

# NUSI: A Tax-Efficient Way to Maximize Income Potential

while offering a measure of downside protection

Most investors are concerned with having enough income to maintain or improve their lifestyles – especially once they reach retirement. Dividends and interest from equities and fixed income securities are important sources of income, but many investors today are looking for alternative yield-oriented strategies to improve their returns.

The challenge lies in constructing a portfolio that maximizes income and minimizes downside risk. The Nationwide Nasdaq-100® Risk-Managed Income ETF ([NUSI](#)) uses a rules-based option strategy that seeks to offer high monthly income with a measure of downside protection in falling markets. NUSI is unique because it sources income by leveraging the volatility of the Nasdaq-100 Index® while also seeking tax-efficient monthly income structured as a return of capital (a type of income distribution not taxable in the year it is received).

We talked to Garrett Paoletta, Portfolio Manager of the Nationwide Risk-Managed Income ETFs, about why this strategy could be effective in the current macroeconomic environment.

## **Q: For background, what is your outlook on the macroeconomy and the market?**

**Garrett:** The Federal Reserve's shift from quantitative easing to quantitative tightening has had a tremendous impact on the financial markets. 2022 was one of the worst years on record for a 60/40 overall allocation. All asset classes – unless they were inflation hedged and/or interest protected – produced a negative return.

The Federal Reserve has raised interest rates nine times, but inflation remains stubbornly high, so it's unclear how many more increases are to come. Moreover, there are geopolitical headwinds from Russia's invasion of Ukraine. All this uncertainty is contributing to volatility – some of which is priced in, and some is not. Rates and yields are slightly higher now, so fixed income looks more attractive. That said, core bond portfolios were down nearly 13% in 2022.

Not surprisingly, investors remain cautious. Given the macro environment, we believe it's critical to build a robust asset allocation for the long term driven by each individual's investment objectives and goals.

## **Q: What are income investors looking for in the current environment, and what challenges are they facing in achieving their objectives and goals?**

**Garrett:** Investors want to protect their money, reduce volatility, and generate more net after-tax income. In addition to receiving dividends and interest on equities and fixed income securities, they're looking for alternative products that generate tax-efficient income – ideally ones that aren't highly correlated with other income buckets.

However, generating income is more difficult nowadays. Intuitively, rising interest rates should 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. It's harder to get back to even much less back to making a return, and many people have less money to invest in income-oriented products.

Herein lies the challenge. Investors need to figure out how much more income they need now compared to 12-18 months ago, and how they can leverage yield-oriented products to generate that income without taking on more risk.

## Q: How does NUSI generate income while managing risk?

**Garrett:** As its core underlying investment, NUSI buys all of the stocks in the Nasdaq-100 Index® (NDX®). Each month, it deploys an options overlay strategy, called a net credit collar, that seeks to generate tax-efficient income, lower portfolio volatility, and provide a measure of downside protection.

NUSI's rules-based options strategy starts by selling an out-of-the-money Nasdaq-100 Index® call option, which generates option premium. A portion of that premium is then used to buy an out-of-the-money NDX® put option, which seeks to provide a measure of downside protection. The rules-based option strategy is unique in that there are built-in triggers that indicate – based on years of data and research – opportune times to close the short call. For example, if most of the option premium has been captured or if the market moves higher, the model may indicate that it's time to close the call, potentially "uncapping" the portfolio and allowing the underlying portfolio securities to appreciate alongside the NDX®.

To be clear though, NUSI is an income-first product, even though it may from time to time be able to capture a portion of NDX® appreciation or offer a measure of downside protection. The Fund earns its income from multiple sources, those being the rules-based net-credit collar option strategy, equity dividends, and long-term capital appreciation from the underlying equities.

We strongly believe it's a viable option for investors seeking high current income, having maintained its consistent track record of delivering monthly distributions since its inception on December 19, 2019 through the first quarter of 2023.

## Q: Why is NUSI tax efficient?

**Garrett:** The NDX® index options get preferential tax treatment through Section 1256 of the Internal Revenue Code. Index options are taxed at 60% long-term capital gains and 40% short-term capital gains. Therefore, any gains – regardless of the holding periods – are taxed more favorably than some short-term equity exposures, equity options or even fixed income, which is taxed as ordinary income.

Essentially, the strategy is built to help convert both the income and gains received from the options, as well as the capital gains on the equities into a return of capital. As mentioned earlier, distributions classified as a return of capital are not taxed in the year they are received. Additionally, any losses in the portfolio are harvested over the course of the year in an attempt to offset the distribution amount.

The tax-deferred nature of the income distributions reduces your cost basis in the Fund, but again that may allow investors to earn about a 7% tax-free distribution each year they hold NUSI. Even with interest rates where they are today, that's a significant net after-tax yield.

## Q: What shall readers take away from our conversation?

**Garrett:** NUSI is an income-focused product that aims to offer reliable, tax-efficient monthly income distributions with lower volatility. The rules-based options model seeks a measure of downside protection in falling markets and the opportunity for partial upside capture in rising markets through its exposure to the Nasdaq-100 Index.

We want investors to be aware of NUSI's net after-tax distributions, which we believe are compelling. It's important to consider what you'd have to be invested in elsewhere to generate a similar income distribution, as well as the potential risks that may accompany it.

Call 1-800-617-0004 to request a summary prospectus and/or a prospectus, or download prospectuses at [etf.nationwidefinancial.com](http://etf.nationwidefinancial.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. Diversification does not assure a profit nor protect against loss in a declining market.

**KEY RISKS:** The Fund is subject to the risks of investing in equity securities, including tracking stock (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 risk includes: Collared options strategy risk, correlation risk, derivatives risk, foreign investment risk, and industry concentration risk.

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