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ETFs

White paper

A dynamic option for generating income while managing risk

Have *options* work for your income goals
with the Nationwide Risk-Managed Income ETF (NUSI)

Key highlights

- **The current low interest rate environment** may limit the ability of investors to generate income without assuming undue risk.
- **Options offer investors the ability to** seek income and total return goals while effectively managing market risks.
- **NUSI combines widely used options strategies to help yield-seeking investors** generate consistent income with the potential for capital appreciation while managing downside market risks.

Summary

As interest rates around the world trend toward historically low levels, yield-seeking investors seem to have fewer options for generating the income needed to help fulfill their cash-flow needs.

In order to generate sufficient income, investors often believe they must assume higher risks, either by extending duration via longer-term fixed income securities, assuming greater credit risk with speculative-grade bonds or exploring alternative asset classes in narrow slices of the financial markets.

Rather than assuming greater risks, a solution that combines dynamic options strategies for income-generation potential and 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.

The **Nationwide Risk Managed Income ETF (NUSI)** seeks a high level of income by combining covered call and protective put options strategies to generate yield, with the potential to participate in market growth while limiting drawdown risks.

Seeking income in a low-yield world

Massive monetary stimulus from the world's central banks in the form of low interest rates and asset purchases (i.e., quantitative easing) helped the global economy recover from the 2008-09 financial crisis and the ensuing recession. However, these accommodative monetary policies made it harder for income-seeking investors to generate sufficient income due to the low yields on traditional bond investments.

While the pace of global economic growth returned to its long-term average in the recovery from the "Great Recession," recent estimates of future Gross Domestic Product (GDP) growth have been below historical trends. Concerns about a global economic slowdown have increased, along with the likelihood of a contraction in growth and recession.

A slowdown in the global economy would impact corporate earnings, which would likely decline on a year-over-year basis as economic activity stalls. Moreover, in the event of a global slowdown, the Federal Reserve and other central banks are likely to resume accommodative monetary policies, lowering their target interest rates and increasing demand for fixed income securities through renewed quantitative easing measures. The net effect may be lower interest rates that will likely stimulate the economy, but also may result in lower yields for investors in fixed income securities.

Should yields remain at historic lows, income investors may again find few options for capturing income on a consistent basis. To seek adequate yield for their income goals in a low-rate climate, investors would have to assume higher risks, including:

- **Extend duration or assume more credit risk**—The common way for fixed income investors to seek more yield is to invest in longer-term bonds or more speculative bonds such as high yield corporate notes. While both options may be suitable for certain investors, they also come with greater risks, including higher duration and credit risks.

  In addition, with the amount of negative yielding debt exploding worldwide, the market for bonds offering viable yields is narrowing. As global yields trend toward lower levels, it becomes more difficult to achieve adequate total return for cash flow objectives or protect a fixed income portfolio against declines in principal value.

- **Explore other yield-producing asset classes**—In recent years, higher-yielding investments such as emerging market bonds, fixed-rate preferred stocks and master limited partnerships (MLPs) have surged in popularity. These asset classes have offered higher yields, but they also come with their own unique risks that investors must consider before investing, such as interest rate, currency and political risks.

Income investors have also turned to higher-yielding stocks such as energy, utilities and real estate, but these sectors comprise a small portion of the overall equity market (relative to other sectors in the S&P 500® Index.) In any case, investors have to allocate a large portion of their portfolios to these asset classes to generate adequate yield—assuming higher risks with which most investors would be uncomfortable.

Should yields remain at historic lows, income investors may again **find few options** for capturing income on a consistent basis.

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.

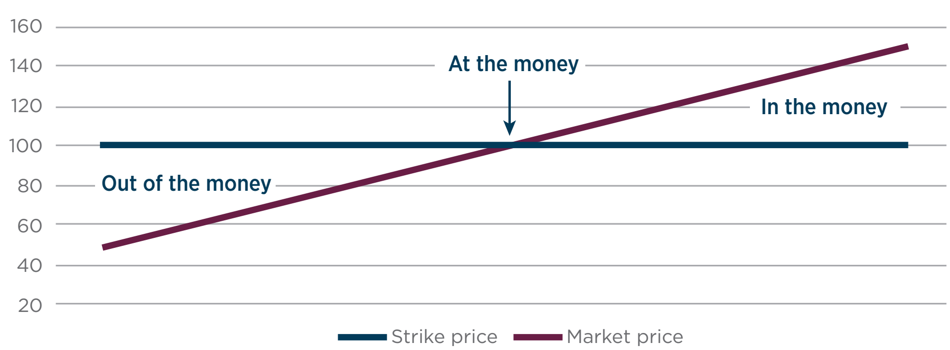
What is "moneyness"?

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



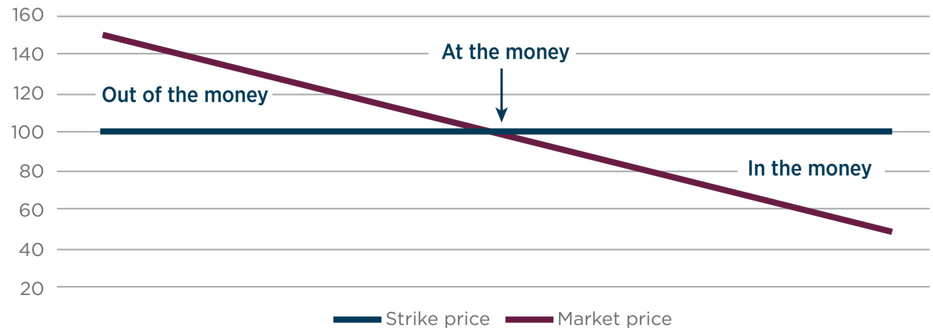
If you're **bearish** on a stock, you can purchase a **put option** that allows you to sell shares in the stock (usually 100) at the strike price. But to sell the stock, you have to own shares previously or buy shares before exercising the option.

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.***

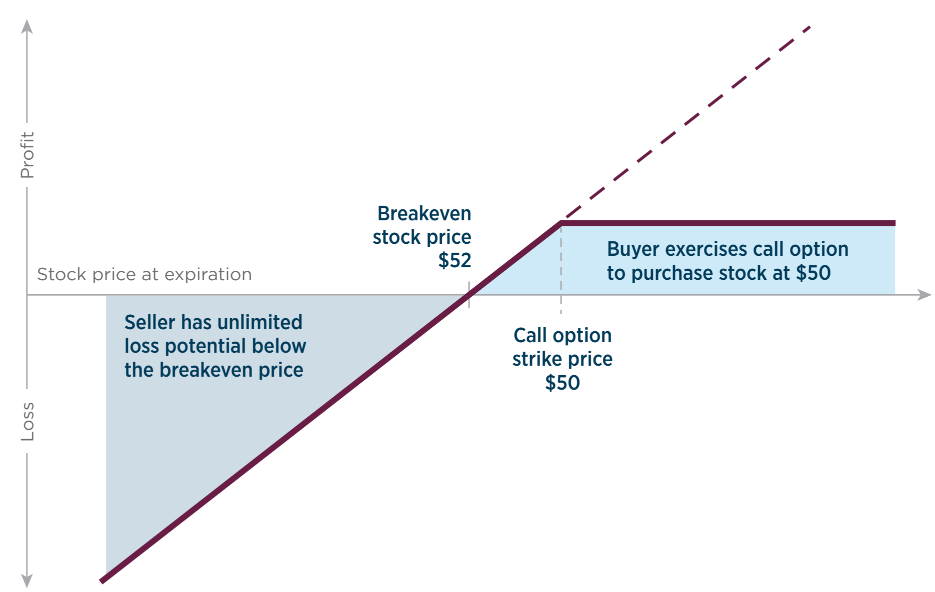
Also like other financial transactions, options come with costs that buyers pay to sellers or writers. The fee that option writers earn when they sell contracts to option buyers is called premium. This **premium** can be a source of return that the option writer can reinvest in a portfolio of securities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

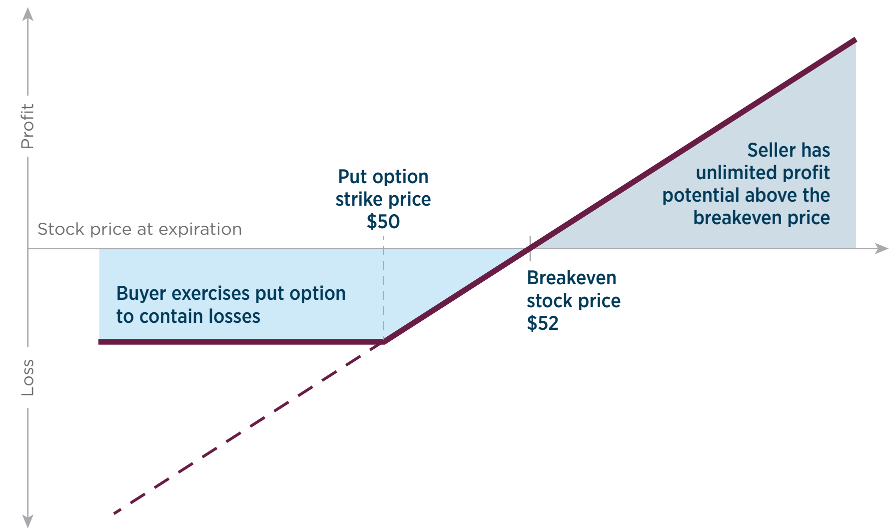
Covered call option example



Using puts for downside protection

In buying a put option, an investor can get downside protection when they are bullish or "long" on 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.

Protective put option example



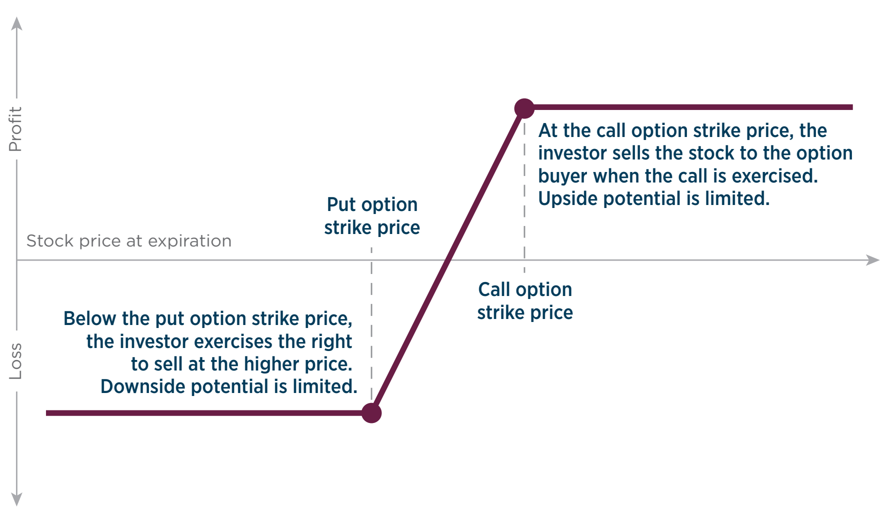
In the example here, let's say an investor purchases a put option on a stock they own in their portfolio. According to the option contract, the investor has the right to sell the stock at $50 per share by the expiration date. The option premium is $2 per share, so the breakeven point is $52 per share. 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.

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.)

Protective collar options strategy



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.

How NUSI uses protective net-credit collars

The Nationwide Risk-Managed Income ETF (NUSI) uses a protective net-credit collar strategy with call and put options on the Nasdaq-100 Index. Historically, the Nasdaq-100 has displayed more volatility than the broader U.S. equity market (as represented by the S&P 500 Index) due to its concentration of technology stocks, which typically offer fast growth and a high degree of volatility.

Volatility is an important factor in the pricing of option premiums since investors are more likely to pay higher premiums for options that help them hedge the higher risks of more volatile investments. By focusing on writing Nasdaq-100 call options, NUSI managers can seek to generate greater premium flow that can provide a more reliable income stream to investors.

How the NUSI protective net-credit collar works

STEP 1

Purchase all underlying stocks in the Nasdaq-100 Index

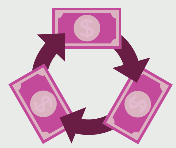
- The Fund directly owns all 100 stocks in the index, not through an ETF (e.g., QQQ).

STEP 2

Deploys a rules-based options collar strategy

- Writes covered calls on the Nasdaq-100 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 Nasdaq-100 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 Nasdaq-100 protective puts.
- Out-of-the-money puts are purchased with some of the premium generated by selling the Nasdaq-100 covered calls.

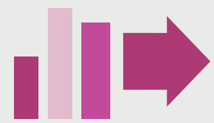
STEP 3



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 Nasdaq-100 stocks.

NUSI vs. other income strategies

The protective net-credit collar strategy employed by NUSI 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 ETF	✔	✔	✔	✔					
REITs	✔				✔		✔		✔
MLPs	✔				✔		✔	✔	✔
Fixed Rate Preferreds	✔				✔	✔			
High Yield Bonds	✔	✔			✔	✔	✔		
EM Debt	✔				✔	✔	✔		
High Dividend Stocks				✔	✔		✔		

How the NUSI strategy is intended to perform

The protective net-credit collar strategy used by NUSI 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 NUSI 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.

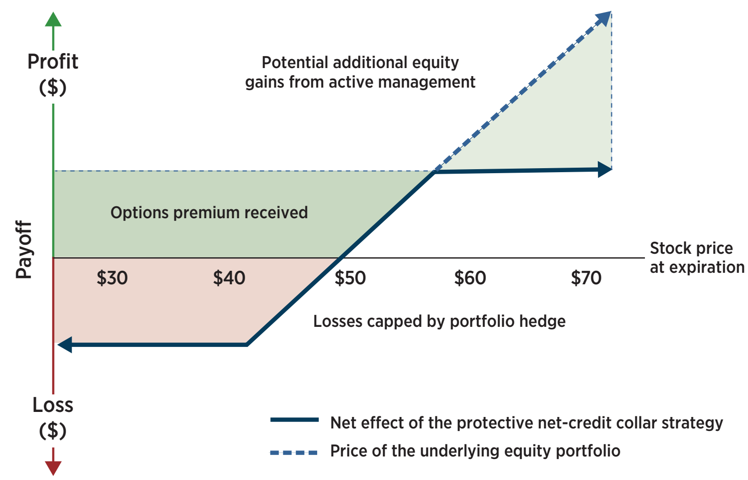
In a declining market

In a down-trending stock market, NUSI is 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.

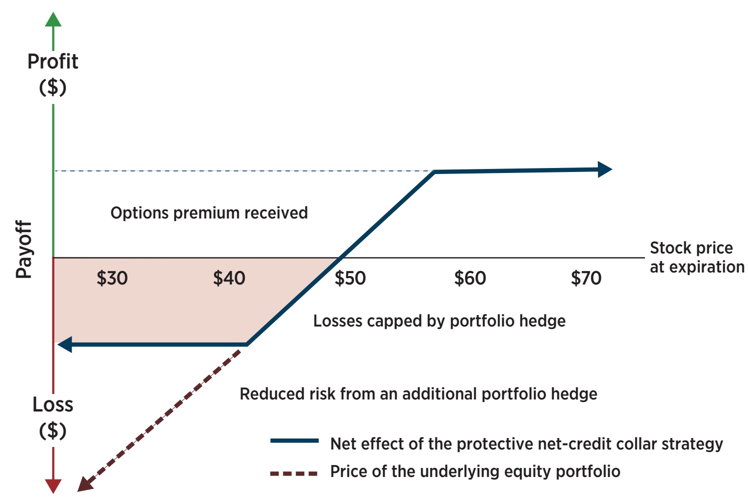
In a flat market

During periods of low stock market volatility, NUSI's 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.

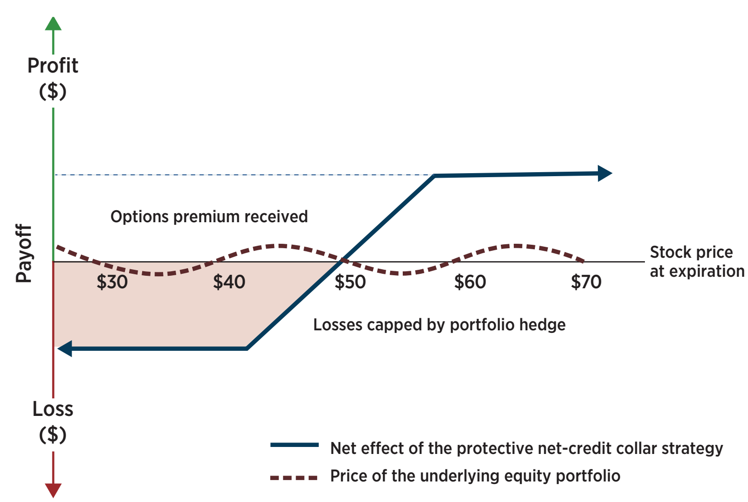
In a rising market



In a declining market



In a flat market



Where NUSI fits in a portfolio

The Nationwide Risk Managed Income ETF is suitable for income-focused investors seeking to lower their exposure to market volatility and minimize the potential for losses during down markets. NUSI 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.

Investing involves risk, including the possible loss of principal. Shares of any ETF are bought and sold at market price (not NAV), may trade at a discount or premium to NAV and are not individually redeemed from the Fund. Brokerage commissions will reduce returns. The Fund's return may not match or achieve a high degree of correlation with the return of the underlying index.

KEY RISKS: The Fund is subject to the risks of investing in equity securities, including tracking stocks (a class of common stock that "tracks" the performance of a unit or division within a larger company). A tracking stock's value may decline even if the larger company's stock increases in value. The Fund is subject to the risks of investing in foreign securities (currency fluctuations, political risks, differences in accounting and limited availability of information, all of which are magnified in emerging markets). The Fund may invest in more-aggressive investments such as derivatives (which create investment leverage and illiquidity and are highly volatile). The Fund employs a collared options strategy **(using call and put options is speculative and can lead to losses because of adverse movements in the price or value of the reference asset)**. The success of the Fund's investment strategy may depend on the effectiveness of the subadviser's quantitative tools for screening securities and on data provided by third parties. The Fund expects to invest a portion of its assets to replicate the holdings of an index. Correlation between Fund performance and index performance may be affected by Fund expenses and because the Fund may not be invested fully in the securities of the index or may hold securities not included in the index. The Fund frequently may buy and sell portfolio securities and other assets to rebalance its exposure to various market sectors. Higher portfolio turnover may result in higher levels of transaction costs paid by the Fund and greater tax liabilities for shareholders. The Fund may concentrate on specific sectors or industries, subjecting it to greater volatility than that of other ETFs. The Fund may hold large positions in a small number of securities, and an increase or decrease in the value of such securities may have a disproportionate impact on the Fund's value and total return. Although the Fund intends to invest in a variety of securities and instruments, the Fund will be considered nondiversified. Additional Fund risks include: Collared options strategy risk, correlation risk, derivatives risk, foreign investment risk, and industry concentration risk.

Cash flow is the total amount of money being transferred into and out of a business, especially as affecting liquidity.

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

S&P 500® Index: An unmanaged, market capitalization-weighted index of 500 stocks of leading large-cap U.S. companies in leading industries. Market index performance is provided by a third-party source Nationwide Funds Group deems to be reliable (Morningstar). Indexes are unmanaged and have been provided for comparison purposes only. No fees or expenses have been reflected. Individuals cannot invest directly in an index.

CBOE S&P 500 Zero-Cost Put Spread Collar Index: An index designed to track the performance of a hypothetical option trading strategy that 1) holds a long position indexed to the S&P 500 Index; 2) on a monthly basis buys a 2.5% - 5% S&P 500 Index (SPX) put option spread; and 3) sells a monthly out-of-the-money (OTM) SPX call option to cover the cost of the put spread.

Nasdaq-100 Index: An unmanaged, market capitalization-weighted index of 103 equity securities issued by 100 of the largest non-financial companies, with certain rules capping the influence of the largest components. It is based on exchange, and it is not an index of U.S.-based companies. Market index performance is provided by a third-party source Nationwide Funds Group deems to be reliable (Morningstar). Indexes are unmanaged and have been provided for comparison purposes only. No fees or expenses have been reflected. Individuals cannot invest directly in an index.

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