

<sup>1</sup> Trustees remain in office until they resign, retire or are removed by shareholder vote. 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 their employment with the investment adviser and the distributor, Messrs. Schwab and Merk also own stock of The Charles Schwab Corporation. Mr. Schwab and Mr. Merk are Interested Trustees because they are employees of Schwab and/or the adviser.

<sup>3</sup> The President, Treasurer and Secretary hold office until their respective successors are chosen and qualified or until he or she sooner dies, resigns, is removed or becomes disqualified. Each other officer serves at the pleasure of the Board.

*charles* SCHWAB

Large Blend

**Schwab S&P 500  
Index Portfolio**

(formerly Schwab S&P 500 Portfolio)

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*Large-Cap*

Semiannual report for the period ended June 30, 2006

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 1-888-311-4887 for a prospectus. Please read the prospectus carefully before you invest.

**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 website at [www.schwab.com/schwabfunds](http://www.schwab.com/schwabfunds), the SEC's website at [www.sec.gov](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 website at [www.schwab.com/schwabfunds](http://www.schwab.com/schwabfunds) or the SEC's website at [www.sec.gov](http://www.sec.gov).

The industry/sector classification of the fund's portfolio holdings uses the Global Industry Classification Standard (GICS) which was developed by and is the exclusive property of Morgan Stanley Capital International Inc. and Standard & Poor's. GICS is a service mark of MSCI and S&P and has been licensed for use by Charles Schwab & Co., Inc.



# Management's Discussion for the six months ended June 30, 2006



**Jeffrey Mortimer, CFA**, senior vice president and chief investment officer, equities, of the investment adviser, is responsible for the overall management of the portfolio. Prior to joining the firm in October 1997, he worked for more than eight years in asset management.



**Larry Mano**, a vice president and senior portfolio manager of the investment adviser, is responsible for the day-to-day co-management of the portfolio. Prior to joining the firm in November 1998, he worked for 20 years in equity management.

## The Investment Environment and the Fund

After a volatile six months in the domestic markets, equity and fixed income funds ended the period with mixed returns. Several key issues dominated market discussions throughout the period, including slowing economic growth, inflation fears, U.S. Federal Reserve (the Fed) interest rate increases, and volatile crude oil prices.

The markets remained in a steady growth mode over the first quarter of 2006 and ended the period on a positive note. Volatility was up during the second quarter of the year, but remained lower than its historical norm. During the six-month report period, oil prices hit new record highs and the Fed continued to raise short-term interest rates to curb inflationary pressures, boosting its Fed Funds target rate four consecutive times during the six-month period and bringing the benchmark rate up to 5.25%. This was the 17th rate hike over the past two years.

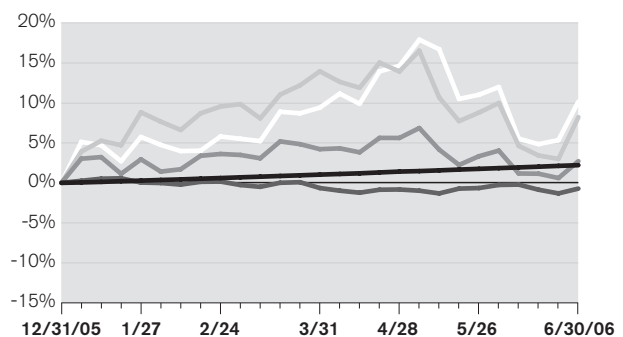
Rising sharply in the second half of the report period, crude oil prices peaked in April at around \$75 per barrel while domestic gasoline prices were above \$3 a gallon. In recent months, crude oil prices climbed back in response to declining crude inventories and geopolitical concerns. Despite the volatility in energy prices, gains in productivity have remained strong and corporate earnings continue to rise. Reasonable valuations, a solid earnings season, and expectations that monetary policy tightening will soon come to an end, helped support the markets. Additionally, job and income growth remained positive, though they slowed during the report period. Moderate inflationary expectations and large foreign capital inflows helped to contain increases in long-term interest rates.

As noted above, the Fed continued its tightening cycle throughout the period, raising its Fed Funds target 0.25% at each of its four meetings. As the Fed raised rates, the yield curve flattened and had brief periods of inversion. Historically, economic slowdowns or recessions have followed

### Asset Class Performance Comparison % returns during the report period

This graph compares the performance of various asset classes during the report period. Final performance figures for the period are in the key below.

- 2.21% **Three-Month U.S. Treasury Bills (T-Bills):** measures short-term U.S. Treasury obligations
- -0.72% **Lehman Brothers U.S. Aggregate Bond Index:** measures the U.S. bond market
- 2.71% **S&P 500® Index:** measures U.S. large-cap stocks
- 8.21% **Russell 2000® Index:** measures U.S. small-cap stocks
- 10.16% **MSCI EAFE® Index:** measures (in U.S. dollars) large-cap stocks in Europe, Australasia and the Far East



These figures 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. Remember that past performance is not an indication of future results.

Data source: Charles Schwab & Co., Inc.

Source of Sector Classification: S&P and MSCI.



**Tom Brown**, an associate portfolio manager of the investment adviser, is the day-to-day co-manager of the portfolio. He joined Schwab in 1995, became a trader in 1999, and was named to his current position in 2004.

the inversion of the yield curve. Following a strong start to 2006, economic growth has moderated over the past six months.

Despite rising interest rates and soaring energy prices, the S&P 500 Index<sup>1</sup> posted gains of 2.71% for the six-month period ending June 30, 2006 while the Russell 2000 Index also displayed a positive return of 8.21%. As improving fundamentals and attractive valuations have strengthened investor interest in emerging markets, the MSCI EAFE (Morgan Stanley Capital International, Inc. Europe, Australasia, and Far East) Index also had an impressive return of 10.16% for the six-month period.

Although performance of the bond markets was sluggish, as measured by the Lehman Brothers U.S. Aggregate Bond Index, which was down 0.72% for the six-month period, these types of results are not unusual. When the economy is strong and job growth is robust, investors normally expect to see more inflation, which generally leads to higher interest rates and lower bond prices.

Rising interest rates have led to volatility in the equities markets and have weighed down bond returns. Meanwhile, money market funds enticed investors as the rise in short-term interest rates offered yields that have not been seen in years. The mixed messages that arose from the slowing economy and rising inflation have left investors puzzled about the direction of the Fed policy. The June 29 Federal Open Market Committee (FOMC) policy statement did little to alleviate uncertainty, as the Fed acknowledged slower growth while expressing concern about inflation risks.

**The Schwab S&P 500 Index Portfolio** was up 2.65%, closely tracking its benchmark, the S&P 500 Index, which was up 2.71%. Bear in mind that the fund's return, unlike the index, includes the impact of operating expenses. Most of the fund's appreciation occurred during the first quarter of 2006. Within the portfolio, the best performing Sectors were Energy and Telecommunication Services. With the price of crude oil appreciating during the period, energy-related stocks were the overall top performers in the fund. On the downside, Information Technology was the worst performing Sector and slightly detracted from the fund's overall performance.

Past performance does not indicate future results.

Source of Sector Classification: S&P and MSCI.

All portfolio 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. The portfolio's share price and principal values change and when you sell your shares they may be worth more or less than what you paid for them.

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.

Portfolio returns do not reflect the additional fees and expenses imposed by the insurance company under the variable insurance product contract.

Portfolio expenses have been partially absorbed by CSIM and Schwab. Without these reductions, the portfolio's returns would have been lower.

<sup>1</sup> Standard & Poor's®, S&P®, S&P 500®, Standard & Poor's 500® and 500® are trademarks of The McGraw-Hill Companies, Inc. and have been licensed for use by the fund. The fund is not sponsored, endorsed, sold or promoted by Standard & Poor's, and Standard & Poor's makes no representation regarding the advisability of investing in the fund.

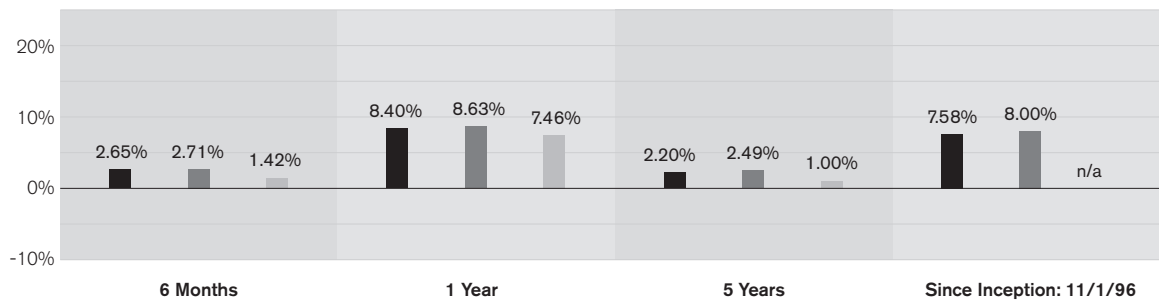
# Schwab S&P 500 Index Portfolio

Performance as of 6/30/06

## Average Annual Total Returns<sup>1, 2, 3</sup>

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

**Portfolio**  
 Benchmark: **S&P 500® Index**  
 Fund Category: **Morningstar Large-Cap Blend**

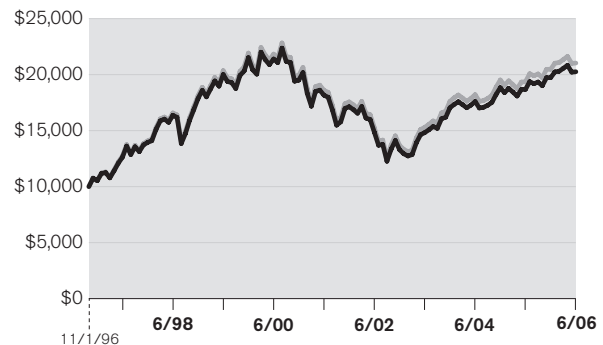


The performance data quoted represents past performance. Past performance does not guarantee future results. Investment returns and principal value will fluctuate so that an investor's shares may be worth more or less than their original cost. Current performance may be lower or higher than performance 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, 2</sup>

This graph shows performance since inception of a hypothetical \$10,000 investment in the portfolio, compared with a similar investment in its benchmark.

\$20,255 **Portfolio**  
 \$21,032 **S&P 500® Index**



All portfolio 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.

<sup>1</sup> Portfolio expenses have been partially absorbed by CSIM and Schwab. Without these reductions, the portfolio's returns would have been lower. Portfolio returns do not reflect the additional fees and expenses imposed by the insurance company under the variable insurance product contract. If those contract fees and expenses were included, the returns would be less than those shown. Please refer to the variable insurance product prospectus for a complete listing of these expenses.

<sup>2</sup> Standard & Poor's®, S&P®, S&P 500®, Standard & Poor's 500® and 500® are trademarks of The McGraw-Hill Companies, Inc. and have been licensed for use by the portfolio. The portfolio is not sponsored, endorsed, sold or promoted by Standard & Poor's, and Standard & Poor's makes no representation regarding the advisability of investing in the portfolio.

<sup>3</sup> Source for category information: Morningstar, Inc.

## Portfolio Facts as of 6/30/06

### Style Assessment<sup>1</sup>



### Statistics

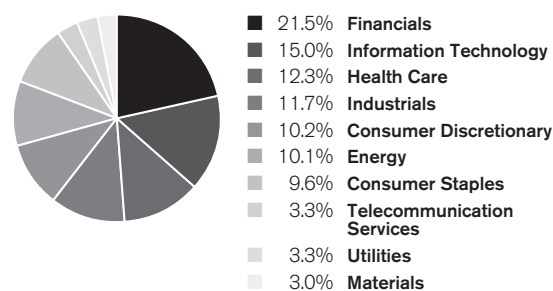
Number of Holdings	501
Weighted Average Market Cap (\$ x 1,000,000)	\$87,250
Price/Earnings Ratio (P/E)	17.2
Price/Book Ratio (P/B)	2.8
Portfolio Turnover Rate <sup>2</sup>	2%

### Top Holdings<sup>3</sup>

Security	% of Net Assets
① Exxon Mobil Corp.	3.2%
② General Electric Co.	3.0%
③ Citigroup, Inc.	2.1%
④ Bank of America Corp.	1.9%
⑤ Microsoft Corp.	1.8%
⑥ Procter & Gamble Co.	1.6%
⑦ Johnson & Johnson	1.6%
⑧ Pfizer, Inc.	1.5%
⑨ Altria Group, Inc.	1.3%
⑩ American International Group, Inc.	1.3%
<b>Total</b>	<b>19.3%</b>

### Sector Weightings % of Investments

This chart shows the portfolio's sector composition as of the report date. A sector is a portion of the overall stock market that is made up of industries whose business components share similar characteristics.



Portfolio holdings may have changed since the report date.

Source of Sector Classification: S&P and MSCI.

<sup>1</sup> Source: Morningstar, Inc. This style assessment is the result of evaluating the portfolio based on a ten-factor model for value and growth characteristics. The portfolio's market capitalization placement is determined by the geometric mean of its holdings' market capitalizations. The assessment reflects the portfolio as of 6/30/06, which may have changed since then, and is not a precise indication of risk or performance—past, present, or future.

<sup>2</sup> Not annualized.

<sup>3</sup> This list is not a recommendation of any security by the investment adviser.

# Portfolio Expenses (unaudited)

## 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 January 1, 2006 and held through June 30, 2006.

**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 ÷ \$1,000 = 8.6), then multiply the result by the number given for your fund 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 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> (Annualized)	Beginning Account Value at 1/1/06	Ending Account Value (Net of Expenses) at 6/30/06	Expenses Paid During Period <sup>2</sup> 1/1/06–6/30/06
<b>Schwab S&amp;P 500 Index Portfolio</b>				
Actual Return	0.28%	\$1,000	\$1,026.50	\$1.41
Hypothetical 5% Return	0.28%	\$1,000	\$1,023.41	\$1.40

<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 the portfolio 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 S&P 500 Index Portfolio

## Financial Statements

### Financial Highlights

	1/1/06– 6/30/06*	1/1/05– 12/31/05	1/1/04– 12/31/04	1/1/03– 12/31/03	1/1/02– 12/31/02	1/1/01– 12/31/01
<b>Per-Share Data (\$)</b>						
Net asset value at beginning of period	18.09	17.56	16.06	12.66	16.54	19.02
Income or loss from investment operations:						
Net investment income	0.18	0.31	0.29	0.17	0.19	0.15
Net realized and unrealized gains or losses	0.30	0.53	1.40	3.40	(3.90)	(2.46)
Total income or loss from investment operations	0.48	0.84	1.69	3.57	(3.71)	(2.31)
Less distributions:						
Dividends from net investment income	–	(0.31)	(0.19)	(0.17)	(0.17)	(0.17)
Net asset value at end of period	18.57	18.09	17.56	16.06	12.66	16.54
Total return (%)	2.65 <sup>1</sup>	4.75	10.53	28.22	(22.43)	(12.16)
<b>Ratios/Supplemental Data (%)</b>						
Ratios to average net assets:						
Net operating expenses	0.28 <sup>2</sup>	0.27	0.28	0.28	0.28	0.28
Gross operating expenses	0.31 <sup>2</sup>	0.30	0.31	0.32	0.35	0.33
Net investment income	1.63 <sup>2</sup>	1.59	1.75	1.50	1.33	1.09
Portfolio turnover rate	2	4	4	2	11	5
Net assets, end of period (\$ x 1,000,000)	150	157	162	146	98	128

\* Unaudited.

<sup>1</sup> Not annualized.

<sup>2</sup> Annualized.

**Portfolio Holdings** as of June 30, 2006, (Unaudited)

This section shows all the securities in the fund's portfolio by industry classification 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 Form N-Q is available on the SEC's website at [www.sec.gov](http://www.sec.gov) and may be viewed 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 also available by visiting Schwab's website at [www.schwab.com/schwabfunds](http://www.schwab.com/schwabfunds).

<b>Holdings by Category</b>		<b>Cost</b>	<b>Value</b>
		(\$ x 1,000)	(\$ x 1,000)
<b>99.7%</b>	<b>Common Stock</b>	112,654	149,320
<b>0.2%</b>	<b>Short-Term Investments</b>	199	199
<b>—%</b>	<b>U.S. Government Securities</b>	45	45
<b>99.9%</b>	<b>Total Investments</b>	<b>112,898</b>	<b>149,564</b>
<b>3.7%</b>	<b>Collateral Invested for Securities on Loan</b>	5,618	5,618
<b>(3.6)%</b>	<b>Other Assets and Liabilities</b>		(5,446)
<b>100.0%</b>	<b>Net Assets</b>		<b>149,736</b>

<b>Security</b>	<b>Number of Shares</b>	<b>Value</b>
		(\$ x 1,000)
<b>Common Stock 99.7% of net assets</b>		
<b>Automobiles &amp; Components 0.5%</b>		
Cooper Tire & Rubber Co. (b)(c)	400	4
Ford Motor Co. (b)(c)	24,213	168
General Motors Corp. (b)(c)	6,278	187
Harley-Davidson, Inc. (b)(c)	3,800	208
Johnson Controls, Inc.	2,600	214
The Goodyear Tire & Rubber Co. (b)(c)*	2,500	28
		<b>809</b>
<b>Banks 7.8%</b>		
AmSouth Bancorp	4,453	118
Bank of America Corp.	60,202	2,896
BB&T Corp.	6,870	286
Comerica, Inc.	2,330	121
Commerce Bancorp, Inc. (b)(c)	2,300	82
Compass Bancshares, Inc.	1,610	89

<b>Security</b>	<b>Number of Shares</b>	<b>Value</b>
		(\$ x 1,000)
Countrywide Financial Corp.	8,000	305
Fannie Mae	12,540	603
Fifth Third Bancorp	7,405	274
First Horizon National Corp.	1,400	56
Freddie Mac	9,010	514
Golden West Financial Corp.	3,500	260
Huntington Bancshares, Inc.	3,256	77
KeyCorp	5,400	193
M&T Bank Corp. (b)(c)	1,071	126
Marshall & Ilsley Corp.	2,738	125
MGIC Investment Corp.	733	48
National City Corp.	7,100	257
North Fork Bancorp, Inc.	6,200	187
PNC Financial Services Group, Inc.	3,770	264
Regions Financial Corp.	6,127	203
Sovereign Bancorp, Inc.	3,606	73
SunTrust Banks, Inc.	4,800	366
Synovus Financial Corp.	4,300	115
U.S. Bancorp	23,571	728
Wachovia Corp.	20,995	1,135
Washington Mutual, Inc.	12,845	585
Wells Fargo & Co.	21,779	1,461
Zions Bancorp	1,408	110
		<b>11,657</b>

**Capital Goods 8.9%**

<b>Security</b>	<b>Number of Shares</b>	<b>Value</b>
		(\$ x 1,000)
3M Co.	9,840	795
American Power Conversion Corp.	2,025	39
American Standard Cos., Inc.	2,400	104
Caterpillar, Inc.	8,680	647
Cooper Industries Ltd., Class A	1,300	121
Cummins, Inc. (b)(c)	600	73
Danaher Corp.	3,126	201
Deere & Co.	3,100	259
Dover Corp.	2,800	138
Eaton Corp.	1,740	131
Emerson Electric Co.	5,380	451
Fluor Corp. (b)(c)	1,100	102
General Dynamics Corp.	5,230	342
General Electric Co. (c)	135,130	4,454
Goodrich Corp.	1,660	67
Honeywell International, Inc.	11,037	445
Illinois Tool Works, Inc.	5,344	254
Ingersoll-Rand Co., Class A	4,400	188
ITT Industries, Inc.	2,480	123

**Portfolio Holdings** (Unaudited) continued

Security	Number of Shares	Value (\$ x 1,000)	Security	Number of Shares	Value (\$ x 1,000)
L-3 Communications Holdings, Inc.	1,500	113	Mattel, Inc.	5,301	88
Lockheed Martin Corp.	4,690	336	Newell Rubbermaid, Inc.	3,924	101
Masco Corp.	5,710	169	Nike, Inc., Class B	2,460	199
Navistar International Corp. *	1,000	25	Pulte Homes, Inc.	2,800	81
Northrop Grumman Corp.	4,534	290	Snap-On, Inc.	800	32
Paccar, Inc.	1,864	154	The Black & Decker Corp.	1,010	85
Pall Corp.	1,400	39	The Stanley Works	391	18
Parker Hannifin Corp.	1,650	128	VF Corp.	1,110	75
Raytheon Co.	5,830	260	Whirlpool Corp.	1,033	85
Rockwell Automation, Inc.	2,350	169			<b>1,693</b>
Rockwell Collins, Inc.	2,500	140			
Textron, Inc.	1,700	157			
The Boeing Co.	10,396	852			
Tyco International Ltd.	26,380	725			
United Technologies Corp.	13,201	837			
W.W. Grainger, Inc.	800	60			
		<b>13,388</b>			
<b>Commercial Services &amp; Supplies 0.8%</b>			<b>Consumer Services 1.6%</b>		
Allied Waste Industries, Inc. *	525	6	Apollo Group, Inc., Class A (b)(c)*	1,327	69
Avery Dennison Corp.	1,300	75	Carnival Corp.	5,222	218
Cendant Corp.	13,603	222	Darden Restaurants, Inc.	2,090	82
Cintas Corp.	1,157	46	Harrah's Entertainment, Inc.	2,400	171
Equifax, Inc.	2,000	69	Hilton Hotels Corp.	4,410	125
H&R Block, Inc.	4,200	100	International Game Technology	4,700	178
Monster Worldwide, Inc. *	1,704	73	Marriott International, Inc., Class A	3,512	134
Pitney Bowes, Inc.	3,000	124	McDonald's Corp.	16,301	548
R.R. Donnelley & Sons Co.	2,960	94	Starbucks Corp. *	10,121	382
Robert Half International, Inc.	1,550	65	Starwood Hotels & Resorts Worldwide, Inc.	2,900	175
Waste Management, Inc.	7,358	264	Wendy's International, Inc.	1,500	87
		<b>1,138</b>	YUM! Brands, Inc.	3,700	186
					<b>2,355</b>
<b>Consumer Durables &amp; Apparel 1.1%</b>			<b>Diversified Financials 8.0%</b>		
Brunswick Corp.	1,200	40	American Express Co.	16,071	855
Centex Corp.	1,600	81	Ameriprise Financial, Inc.	3,278	146
Coach, Inc. *	5,101	153	Capital One Financial Corp.	3,980	340
D.R. Horton, Inc. (b)(c)	3,600	86	CIT Group, Inc.	2,600	136
Eastman Kodak Co. (b)(c)	3,155	75	Citigroup, Inc. (c)	64,683	3,120
Fortune Brands, Inc.	1,607	114	E*TRADE Financial Corp. *	5,160	118
Harman International Industries, Inc.	800	68	Federated Investors, Inc., Class B	1,100	35
Hasbro, Inc.	2,525	46	Franklin Resources, Inc.	2,100	182
Jones Apparel Group, Inc.	1,500	48	Janus Capital Group, Inc.	1,941	35
KB Home	960	44	JPMorgan Chase & Co.	45,246	1,900
Leggett & Platt, Inc.	2,300	57	Legg Mason, Inc.	1,500	149
Lennar Corp., Class A	1,800	80	Lehman Brothers Holdings, Inc.	7,000	456
Liz Claiborne, Inc.	997	37	Mellon Financial Corp.	5,600	193
			Merrill Lynch & Co., Inc.	11,880	826
			Moody's Corp.	3,180	173
			Morgan Stanley	14,147	894



## Portfolio Holdings (Unaudited) continued

Security	Number of Shares	Value (\$ x 1,000)	Security	Number of Shares	Value (\$ x 1,000)
Northern Trust Corp.	2,470	137			
SLM Corp.	5,600	296			
State Street Corp.	4,500	261			
T. Rowe Price Group, Inc.	3,400	129			
The Bank of New York Co., Inc.	10,300	332			
The Bear Stearns Cos., Inc.	1,512	212			
The Charles Schwab Corp. (a)	14,146	226			
The Goldman Sachs Group, Inc.	5,607	844			
		<b>11,995</b>			
<b>Energy 10.0%</b>			<b>Food &amp; Staples Retailing 2.4%</b>		
Anadarko Petroleum Corp.	6,094	291	Costco Wholesale Corp.	6,100	349
Apache Corp.	4,008	274	CVS Corp.	10,900	335
Baker Hughes, Inc.	4,400	360	Safeway, Inc.	6,200	161
BJ Services Co.	4,300	160	Supervalu, Inc.	2,735	84
Chesapeake Energy Corp. (b)(c)	4,800	145	Sysco Corp.	8,300	254
ChevronTexaco Corp.	28,839	1,790	The Kroger Co.	9,400	205
ConocoPhillips	21,353	1,399	Wal-Mart Stores, Inc.	32,331	1,557
CONSOL Energy, Inc.	1,200	56	Walgreen Co.	12,976	582
Devon Energy Corp.	5,863	354	Whole Foods Market, Inc.	1,800	116
El Paso Corp.	6,441	97			<b>3,643</b>
EOG Resources, Inc. (b)(c)	3,214	223	<b>Food, Beverage &amp; Tobacco 4.8%</b>		
Exxon Mobil Corp. (c)	79,219	4,860	Altria Group, Inc.	27,111	1,991
Halliburton Co. (b)(c)	6,710	498	Anheuser-Busch Cos., Inc. (b)(c)	9,783	446
Hess Corp. (b)(c)	2,610	138	Archer-Daniels-Midland Co.	8,700	359
Kerr-McGee Corp.	2,552	177	Brown-Forman Corp., Class B	1,204	86
Kinder Morgan, Inc.	1,350	135	Campbell Soup Co.	2,300	85
Marathon Oil Corp.	4,832	402	Coca-Cola Enterprises, Inc.	4,000	81
Murphy Oil Corp.	1,632	91	ConAgra Foods, Inc. (b)(c)	6,770	150
Nabors Industries, Ltd. (b)(c)*	4,000	135	Constellation Brands, Inc., Class A *	2,300	58
National-Oilwell Varco, Inc. *	1,893	120	Dean Foods Co. *	1,700	63
Noble Corp.	1,800	134	General Mills, Inc.	4,880	252
Occidental Petroleum Corp.	5,500	564	H.J. Heinz Co.	4,510	186
Rowan Cos., Inc.	1,400	50	Kellogg Co.	3,400	165
Schlumberger Ltd.	15,340	999	McCormick & Co., Inc.	1,700	57
Sunoco, Inc.	1,740	121	Molson Coors Brewing Co., Class B	339	23
Transocean, Inc. *	4,033	324	PepsiCo, Inc.	21,441	1,287
Valero Energy Corp.	8,260	549	Reynolds American, Inc.	1,078	124
Weatherford International, Ltd. *	4,280	212	Sara Lee Corp.	10,600	170
Williams Cos., Inc.	7,900	184	The Coca-Cola Co.	26,963	1,160
XTO Energy, Inc.	4,229	187	The Hershey Co.	2,244	124
		<b>15,029</b>	The Pepsi Bottling Group, Inc.	1,902	61
			Tyson Foods, Inc., Class A	1,186	18
			UST, Inc.	2,200	99
			Wm. Wrigley Jr. Co., Class A	1,929	87
			Wm. Wrigley Jr. Co., Class B	482	22
					<b>7,154</b>
			<b>Health Care Equipment &amp; Services 4.3%</b>		
			Aetna, Inc.	7,640	305
			AmerisourceBergen Corp.	2,720	114
			Bausch & Lomb, Inc.	800	39
			Baxter International, Inc.	8,690	320
			Becton Dickinson & Co.	3,300	202

## Portfolio Holdings (Unaudited) continued

Security	Number of Shares	Value (\$ x 1,000)	Security	Number of Shares	Value (\$ x 1,000)
Biomet, Inc.	2,507	79	Genworth Financial, Inc., Class A	5,000	174
Boston Scientific Corp. *	15,090	254	Lincoln National Corp.	3,661	207
C.R. Bard, Inc.	1,520	111	Loews Corp.	5,640	200
Cardinal Health, Inc.	5,665	364	Marsh & McLennan Cos., Inc. (b)(c)	7,200	194
Caremark Rx, Inc.	6,054	302	MBIA, Inc.	1,750	102
CIGNA Corp.	1,560	154	Metlife, Inc.	9,807	502
Coventry Health Care, Inc. *	2,050	113	Principal Financial Group, Inc.	3,874	216
Express Scripts, Inc. *	2,040	146	Prudential Financial, Inc.	6,470	503
HCA, Inc.	4,890	211	SAFECO Corp.	1,600	90
Health Management Associates, Inc., Class A	1,870	37	The Allstate Corp.	8,440	462
Hospira, Inc. *	2,100	90	The Chubb Corp.	5,160	258
Humana, Inc. *	2,100	113	The Hartford Financial Services Group, Inc.	3,930	333
IMS Health, Inc.	2,600	70	The Progressive Corp.	10,201	262
Laboratory Corp. of America Holdings *	1,504	94	The St. Paul Travelers Cos., Inc.	8,999	401
Manor Care, Inc.	387	18	Torchmark Corp.	1,500	91
McKesson Corp.	3,956	187	UnumProvident Corp.	4,276	78
Medco Health Solutions, Inc. *	3,888	223	XL Capital Ltd., Class A	1,900	116
Medtronic, Inc.	15,710	737			<b>7,059</b>
Patterson Cos., Inc. *	980	34			
Quest Diagnostics	2,260	135			
St. Jude Medical, Inc. *	4,204	136	<b>Materials 3.0%</b>		
Stryker Corp.	3,900	164	Air Products & Chemicals, Inc.	3,000	192
Tenet Healthcare Corp. *	6,500	45	Alcoa, Inc.	11,672	378
UnitedHealth Group, Inc.	17,631	790	Allegheny Technologies, Inc.	770	53
WellPoint, Inc. *	8,636	628	Ashland, Inc.	900	60
Zimmer Holdings, Inc. *	3,184	181	Ball Corp.	1,400	52
		<b>6,396</b>	Bemis Co.	1,400	43
<b>Household &amp; Personal Products 2.4%</b>			E.I. du Pont de Nemours & Co.	12,115	504
Alberto-Culver Co., Class B	1,000	49	Eastman Chemical Co.	1,000	54
Avon Products, Inc.	5,116	159	Ecolab, Inc.	2,604	106
Clorox Co.	2,100	128	Freeport-McMoran Copper & Gold, Inc., Class B (b)(c)	2,400	133
Colgate-Palmolive Co.	6,671	399	Hercules, Inc. *	700	11
Kimberly-Clark Corp.	5,706	352	International Flavors & Fragrances, Inc.	1,000	35
Procter & Gamble Co. (c)	42,674	2,373	International Paper Co.	6,498	210
The Estee Lauder Cos., Inc., Class A	1,500	58	Louisiana-Pacific Corp.	1,260	28
		<b>3,518</b>	MeadWestvaco Corp.	2,549	71
<b>Insurance 4.7%</b>			Monsanto Co.	3,525	297
ACE Ltd.	3,900	197	Newmont Mining Corp. (b)(c)	5,446	288
AFLAC, Inc.	6,610	306	Nucor Corp.	4,000	217
Ambac Financial Group, Inc.	1,392	113	Pactiv Corp. *	1,800	44
American International Group, Inc.	33,639	1,986	Phelps Dodge Corp.	2,690	221
AON Corp.	4,550	158	PPG Industries, Inc.	2,300	152
Cincinnati Financial Corp.	2,335	110	Praxair, Inc.	4,165	225

## Portfolio Holdings (Unaudited) continued

Security	Number of Shares	Value (\$ x 1,000)	Security	Number of Shares	Value (\$ x 1,000)
Rohm & Haas Co.	2,105	105	Johnson & Johnson	38,599	2,313
Sealed Air Corp.	1,214	63	King Pharmaceuticals, Inc. *	3,466	59
Sigma-Aldrich Corp.	641	47	MedImmune, Inc. *	3,400	92
Temple-Inland, Inc.	1,600	69	Merck & Co., Inc.	28,301	1,031
The Dow Chemical Co.	12,706	496	Millipore Corp. *	700	44
United States Steel Corp.	1,500	105	Mylan Laboratories, Inc.	3,091	62
Vulcan Materials Co.	1,300	101	PerkinElmer, Inc.	1,700	35
Weyerhaeuser Co.	3,300	205	Pfizer, Inc. (c)	95,432	2,240
		<b>4,565</b>	Schering-Plough Corp.	19,190	365
<b>Media 3.5%</b>			Thermo Electron Corp. *	1,380	50
CBS Corp., Class B	10,980	297	Waters Corp. *	1,400	62
Clear Channel Communications, Inc. *	5,956	184	Watson Pharmaceuticals, Inc. *	1,500	35
Comcast Corp., Class A *	27,726	908	Wyeth	17,470	776
Dow Jones & Co., Inc. (b)(c)	800	28			<b>11,920</b>
Gannett Co., Inc.	3,160	177	<b>Real Estate 1.0%</b>		
McGraw-Hill Cos., Inc.	4,750	239	Apartment Investment & Management Co., Class A	1,300	56
Meredith Corp.	500	25	Archstone-Smith Trust	2,700	137
News Corp., Class A	30,575	586	Boston Properties, Inc.	1,216	110
Omnicom Group, Inc.	2,300	205	Equity Office Properties Trust (b)(c)	5,001	183
The E.W. Scripps Co., Class A	1,000	43	Equity Residential	4,001	179
The Interpublic Group of Cos., Inc. (b)(c)*	4,997	42	Kimco Realty Corp.	2,710	99
The New York Times Co., Class A (b)(c)	1,900	47	Plum Creek Timber Co., Inc.	2,560	91
The Walt Disney Co.	28,501	855	ProLogis	2,600	136
Time Warner, Inc.	58,962	1,020	Public Storage, Inc.	1,100	83
Tribune Co.	3,400	110	Simon Property Group, Inc.	2,400	199
Univision Communications, Inc., Class A *	3,025	101	Vornado Realty Trust	1,600	156
Viacom, Inc., Class B *	9,380	336			<b>1,429</b>
		<b>5,203</b>	<b>Retailing 3.4%</b>		
<b>Pharmaceuticals &amp; Biotechnology 8.0%</b>			Amazon.com, Inc. *	3,000	116
Abbott Laboratories	20,130	878	AutoNation, Inc. (b)(c)*	1,900	41
Allergan, Inc. (b)(c)	1,880	202	AutoZone, Inc. *	700	62
Amgen, Inc. *	15,154	988	Bed, Bath & Beyond, Inc. *	3,016	100
Applera Corp. - Applied Biosystems Group	2,800	90	Best Buy Co., Inc.	5,475	300
Barr Pharmaceuticals, Inc. *	1,400	67	Big Lots, Inc. *	1,400	24
Biogen Idec, Inc. *	4,700	218	Circuit City Stores, Inc.	2,054	56
Bristol-Myers Squibb Co.	25,640	663	Dillard's, Inc., Class A	600	19
Eli Lilly & Co.	14,620	808	Dollar General Corp.	4,263	60
Fisher Scientific International, Inc. *	1,605	117	Family Dollar Stores, Inc.	2,000	49
Forest Laboratories, Inc. *	3,720	144	Federated Department Stores, Inc.	6,822	250
Genzyme Corp. *	3,500	214	Genuine Parts Co.	2,500	104
Gilead Sciences, Inc. *	6,200	367	Home Depot, Inc.	27,551	986
			J.C. Penney Co., Inc.	3,100	209
			Kohl's Corp. *	4,610	272

## Portfolio Holdings (Unaudited) continued

Security	Number of Shares	Value (\$ x 1,000)	Security	Number of Shares	Value (\$ x 1,000)
Limited Brands, Inc.	3,908	100	Citrix Systems, Inc. *	2,360	95
Lowe's Cos., Inc.	10,230	621	Computer Sciences Corp. *	2,400	116
Nordstrom, Inc.	2,850	104	Compuware Corp. *	5,150	35
Office Depot, Inc. *	4,100	156	Convergys Corp. *	1,354	26
OfficeMax, Inc.	900	37	eBay, Inc. *	15,288	448
RadioShack Corp.	259	4	Electronic Arts, Inc. *	4,058	175
Sears Holdings Corp. *	1,275	197	Electronic Data Systems Corp.	7,220	174
Staples, Inc.	9,850	239	First Data Corp.	9,959	449
Target Corp.	11,371	556	Fiserv, Inc. *	2,700	122
The Gap, Inc.	8,162	142	Google, Inc., Class A *	2,577	1,081
The Sherwin-Williams Co.	1,133	54	Intuit, Inc. *	2,520	152
The TJX Cos., Inc.	6,310	144	Microsoft Corp. (c)	115,291	2,686
Tiffany & Co.	1,126	37	Novell, Inc. *	5,200	34
		<b>5,039</b>	Oracle Corp. *	49,321	715
<b>Semiconductors &amp; Semiconductor Equipment 2.7%</b>			Parametric Technology Corp. *	1,484	19
Advanced Micro Devices, Inc. *	5,530	135	Paychex, Inc.	4,450	173
Altera Corp. *	4,880	86	Sabre Holdings Corp., Class A (b)(c)	1,883	41
Analog Devices, Inc.	4,730	152	Symantec Corp. *	13,941	217
Applied Materials, Inc. (c)	20,571	335	Unisys Corp. *	4,700	30
Broadcom Corp., Class A *	6,165	185	VeriSign, Inc. *	2,025	47
Freescale Semiconductor, Inc., Class B *	5,566	164	Yahoo! Inc. (b)(c)*	16,601	548
Intel Corp.	76,272	1,445			<b>8,352</b>
KLA-Tencor Corp.	2,700	112	<b>Technology Hardware &amp; Equipment 6.6%</b>		
Linear Technology Corp. (b)(c)	4,000	134	ADC Telecommunications, Inc. *	971	16
LSI Logic Corp. *	5,410	48	Agilent Technologies, Inc. *	5,867	185
Maxim Integrated Products, Inc.	4,200	135	Andrew Corp. *	1,450	13
Micron Technology, Inc. (b)(c)*	8,800	133	Apple Computer, Inc. *	11,200	640
National Semiconductor Corp.	4,400	105	Avaya, Inc. *	5,632	64
Novellus Systems, Inc. *	1,900	47	CIENA Corp. *	6,700	32
NVIDIA Corp. *	4,800	102	Cisco Systems, Inc. *	79,601	1,555
PMC - Sierra, Inc. *	2,390	23	Comverse Technology, Inc. *	2,700	53
Teradyne, Inc. *	2,100	29	Corning, Inc. *	20,650	499
Texas Instruments, Inc.	20,941	634	Dell, Inc. *	30,772	751
Xilinx, Inc.	4,400	100	EMC Corp. *	30,822	338
		<b>4,104</b>	Gateway, Inc. *	1,000	2
<b>Software &amp; Services 5.6%</b>			Hewlett-Packard Co.	37,013	1,173
Adobe Systems, Inc. *	7,900	240	International Business Machines Corp.	20,285	1,558
Affiliated Computer Services, Inc., Class A *	1,591	82	Jabil Circuit, Inc.	2,327	60
Autodesk, Inc. *	3,320	114	JDS Uniphase Corp. *	20,155	51
Automatic Data Processing, Inc.	7,173	325	Juniper Networks, Inc. *	7,200	115
BMC Software, Inc. *	3,200	76	Lexmark International, Inc., Class A *	1,300	73
CA, Inc.	6,444	132	Lucent Technologies, Inc. (b)(c)*	60,296	146

## Portfolio Holdings (Unaudited) continued

Security	Number of Shares	Value (\$ x 1,000)
Molex, Inc.	1,800	60
Motorola, Inc.	32,435	654
NCR Corp. *	2,400	88
Network Appliance, Inc. *	4,800	169
QLogic Corp. *	2,590	45
Qualcomm, Inc.	21,490	861
SanDisk Corp. *	2,000	102
Sanmina – SCI Corp. *	7,400	34
Solectron Corp. *	13,490	46
Sun Microsystems, Inc. *	45,801	190
Symbol Technologies, Inc.	2,212	24
Tektronix, Inc.	1,100	32
Tellabs, Inc. *	6,230	83
Xerox Corp. (b)(c)*	12,190	170
		<b>9,882</b>
<b>Telecommunication Services 3.3%</b>		
Alltel Corp.	5,160	329
AT&T Corp.	50,212	1,400
BellSouth Corp.	23,530	852
CenturyTel, Inc.	1,490	55
Citizens Communications Co.	4,718	62
Embarq Corp *	1,997	82
Qwest Communications International, Inc. *	21,216	172
Sprint Nextel Corp.	38,840	776
Verizon Communications, Inc.	38,305	1,283
		<b>5,011</b>
<b>Transportation 2.0%</b>		
Burlington Northern Santa Fe Corp.	4,730	375
CSX Corp.	3,010	212
FedEx Corp.	3,920	458
Norfolk Southern Corp.	5,600	298
Ryder System, Inc.	600	35
Southwest Airlines Co.	7,887	129
Union Pacific Corp.	3,570	332
United Parcel Service, Inc., Class B	14,116	1,162
		<b>3,001</b>
<b>Utilities 3.3%</b>		
Allegheny Energy, Inc. *	2,241	83
Ameren Corp.	2,700	136
American Electric Power Co., Inc.	5,170	177
CenterPoint Energy, Inc.	4,150	52
CMS Energy Corp. *	2,960	38

Security	Number of Shares	Value (\$ x 1,000)
Consolidated Edison, Inc.	3,300	147
Constellation Energy Group, Inc.	2,500	136
Dominion Resources, Inc. (b)(c)	4,380	328
DTE Energy Co.	2,400	98
Duke Energy Corp.	15,564	457
Dynegy, Inc., Class A *	4,200	23
Edison International	4,200	164
Entergy Corp.	2,377	168
Exelon Corp.	8,690	494
FirstEnergy Corp.	4,288	233
FPL Group, Inc.	5,400	224
KeySpan Corp.	2,300	93
Nicor, Inc. (b)(c)	510	21
NiSource, Inc.	3,546	77
Peoples Energy Corp. (b)(c)	500	18
PG&E Corp.	4,800	189
Pinnacle West Capital Corp.	1,200	48
PPL Corp. (b)(c)	4,960	160
Progress Energy, Inc.	2,730	117
Public Service Enterprise Group, Inc.	3,300	218
Sempra Energy	3,141	143
TECO Energy, Inc.	2,840	42
The AES Corp. *	8,800	162
The Southern Co.	9,511	305
TXU Corp.	5,954	356
Xcel Energy, Inc.	3,809	73
		<b>4,980</b>

Security	Face Amount (\$ x 1,000)	Value (\$ x 1,000)
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**Short-Term Investments 0.2% of net assets**

Brown Brothers Harriman & Co. Cash Management Sweep	199	<b>199</b>
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Security Rate, Maturity Date	Face Amount (\$ x 1,000)	Value (\$ x 1,000)
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**U.S. Government Securities 0.0% of net assets**

**Treasury Bills 0.0%**

U.S. Treasury Bill 4.71%, 09/14/06	45	<b>45</b>
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**End of Investments.**

**Portfolio Holdings** (Unaudited) continued

Security	Number of Shares	Value (\$ x 1,000)
Collateral Invested for Securities on Loan 3.7% of net assets		
State Street Navigator Security Lending Prime Portfolio	5,618	<b>5,618</b>

**End of collateral invested for securities on loan.**

At June 30, 2006 the tax basis cost of the fund's investments was \$113,991, and the unrealized appreciation and depreciation was \$46,494 and (\$10,921), respectively, with a net unrealized appreciation of \$35,573.

In addition to the above, the fund held the following at 06/30/06. All numbers x 1,000 except number of contracts.

	Number of Contracts	Contract Value	Unrealized Gains
Futures Contract			
S & P Mini 500 Index Future, Long Expires 9/15/06	4	256	<b>6</b>

\* Non-income producing security.

(a) Issuer is affiliated with the fund's adviser.

(b) All or portion of security is on loan.

(c) All or a portion of this security is held as collateral for open futures contracts.

Statement of

**Assets and Liabilities**

As of June 30, 2006; unaudited. All numbers x 1,000 except NAV.

**Assets**

Investments, at value including securities on loan of \$5,501 (cost \$112,898)	\$149,564
Collateral invested for securities on loan	5,618
Receivables:	
Fund shares sold	57
Dividends	173
Prepaid expenses	+ 24
<b>Total assets</b>	<b>155,436</b>

**Liabilities**

Collateral invested for securities on loan	5,618
Payables:	
Due to brokers for futures	1
Fund shares redeemed	14
Investment adviser and administrator fees	2
Accrued expenses	+ 65
<b>Total liabilities</b>	<b>5,700</b>

**Net Assets**

<b>Total assets</b>	155,436
<b>Total liabilities</b>	- 5,700
<b>Net assets</b>	<b>\$149,736</b>

**Net Assets by Source**

Capital received from investors	124,650
Net investment income not yet distributed	3,762
Net realized capital losses	(15,348)
Net unrealized capital gains	36,672

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

<b>Net Assets</b>	+	<b>Outstanding</b>	=	<b>Shares NAV</b>
\$149,736		8,065		\$18.57

## Statement of

**Operations**

For January 1, 2006 through June 30, 2006; unaudited. All numbers x 1,000.

<b>Investment Income</b>	
Dividends	\$1,474
Interest	7
Securities on loan	+ 3
<b>Total investment income</b>	<b>\$1,484</b>
<b>Net Realized Gains and Losses</b>	
Net realized losses received from affiliated issuers	(1)
Net realized losses on investments sold	+ (718)
<b>Net realized losses</b>	<b>(719)</b>
<b>Net Unrealized Gains and Losses</b>	
Net unrealized gains on investments	3,652
Net unrealized gains on futures contracts	+ 16
<b>Net unrealized gains</b>	<b>3,668</b>
<b>Expenses</b>	
Investment adviser and administrator fees	155
Trustees' fees	15
Custodian fees	9
Portfolio accounting fees	18
Professional fees	15
Shareholder reports	19
Other expenses	+ 12
Total expenses	243
Expense reduction	- 26
<b>Net expenses</b>	<b>217</b>
<b>Increase in Net Assets from Operations</b>	
<b>Total investment income</b>	1,484
<b>Net expenses</b>	- 217
<b>Net investment income</b>	<b>1,267</b>
<b>Net realized losses</b>	<b>(719)</b>
<b>Net unrealized gains</b>	+ 3,668
<b>Increase in net assets from operations</b>	<b>\$4,216</b>



Statements of

**Changes in Net Assets**

For the current and prior report periods. All numbers x 1,000.

Figures for current period are unaudited.

**Operations**

	1/1/06-6/30/06	1/1/05-12/31/05
Net investment income	\$1,267	\$2,490
Net realized losses	(719)	(3,306)
Net unrealized gains	+ 3,668	7,901
<b>Increase in net assets from operations</b>	<b>4,216</b>	<b>7,085</b>

**Distributions Paid**

Dividends from net investment income	—	2,644
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**Transactions in Fund Shares**

	1/1/06-6/30/06		1/1/05-12/31/05	
	SHARES	VALUE	SHARES	VALUE
Shares sold	441	\$8,225	1,528	\$26,939
Shares reinvested	—	—	144	2,644
Shares redeemed	+ (1,077)	(20,091)	(2,193)	(38,629)
<b>Net transactions in fund shares</b>	<b>(636)</b>	<b>(\$11,866)</b>	<b>(521)</b>	<b>(\$9,046)</b>

**Shares Outstanding and Net Assets**

	SHARES	NET ASSETS	SHARES	NET ASSETS
Beginning of period	8,701	\$157,386	9,222	\$161,991
Total decrease	+ (636)	(7,650)	(521)	(4,605)
<b>End of period</b>	<b>8,065</b>	<b>\$149,736</b>	<b>8,701</b>	<b>\$157,386</b>
Net investment income not yet distributed		<b>\$3,762</b>		<b>\$2,495</b>

## Financial Notes, unaudited.

Unless stated, all dollar amounts are x 1,000.

### 1. Business Structure of the Fund

Schwab S&P 500 Index Portfolio is a series of Schwab Annuity Portfolios, 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 list below shows all the funds in the trust including the fund in this report, which is highlighted:

#### Schwab Annuity Portfolios

Organized January 21, 1994

Schwab Money Market Portfolio

Schwab MarketTrack Growth Portfolio II

**Schwab S&P 500 Index Portfolio**

Schwab S&P 500 Index Portfolio 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 fund is intended as an investment vehicle for variable annuity contracts and variable life insurance policies to be offered by separate accounts of participating life insurance companies and for pension and retirement plans qualified under the Internal Revenue Code of 1986, as amended.

### 2. Significant Accounting Policies

The following is a summary of the significant accounting policies the fund uses in its operations and in the preparation of financial statements:

#### (a) Security Valuation:

The fund values the securities in its portfolio every business day. The fund uses the following policies to value various types of securities:

- **Securities traded on an exchange or over-the-counter:** valued at the closing value for the day, or, on days when no closing value has been reported, halfway between the most recent bid and asked quotes. Securities that are primarily traded on foreign exchanges are valued at the closing values of such securities on their respective exchanges with these values then translated into U.S. dollars at the current exchange rate.
- **Securities for which no quoted value is available or when a significant event has occurred between the time of the security's last close and the time the fund calculates net asset value:** 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 and the Pricing Committee. Some of the more common reasons that may necessitate that a security be valued at fair value include: the security's trading has been halted or suspended; the security has been de-listed from a national exchange; the security's primary trading market is temporarily closed at a time when under normal conditions it would be open; or the security's primary pricing source is not able or willing to provide a price.

**Financial Notes**, unaudited (continued).

Unless stated, all dollar amounts are x 1,000.

**2. Significant Accounting Policies (continued)**

- **Futures:** open contracts are valued at their settlement prices as of the close of their exchanges. When a fund closes out a futures 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.

**(b) Portfolio Investments:**

**Futures Contract:** The fund 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 the 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. The potential for losses associated with futures contracts may exceed amounts recorded in the Statement of Assets and Liabilities.

Because futures carry inherent risks, the 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. The fund records the change in market value of futures, and also the change in the amount of margin deposit required (“due to/from broker”).

**Securities Lending:** The fund may loan securities to certain brokers, dealers and other financial institutions who pay the fund negotiated fees. The fund receives 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. If the value of the collateral falls below 100%, it will be adjusted the following day.

**(c) Security Transactions:**

Security transactions are recorded as of the date the order to buy or sell the security is executed. Realized gains and losses from security transactions are based on the identified costs of the securities involved.

Assets and liabilities denominated in foreign currencies are reported in U.S. dollars. For assets and liabilities held on a given date, the dollar value is based on market exchange rates in effect on that date. Transactions involving foreign currencies, including purchases, sales, income receipts and expense payments, are calculated using exchange rates in effect on the transaction date.

For the period ended June 30, 2006, purchases and sales of securities (excluding short-term obligations) were as follows:

<u>Purchases</u>	<u>Sales/Maturities</u>
\$3,083	\$11,970

## Financial Notes, unaudited (continued).

Unless stated, all dollar amounts are x 1,000.

### 2. Significant Accounting Policies (continued)

#### (d) Income, Expenses and Distributions:

Income from interest and the accretion of discount is recorded as it accrues. Dividends and distributions from portfolio securities and underlying funds are recorded on the date they are effective (the ex-dividend date), although the fund records certain foreign security dividends on the day it learns of the ex-dividend date.

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

The fund pays dividends from net investment income and makes distributions from net realized capital gains once a year.

The fund maintains its own account for purposes of holding assets and accounting, and is considered a separate entity for tax purposes. Within its account, the fund also keeps certain assets in segregated accounts, as may be required by securities law.

#### (e) Borrowing:

The fund may borrow money from banks and custodians. The fund may obtain temporary bank loans through the trust to which the fund belongs to use for meeting shareholder redemptions or for extraordinary or emergency purposes. The trust has 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 fund pays interest on the amounts it borrows at rates that are negotiated periodically.

	Amount Outstanding at 6/30/06 (\$ x 1000)	Average Borrowing* (\$ x 1000)	Weighted Average Interest Rate* (%)
S&P 500 Index Portfolio	—	238	5.06

\* Based on the number of days for which the borrowing is outstanding.

#### (f) Accounting Estimates:

The accounting policies described in this report 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.

#### (g) Indemnification:

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

## Financial Notes, unaudited (continued).

Unless stated, all dollar amounts are x 1,000.

### 3. Affiliates and Affiliated Transactions

Charles Schwab Investment Management, Inc. (CSIM or the investment adviser), a wholly owned subsidiary of The Charles Schwab Corporation, serves as the fund's investment adviser and administrator pursuant to an Investment Advisory and Administration Agreement (Advisory Agreement) between it and the trust. Charles Schwab & Co., Inc. ("Schwab") is an affiliate of the investment adviser and is the trust's shareholder services agent and transfer agent.

For its advisory and administrative services to the fund, the investment adviser is entitled to receive an annual fee payable monthly based on the fund's average daily net assets described as follows:

<u>Average daily net assets</u>	
First \$500 million	0.20%
Over \$500 million	0.17%

Schwab does not charge the fund for transfer agent and shareholder services fees.

Although these agreements specify certain fees for these services, CSIM and Schwab have made additional agreements with the fund to limit the total expenses charged, excluding interest, taxes and certain non-routine expenses to 0.28% through April 29, 2007.

The fund may engage in certain transactions involving related parties. For instance, the fund may own shares of The Charles Schwab Corporation if that company is included in an index which the fund uses as part of an indexing strategy.

The fund 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. For the period ended June 30, 2006, the fund had no security transactions with other Schwab Funds.

Pursuant to an exemptive order issued by the SEC, the fund 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. There was no interfund borrowing or lending activity for the fund during the period.

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 the fund's Statement of Operations.

### 4. Federal Income Taxes

The fund intends to meet federal income and excise tax requirements for regulated investment companies. Accordingly, the fund distributes substantially all of its net investment income and realized net capital gains (if any) to the participating

**Financial Notes**, unaudited (continued).

Unless stated, all dollar amounts are x 1,000.

**4. Federal Income Taxes (continued)**

insurance company separate accounts 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 losses on wash sales. As long as the fund meets the tax requirements, it is not required to pay federal income tax.

As of December 31, 2005, the components of distributable earnings on a tax basis were as follows:

Ordinary income	\$2,495
Long-term capital gains	—

As of December 31, 2005, the fund had capital loss carry forwards available to offset future net capital gains before the expiration dates:

<u>Expire</u>	
2008	\$664
2009	1,821
2010	7,810
2011	38
2012	359
2013	<u>2,130</u>
Total	<u><u>\$12,822</u></u>

The fund deferred capital losses occurring after December 31, 2005 to the next fiscal year ending at December 31, 2006. The aggregate amounts of these deferred losses are \$732.

The tax-basis components of distributions for the fiscal year ended December 31, 2005 were:

From ordinary income	\$2,644
From long-term capital gains	—
From return of capital	—

# Investment Advisory Agreement Approval

The Investment Company Act of 1940 (the “1940 Act”) requires that initial approval of, as well as the continuation of, a fund’s investment advisory agreement must be specifically approved (1) by the vote of the trustees or by a vote of the shareholders of the fund, and (2) by the vote of a majority of the trustees who are not parties to the investment advisory agreement or “interested persons” of any party (the “Independent Trustees”), cast in person at a meeting called for the purpose of voting on such approval. In connection with such approvals, the fund’s trustees must request and evaluate, and the investment adviser is required to furnish, such information as may be reasonably necessary to evaluate the terms of the advisory agreement. In addition, the Securities and Exchange Commission (the “SEC”) takes the position that, as part of their fiduciary duties with respect to fund fees, fund boards are required to evaluate the material factors applicable to a decision to approve an investment advisory agreement.

Consistent with these responsibilities, the Board of Trustees (the “Board”) calls and holds one or more meetings each year that are dedicated, in whole or in part, to considering whether to renew the investment advisory agreement between Schwab Annuity Portfolios (the “Trust”) and CSIM (the “Agreement”) with respect to existing funds in the Trust, including the Schwab S&P 500 Index Portfolio, and to review certain other agreements pursuant to which CSIM provides investment advisory services to certain other registered investment companies. In preparation for the meeting(s), the Board requests and reviews a wide variety of materials provided by CSIM, including information about CSIM’s affiliates, personnel and operations. The Board also receives extensive data provided by third parties. This information is in addition to the detailed information about the funds that the Board reviews during the course of each year, including information that relates to fund operations and fund performance. The trustees also receive a

memorandum from fund counsel regarding the responsibilities of trustees for the approval of investment advisory contracts. In addition, the Independent Trustees receive advice from independent counsel to the Independent Trustees, meet in executive session outside the presence of fund management and participate in question and answer sessions with representatives of CSIM.

The Board, including a majority of the Independent Trustees, considered information specifically relating to the continuance of the Agreement at meetings held on May 2, 2006, May 24, 2006 and June 12, 2006, and approved the renewal of the Agreement for an additional one year term at the meeting held on June 12, 2006. The Board’s approval of the Agreement was based on consideration and evaluation of a variety of specific factors discussed at these meetings and at prior meetings, including:

1. the nature, extent and quality of the services provided to the funds under the Agreement, including the resources of CSIM and its affiliates dedicated to the funds;
2. each fund’s investment performance and how it compared to that of certain other comparable mutual funds;
3. each fund’s expenses and how those expenses compared to those of certain other comparable mutual funds;
4. the profitability of CSIM and its affiliates, including Charles Schwab & Co., Inc. (“Schwab”), with respect to each fund, including both direct and indirect benefits accruing to CSIM and its affiliates; and
5. the extent to which economies of scale would be realized as the funds grow and whether fee levels in the Agreement reflect those economies of scale for the benefit of fund investors.

**Nature, Extent and Quality of Services.** The Board considered the nature, extent and quality of the services provided by CSIM to the funds and the resources of CSIM and its affiliates dedicated to the funds. In this regard, the trustees evaluated, among other things, CSIM's personnel, experience, track record and compliance program. The trustees considered the role of unaffiliated insurance companies in the distribution of the funds. The information considered by the trustees included specific information concerning changes in the nature, extent and quality of services provided by CSIM since the trustees had last considered approval of the Agreement. The trustees also considered Schwab's excellent reputation as a full service brokerage firm and its overall financial condition, and how this affects the success of the funds. Following such evaluation, the Board concluded, within the context of its full deliberations, that the nature, extent and quality of services provided by CSIM to the funds and the resources of CSIM and its affiliates dedicated to the funds supported renewal of the Agreement.

**Fund Performance.** The Board considered fund performance in determining whether to renew the Agreement. Specifically, the trustees considered each fund's performance relative to a peer group of other mutual funds and appropriate indices/benchmarks, in light of total return, yield, when applicable, and market trends. As part of this review, the trustees considered the composition of the peer group, selection criteria and the reputation of the third party who prepared the peer group analysis. In evaluating the performance of each fund, the trustees considered both risk and shareholder risk expectations for such fund and the appropriateness of the benchmark used to compare the performance of each fund. The trustees further considered the level of fund performance in the context of its review of fund expenses and adviser profitability discussed below. Following such evaluation the Board concluded,

within the context of its full deliberations, that the performance of the funds supported renewal of the Agreement.

**Fund Expenses.** With respect to the funds' expenses, the trustees considered the rate of compensation called for by the Agreement, and each fund's net operating expense ratio, in each case, in comparison to those of other comparable mutual funds, such as peer groups and comparisons having been selected and calculated by an independent third party. The trustees considered the effects of CSIM's and Schwab's historical practice of voluntarily waiving management and other fees to prevent total fund expenses from exceeding a specified cap. The trustees also considered fees charged by CSIM to other mutual funds and to other types of accounts, such as wrap accounts and offshore funds, but, with respect to such other types of accounts, accorded less weight to such comparisons due to the different legal, regulatory, compliance and operating features of mutual funds as compared to these other types of accounts, and the unique insurance dedicated distribution arrangements of the funds as compared to other funds managed by CSIM. Following such evaluation, the Board concluded, within the context of its full deliberations, that the expenses of the funds are reasonable and supported renewal of the Agreement.

**Profitability.** With regard to profitability, the trustees considered the compensation flowing to CSIM and its affiliates, directly or indirectly. In this connection, the trustees reviewed management's profitability analyses, together with certain commentary thereon from an independent accounting firm. The trustees also considered any other benefits derived by CSIM from its relationship with the funds, such as whether, by virtue of its management of the Funds, CSIM obtains investment information or other research resources that aid it in providing



advisory services to other clients. The trustees considered whether the varied levels of compensation and profitability under the Agreement and other service agreements were reasonable and justified in light of the quality of all services rendered to each fund by CSIM and its affiliates. The Board also considered information relating to changes to CSIM's cost structure, including cost savings, technology investments and increased operating efficiencies and how these changes affected CSIM's profitability under the Agreement. Based on this evaluation, the Board concluded, within the context of its full deliberations, that the profitability of CSIM is reasonable and supported renewal of the Agreement.

**Economies of Scale.** The trustees considered the existence of any economies of scale and whether those are passed along to a fund's shareholders through a graduated investment advisory fee schedule or other means, including any fee waivers by CSIM and its affiliates. In this regard, and consistent with their consideration of fund expenses, the trustees considered that CSIM and Schwab have previously committed resources to minimize the effects on shareholders of diseconomies of scale during periods when fund assets were relatively small through their contractual expense waivers. For example, such diseconomies of scale may particularly affect newer funds or funds with investment strategies that are from time to time out of favor, but shareholders may benefit from the continued availability of such funds at subsidized expense levels. The trustees also considered CSIM's agreement to contractual investment advisory fee schedules that include lower fees at higher graduated asset levels. The Board also considered certain commitments by CSIM and Schwab that are designed to pass along potential economies of scale to fund shareholders. Specifically, the Board considered CSIM and Schwab's commitments, which may be changed only with Board approval: (i) to reduce contractual advisory fees or add break-

points for certain funds, and (ii) to implement, by means of expense limitation agreement, reductions in net overall expenses for certain funds. Based on this evaluation, and in consideration of the commitments made by CSIM and Schwab as discussed above, the Board concluded, within the context of its full deliberations, that the funds obtain reasonable benefit from economies of scale.

In the course of their deliberations, the trustees did not identify any particular information or factor that was all-important or controlling. Based on the trustees' deliberation and their evaluation of the information described above, the Board, including all of the Independent Trustees, unanimously approved the continuation of the Agreement and concluded that the compensation under the Agreement is fair and reasonable in light of such services and expenses and such other matters as the trustees have considered to be relevant in the exercise of their reasonable judgment.

# Trustees and Officers

The tables below give information about the trustees and officers for The Schwab Annuity Portfolios, which includes the fund covered in this report. The “Fund Complex” includes The Charles Schwab Family of Funds, Schwab Investments, Schwab Capital Trust, Schwab Annuity Portfolios, Laudus Trust, Laudus Variable Insurance Trust, Excelsior Funds, Inc., Excelsior Tax-Exempt Funds, Inc., and Excelsior Funds Trust. As of June 30, 2006, the Fund Complex included 98 funds.

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.

## Independent Trustees

Name, Year of Birth, and Position(s) with the Trust; (Term of Office, and Length of Time Served')	Principal Occupations During the Past Five Years	Number of Portfolios in Fund Complex Overseen by the Trustee	Other Directorships
<b>Mariann Byerwalter</b> 1960 Trustee (Trustee of The Schwab Annuity Portfolios since 2000.)	Chairman of JDN Corporate Advisory LLC. <i>From 1996 to 2001</i> , Vice President for Business Affairs and Chief Financial Officer of Stanford University, and <i>in 2001</i> , Special Advisor to the President of Stanford University.	98	<i>Board 1</i> —Director, Redwood Trust, Inc. <i>Board 2</i> —Director, PMI Group, Inc.
<b>Donald F. Dorward</b> 1931 Trustee (Trustee of The Schwab Annuity Portfolios since 1989.)	Chief Executive Officer, Dorward & Associates (corporate management, marketing and communications consulting firm). <i>From 1996-1999</i> , Executive Vice President and Managing Director, Grey Advertising. <i>Prior to 1996</i> , President and Chief Executive Officer, Allen & Dorward Advertising.	57	None.
<b>William A. Hasler</b> 1941 Trustee (Trustee of The Schwab Annuity Portfolios since 2000.)	Retired. Dean Emeritus, Haas School of Business, University of California, Berkeley. <i>Until February 2004</i> , Co-Chief Executive Officer, Apton Corp. (bio-pharmaceuticals). <i>Prior to August 1998</i> , Dean of the Haas School of Business, University of California, Berkeley (higher education).	98	<i>Board 1</i> —Director, Apton Corp. <i>Board 2</i> —Director, Mission West Properties <i>Board 3</i> —Director, TOUSA <i>Board 4</i> —Director, Stratex Networks <i>Board 5</i> —Director, Genitope Corp. <i>Board 6</i> —Director & Non-Executive Chairman, Solelectron Corp. <i>Board 7</i> —Director, Ditech Communications Corp.

**Independent Trustees** continued

Name, Year of Birth, and Position(s) with the Trust; (Term of Office, and Length of Time Served <sup>1</sup> )	Principal Occupations During the Past Five Years	Number of Portfolios in Fund Complex Overseen by the Trustee	Other Directorships
<p><b>Robert G. Holmes</b> 1931 Trustee (Trustee of The Schwab Annuity Portfolios since 1989.)</p>	<p>Chairman, Chief Executive Officer and Director, Semloh Financial, Inc. (international financial services and investment advisory firm).</p>	57	None.
<p><b>Gerald B. Smith</b> 1950 Trustee (Trustee of The Schwab Annuity Portfolios since 2000.)</p>	<p>Chairman and Chief Executive Officer and founder of Smith Graham &amp; Co. (investment advisors).</p>	57	<p><i>Board 1</i>—Board of Cooper Industries <i>Board 2</i>—Chairman of the Audit Committee of Northern Border Partners, M.L.P.</p>
<p><b>Donald R. Stephens</b> 1938 Trustee (Trustee of The Schwab Annuity Portfolios since 1989.)</p>	<p>Managing Partner, D.R. Stephens &amp; Company (investments). Prior to 1996, Chairman and Chief Executive Officer of North American Trust (real estate investment trust).</p>	57	None.
<p><b>Michael W. Wilsey</b> 1943 Trustee (Trustee of The Schwab Annuity Portfolios since 1989.)</p>	<p>Chairman and Chief Executive Officer, Wilsey Bennett, Inc. (real estate investment and management, and other investments).</p>	57	None.

## Interested Trustees

Name, Year of Birth, and Position(s) with the Trust; (Term of Office, and Length of Time Served')	Principal Occupations During the Past Five Years	Number of Portfolios in Fund Complex Overseen by the Trustee	Other Directorships
<p><b>Charles R. Schwab</b><sup>2</sup> 1937 Chairman and Trustee (Chairman and Trustee of The Schwab Annuity Portfolios since 1989.)</p>	<p>Chairman, Chief Executive Officer and Director, The Charles Schwab Corporation, Charles Schwab &amp; Co., Inc.; Chairman and Director, Charles Schwab Investment Management, Inc., Charles Schwab Bank, N. A.; Chairman and Chief Executive Officer, Schwab (SIS) Holdings Inc. I, Schwab International Holdings, Inc.; Chief Executive Officer and Director, Schwab Holdings, Inc.; Director, U.S. Trust Company, N. A., U.S. Trust Corporation, United States Trust Company of New York. <i>Until May 2003</i>, Co-Chief Executive Officer, The Charles Schwab Corporation.</p>	57	None.
<p><b>Randall W. Merk</b><sup>2</sup> 1954 Trustee (Trustee of The Schwab Annuity Portfolios since 2005.)</p>	<p>Executive Vice President and President, Schwab Financial Products, Charles Schwab &amp; Co., Inc.; Director, Charles Schwab Asset Management (Ireland) Limited and Charles Schwab Worldwide Funds PLC. <i>From September 2002 to July 2004</i>, Chief Executive Officer and President, Charles Schwab Investment Management, Inc. and Executive Vice President, Charles Schwab &amp; Co., Inc. <i>Prior to September 2002</i>, President and Chief Investment Officer, American Century Investment Management, and Director, American Century Companies, Inc.</p>	98	None.

## Officers of the Trust

Name, Year of Birth, and Position(s) with the Trust; (Term of Office, and Length of Time Served <sup>3</sup> )	Principal Occupations During the Past Five Years
<p><b>Evelyn Dilsaver</b> 1955 President and Chief Executive Officer (Officer of The Schwab Annuity Portfolios since 2004.)</p>	<p>President, Chief Executive Officer, and Director, Charles Schwab Investment Management, Inc.; Executive Vice President, Charles Schwab &amp; Co., Inc; President and Chief Executive Officer, Laudus Trust and Laudus Variable Insurance Trust; President, Excelsior Funds Inc., Excelsior Tax-Exempt Funds, Inc., and Excelsior Funds Trust; President, Mutual Fund Division, UST Advisors, Inc. <i>From June 2003 to July 2004</i>, Senior Vice President, Asset Management Products and Services, Charles Schwab &amp; Co., Inc. <i>Prior to June 2003</i>, Executive Vice President, Chief Financial Officer, and Chief Administrative Officer, U.S. Trust, a subsidiary of The Charles Schwab Corporation.</p>
<p><b>Stephen B. Ward</b> 1955 Senior Vice President and Chief Investment Officer (Officer of The Schwab Annuity Portfolios since 1991.)</p>	<p>Director, Senior Vice President and Chief Investment Officer, Charles Schwab Investment Management, Inc.; Chief Investment Officer, The Charles Schwab Trust Company.</p>
<p><b>George Pereira</b> 1964 Treasurer and Principal Financial Officer (Officer of The Schwab Annuity Portfolios since 2004.)</p>	<p>Senior Vice President and Chief Financial Officer, Charles Schwab Investment Management, Inc.; Chief Financial Officer, Laudus Trust and Laudus Variable Insurance Trust; Chief Financial Officer and Chief Accounting Officer, Excelsior Funds Inc., Excelsior Tax-Exempt Funds, Inc., and Excelsior Funds Trust; Chief Financial Officer, Mutual Fund Division, UST Advisors, Inc. Director, Charles Schwab Worldwide Fund, PLC and Charles Schwab Asset Management (Ireland) Limited. <i>From December 1999 to November 2004</i>, Sr. Vice President, Financial Reporting, Charles Schwab &amp; Co., Inc.</p>
<p><b>Kimon Daifotis</b> 1959 Senior Vice President and Chief Investment Officer—Fixed Income (Officer of The Schwab Annuity Portfolios since 2004.)</p>	<p>Senior Vice President and Chief Investment Officer—Fixed Income, Charles Schwab Investment Management, Inc. <i>Prior to 2004</i>, Vice President and Sr. Portfolio Manager, Charles Schwab Investment Management, Inc.</p>
<p><b>Jeffrey Mortimer</b> 1963 Senior Vice President and Chief Investment Officer—Equities (Officer of The Schwab Annuity Portfolios since 2004.)</p>	<p>Senior Vice President and Chief Investment Officer—Equities, Charles Schwab Investment Management, Inc.; Vice President and Chief Investment Officer, Laudus Trust and Laudus Variable Insurance Trust. <i>Prior to 2004</i>, Vice President and Sr. Portfolio Manager, Charles Schwab Investment Management, Inc.</p>

**Officers of the Trust** continued

Name, Year of Birth, and Position(s) with the Trust; (Term of Office, and Length of Time Served <sup>3</sup> )	Principal Occupations During the Past Five Years
<p><b>Randall Fillmore</b> 1960 Chief Compliance Officer and AML Officer (Officer of The Schwab Annuity Portfolios since 2002.)</p>	<p>Senior Vice President and Chief Compliance Officer, Charles Schwab Investment Management, Inc.; Senior Vice President Charles Schwab &amp; Co., Inc.; Chief Compliance Officer, Laudus Trust and Laudus Variable Insurance Trust; Chief Compliance Officer, Excelsior Funds Inc., Excelsior Tax-Exempt Funds, Inc., and Excelsior Funds Trust. <i>From 2002 to 2003</i>, Vice President, Charles Schwab &amp; Co., Inc., and Charles Schwab Investment Management, Inc. <i>From 2000 to 2002</i>, Vice President, Internal Audit, Charles Schwab &amp; Co., Inc.</p>
<p><b>Koji E. Felton</b> 1961 Secretary and Chief Legal Officer (Officer of The Schwab Annuity Portfolios since 1998.)</p>	<p>Senior Vice President, Chief Counsel and Corporate Secretary, Charles Schwab Investment Management, Inc.; Senior Vice President and Deputy General Counsel, Charles Schwab &amp; Co., Inc.; Chief Legal Officer, Laudus Trust and Laudus Variable Insurance Trust; Chief Legal Officer, Excelsior Funds Inc., Excelsior Tax-Exempt Funds, Inc., and Excelsior Funds Trust. <i>Prior to June 1998</i>, Branch Chief in Enforcement at U.S. Securities and Exchange Commission in San Francisco.</p>

<sup>1</sup> Trustees remain in office until they resign, retire or are removed by shareholder vote. 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 their employment with the investment adviser and the distributor, Messrs. Schwab and Merk also own stock of The Charles Schwab Corporation. Mr. Schwab and Mr. Merk are Interested Trustees because they are employees of Schwab and/or the adviser.

<sup>3</sup> The President, Treasurer and Secretary hold office until their respective successors are chosen and qualified or until he or she sooner dies, resigns, is removed or becomes disqualified. Each other officer serves at the pleasure of the Board.