A dynamic option for seeking to generate income and manage risk

Have *options* work for your income goals with Nationwide Risk-Managed Income ETFs

Key highlights

- **The recent shift in the bond market climate** has made fixed income investors more nervous about rising volatility.
- **Despite the rising nervousness,** investors still need bonds to provide income and act as a ballast against stock volatility.
- **Nationwide Risk-Managed ETFs combine widely used options strategies to help yield-seeking investors** generate consistent income with the potential for capital appreciation while managing downside market risks.

Summary

After many years of declining interest rates and rising bond values, the fixed income market is shifting to an environment where volatility and risk of losses are increasing. Bond investors are facing headwinds from rising inflation to the end of "easy money" Federal Reserve policy. They're seeking alternate approaches for managing these risks while continuing to search for opportunities for yield.

The recent performance of bonds is quite different from what investors have come to expect. With the risk of higher interest rates and rising downside volatility, bonds may not offer a buffer to equity market volatility or adequate income to help yield-seeking investors. As a result of increased fixed income volatility, investors have become more nervous about their bond holdings.

Rather than assuming greater risks, a solution that turns to dynamic options strategies for income-generation potential and a measure of downside protection may offer investors an opportunity to capture the consistent yields needed to meet their income goals while simultaneously managing volatility and market risks.

Nationwide Risk-Managed Income ETFs offer innovative alternatives to traditional income investing by employing a dynamic, risk-managed net credit collar. Our ETFs target high current income and seek to provide investors with a measure of downside protection in falling markets and the potential for upside participation up to the strike price of the calls in rising markets. The written call option may, however, be closed prior to expiration based on indications derived from the Funds' rules-based model, as a measure for potentially capturing gains or minimizing losses.

Seeking income in a more volatile climate

Since 2020, the fixed income market has undergone a significant shift that has altered the calculus for bond investors. Many years of falling interest rates, fueled in large part by easing monetary policies and bond buying programs by the Federal Reserve, conditioned investors to a low-volatility fixed income climate, where they mostly saw the values of their bond holdings appreciate.

COVID was the catalyst for the change in momentum. Although the Fed extended its "easy money" approach early in the pandemic to help bolster the economy, the quick resumption of growth stoked investor fears of inflation. As the Fed has gradually moved to end the era of monetary accommodation, interest rates have started to rise from historically low levels. Accordingly, bond values have fallen, significantly in some cases. 2021 was the first down year for the leading U.S. bond market index since 2013.

Investors expect to see volatility in their stock investments, but not so much in bonds, so the recent downturn in bonds has increased their anxiety. This nervousness is apparent in net flows of bond funds, which turned negative in 2022. Demand from retail investors declined at the same time that the Federal Reserve exited the market as a major buyer of bonds. The central bank's developing plans to reduce its bond holdings, either through selling or not reinvesting upon maturity, is adding more volatility to the fixed income climate.

Despite the recent volatility, investors still need bonds for two primary reasons. First, they provide ballast to the stock holdings in a portfolio and reduce overall volatility. This objective is especially important to investors who are at or near retirement, but has been difficult to achieve given bonds' volatility over the last two years. Second, bonds provide income, which remains an important objective for a significant number of investors. Rising interest rates would be welcomed by yield-seeking investors, but with rates coming off historic lows and inflation at 40-year highs, real rates of return are negative and purchasing power is weakened.

Here is the challenge many investors are facing in this volatile bond market climate—how to seek adequate yields to meet their goals for consistent income while managing the risks of rising interest rates. One strategy that could help meet this challenge is to use option contracts that may provide a measure of protection against downside market risk while seeking to capture opportunities to participate in market appreciation.

Investors expect to see volatility in their stock investments,

but not so much in bonds.

Targeting higher yield and lower risk

An ideal strategy would seek to manage the increased risks of seeking higher yields and provide investors with a layer of downside protection as they look to capture sufficient income to meet their goals. Option contracts offer investors the ability to design a strategy that can manage market risks with the opportunity to participate in market appreciation and income generation. As an example, covered call options offer investors an alternative for capturing consistent income through the sale or writing of call contracts on select securities. Similarly, protective puts can help guard against portfolio declines to help investors preserve the value of their investments.

Before exploring how to create an options strategy to help you manage risk and meet your income goals, let's get into some basics about options and how they work.

What are options?

Investors often see options as complicated and therefore risky. They do come with specific risks, but they potentially can be effective in managing risk, generating income and capturing total return when used as part of an overall investment strategy.

First, a basic definition

An option is a financial contract whose value is based on an underlying investment such as a stock, bond or market index. Options confer the right, but not the obligation, to buy or sell the underlying security at a specific price by a specific date.

Let's break down the options definition

"The right, but not the obligation"

The investor has a choice or option to buy or sell the underlying investment, but doesn't have to. If the choice results in a loss, the investor has the option not to buy or sell.

"Buy or sell the underlying security"

The right to buy a security is a call option. The right to sell a security is a put option.

"At a specific price"

The option strike price is the price at which the investor agrees to buy or sell the underlying investment.

"By a specific date"

On or before the option expiration date, the investor decides whether to buy or sell the underlying investment. The investor can let the option expire if taking action would result in a losing transaction.

For our purposes, we'll discuss options as either calls or puts. An investor purchases a call or put option contract based on how they expect the underlying investment to perform in the time between purchasing the option contract and the option expiration date.

↑ If the investor is **bullish** on the investment (i.e., expects it to go up), they will **purchase a call option** to buy the investment at a lower price than its market price at the option expiration date.

↓ If the investor is **bearish** on the investment (i.e., expects it to go down), they will **purchase a put option** to sell the investment at a higher price than its market price at the option expiration date.

After purchasing an option contract, an investor typically has three choices:

1) Exercise the option on or before the expiration date if the option is **in the money**
2) Let the option expire if the option is **out of the money**
3) Sell the option contract to another investor before the expiration date

"In the money" or "out of the money" are important conditions of any option contract. The examples below illustrate what these "moneyness" terms mean.

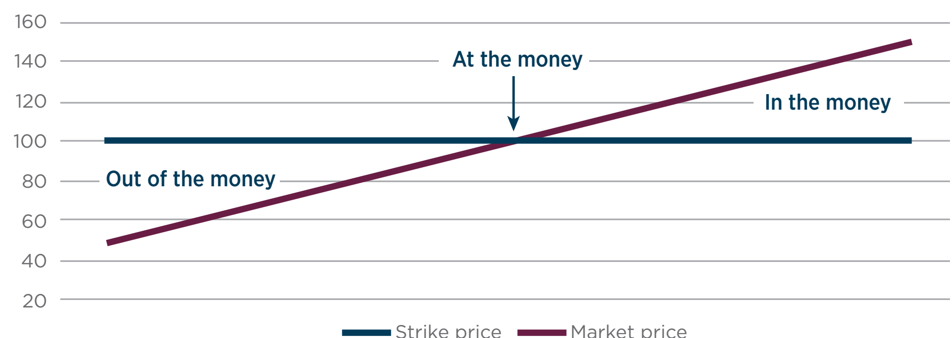
What is "moneyness"?

If you're bullish on a stock, you can purchase a **call option** that allows you to buy a specific number of shares (usually 100) at the strike price, either on or before the option expiration date.

Any time the stock price is above the strike price before the expiration date, the option is **in the money**—you can exercise your option and buy the stock at the cheaper strike price. You profit by selling the stock at the higher market price (less the cost of purchasing the option.)

If the stock price doesn't rise above the strike price, the option is **out of the money**—you don't have to exercise the option (you have "the right, but not the obligation" to do so) and can let the option expire.

Moneyness of a call option



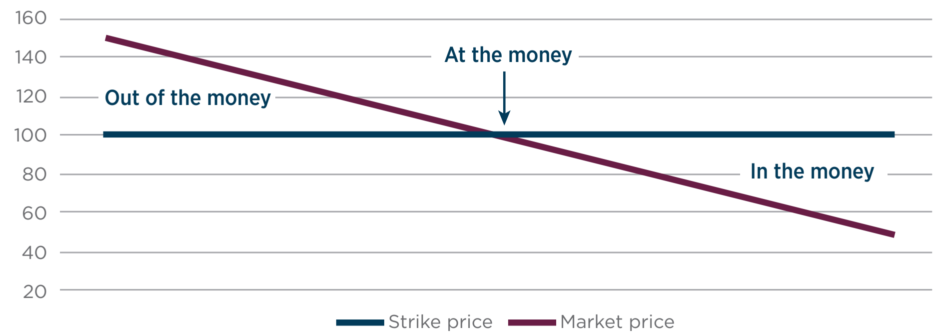
If you're **bearish** on a stock, you can purchase a **put option** that allows you to sell shares in the stock (usually 100) at the strike price. But to sell the stock, you have to own shares previously or buy shares before exercising the option.

A put option is **in the money** if the stock price falls below the strike price any time before the expiration date. When you exercise the put option, you sell the stock at the strike price. Your profit comes if you buy the stock at a lower stock price, then sell it at the higher strike price as specified in the option contract.

If the stock price rises above the strike price, the put option is **out of the money**—you would lose money by selling the stock at a price that's lower than the current market price.

If the put option is out of the money on the expiration date, you don't have to exercise the option.

Moneyness of a put option



An options strategy for income

As with other financial transactions, every option transaction involves two parties—a buyer and a seller. Buying an option means you own the contract. But selling the option means you originate or "write" the contract, so an option seller is usually called an ***option writer.***

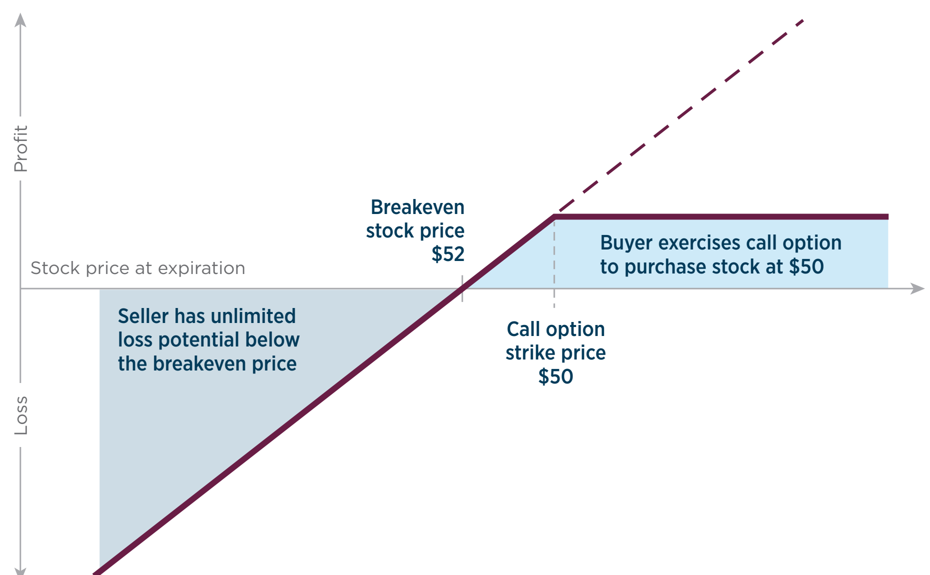
Also like other financial transactions, options come with costs that buyers pay to sellers or writers. The fee that option writers earn when they sell contracts to option buyers is called premium. This **premium** can be a source of return that the option writer can reinvest in a portfolio of securities or return to investors in the form of income.

A **covered call strategy** is a common options strategy for generating income from the premiums received by writing call options. Implementing a covered call starts by purchasing an underlying security such as a large-cap stock, then writing or selling a call option on that security with a strike price above the current market price (i.e., "in the money").

The buyer of the call option has the right to purchase the underlying security at the strike price if the option is in the money on or before the expiration date. That means for the seller or writer of a call option, the upside potential for the underlying security is limited; if the stock, for instance, rises above the call option strike price, the buyer will very likely exercise the option to buy the stock, and the option writer will have to sell it at below current market value. Similarly, a call option has unlimited potential for loss; if the stock price falls below the strike price, the buyer won't exercise the option to purchase, and the call option seller will continue to own the stock at its current depreciated value.

The primary use for covered calls is for the income they generate for the seller from writing call options. Generally, premiums for call options rise when market volatility increases, so the strategy can be particularly useful when implemented with securities that historically demonstrate above-average volatility.

Covered call option example

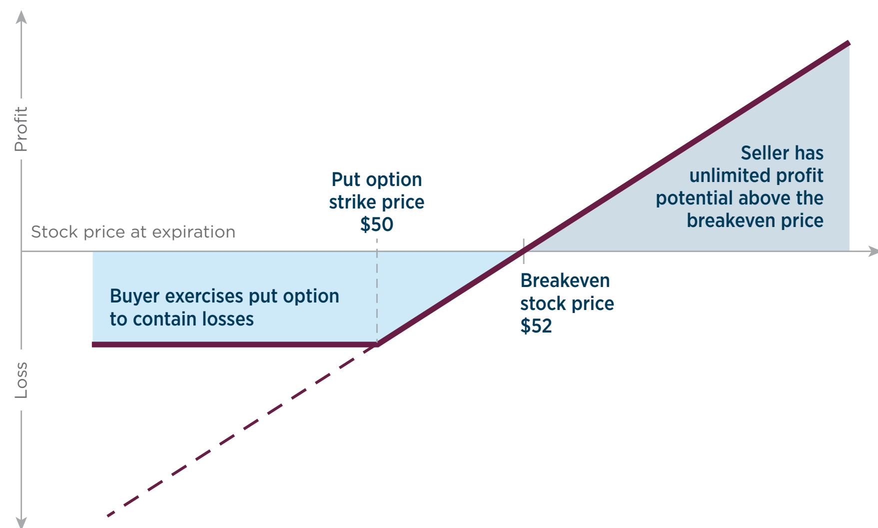


Using puts for downside protection

In buying a put option, an investor can get downside protection when they are "long" an investment. For instance, if the price of a stock declines after purchase, exercising a put option can help an investor recover some or all of the original investment by selling the stock at a higher strike price. Because losses are limited, a protective put strategy has the opposite effect of a covered call strategy—gains are unlimited. If the value of the investment rises, the investor can allow the put option to expire and hold on to the appreciated investment.

In the example here, let's say an investor purchases a put option on a stock they own in their portfolio. According to the option contract, the investor has the right to sell the stock at $50 per share by the expiration date. The option premium is $2 per share, so the breakeven point is $52 per share. Above the breakeven point, the investor has unlimited profit potential. But if the stock drops below $50 per share on or before the put option expiration date, the investor can exercise the right to sell shares at $50 and protect themselves from downside losses.

Protective put option example



The best of both strategies

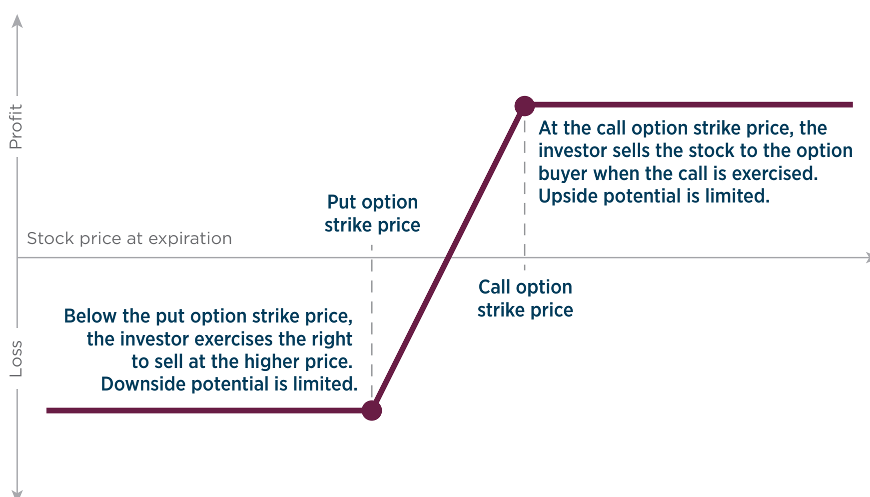
In a sense, covered calls and protective puts are opposing strategies, but they can also be complementary when used together. A **protective net-credit collar strategy** combines the use of covered call and protective put options with the objectives of generating income while protecting investors from down-market losses.

In a sense, a protective collar underscores the benefits of both option strategies. To implement the strategy, the investment manager writes covered call options on securities they own in a portfolio. Typically, the covered calls are near at-the-money or out-of-the-money. (In-the-money options would be exercised by the buyer, so it doesn't make sense for the manager to write in-the-money options.)

The covered calls create a source of premium when the options are sold to buyers. A portion of the proceeds from the premium is used to buy protective put options on the same securities to hedge the downside risk. (Recall covered call options have unlimited downside potential.)

With the remaining premium, the investment manager can pay investors regular income in the form of dividends. The manager may also reinvest some of the premium in the underlying securities in the portfolio.

Protective collar options strategy



How these ETFs use protective net-credit collars

The Nationwide Risk-Managed Income ETFs use a protective net-credit collar strategy with call and put options on their respective underlying indices.

How the protective net-credit collar works

Step 1

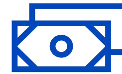
Purchase all underlying stocks in one of four Indexes

- The Funds directly own all stocks in their respective index, not through an ETF (e.g., QQQ or SPY).

Step 2

Deploy a rules-based options collar strategy

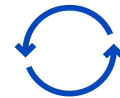
- Writes covered calls on the Index.
- Strike prices near at-the-money or slightly out-of-the-money.
- Expiration dates within one month to guard against liquidity and duration risks.
- Call options are typically closed after a defined percentage of net premia has been generated.
- If the Index rises above the strike price, the manager may close the call option early to minimize potential losses.
- Hedges the risk of the underlying stock portfolio by buying protective puts on the particular Index.
- Out-of-the-money puts are purchased with some of the premium generated by selling the covered calls.



Step 3

Monthly distributions are paid to investors using a portion of the premium generated by the call option.

- If there is any income from net realized capital gains they will be distributed on an annual basis.



Step 4

Additional premium may be used to reinvest in the underlying portfolio of the Index.

Risk-Managed Income ETFs vs. other income strategies

The protective net-credit collar strategy employed by the Nationwide Risk-Managed Income ETFs offers a comprehensive approach for seeking a wide range of investment objectives, including many gaps left by investments in other income-oriented strategies and asset classes. Moreover, a protective net-credit collar may serve as an effective approach for managing different investments risks.

	Potential Benefits				Risks				
Investment type or strategy	**High income**	**Low volatility**	**Portfolio protection**	**Liquidity**	**Interest rate**	**Duration**	**Inflation**	**Commodity**	**Leverage**
Nationwide Risk-Managed Income ETFs	✔	✔	✔	✔					
REITs	✔				✔		✔		✔
MLPs	✔				✔		✔	✔	✔
Fixed Rate Preferreds	✔				✔	✔			
High Yield Bonds	✔				✔	✔	✔		
EM Debt	✔				✔	✔	✔		
High Dividend Stocks	✔			✔	✔		✔		

How the strategy is intended to perform

The protective net-credit collar strategy used by the ETFs can be expected to work best during periods of high stock market volatility. Premiums for call options tend to increase when stock prices turn volatile, so the income (net-credit) these premiums generate can be returned to investors in the form of consistent dividends.

In a rising market

In a rising stock market, total return for the ETFs will likely come from capital appreciation of the underlying stock portfolio. Income is typically generated by the appreciated stock portfolio as well as dividends received from the Fund's equity positions. The covered call options used as part of the net-credit collar strategy may limit upside growth potential, but the Fund managers have the discretion to close out certain call options as a means of minimizing potential losses.

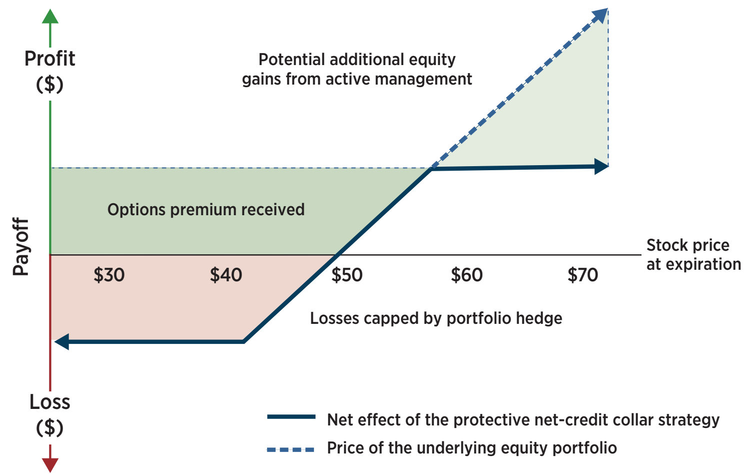
In a declining market

In a down-trending stock market, the ETFs are designed to seek higher total return than other covered call strategies as well as the broad equity market. The higher premiums generated by the covered calls provide income to fund investors, while the protective puts help preserve portfolio values.

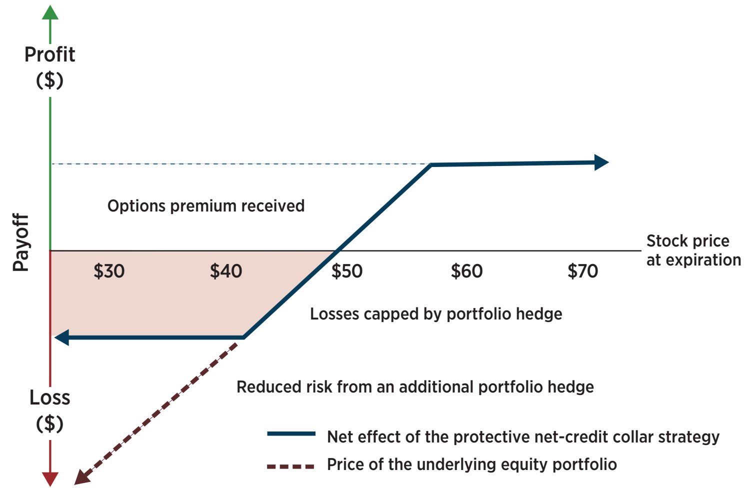
In a flat market

During periods of low stock market volatility, the ETFs' covered call options are likely to generate less premium, due to less demand from call option buyers seeking protection from volatility. As a result, income may potentially be lower in more temperate market environments. Additionally, there may be less premium available to purchase put options to protect the underlying portfolio from a market downturn.

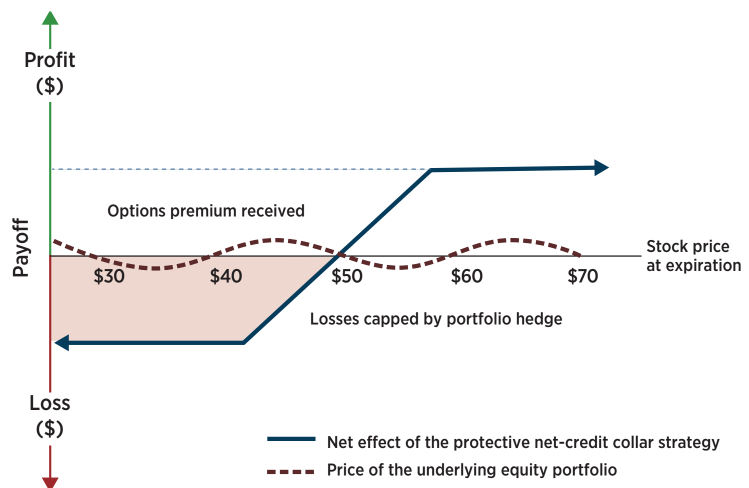
In a rising market



In a declining market



In a flat market



Nationwide Risk-Managed Income ETFs

NUSI
NATIONWIDE NASDAQ-100® RISK-MANAGED INCOME ETF

NSPI
NATIONWIDE S&P 500® RISK-MANAGED INCOME ETF

NDJI
NATIONWIDE DOW JONES® RISK-MANAGED INCOME ETF

NTKI
NATIONWIDE RUSSELL 2000® RISK-MANAGED INCOME ETF

Where these ETFs fit in a portfolio

Nationwide Risk Managed Income ETFs are suitable for income-focused investors seeking to lower their exposure to market volatility and minimize the potential for losses during down markets. The ETFs can be used to enhance and diversify core income-oriented portfolio allocations in the following ways:

- **As a complement to a traditional 60% equity/40% bond portfolio,** potentially enhancing the yield generated by the bond allocation while reducing potential volatility of the equity allocation.
- **As a strategy for managing the risk** of rising interest rates and the possibility of economic recession as an alternative to a traditional bond investment.
- **As a less volatile strategy for maintaining equity exposure** during volatile market periods, where the protective put options offer a degree of downside protection.
- **As a supplement to current income strategies** during cycles of low or falling yields.

To learn more about how Nationwide ETFs can fit into your clients' portfolios, call 1-877-893-1830.

Disclosure

Call 800-617-0004 to request a summary prospectus and/or a prospectus, or download prospectuses at etf.nationwide.com. These prospectuses outline investment objectives, risks, fees, charges and expenses, and other information that you should read and consider carefully before investing.

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Duration is a measure of the sensitivity of the price of a bond or other debt instrument to a change in interest rates.

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