Fund Vision

Global Real Estate Investing

Certain types of real estate have been shown to be less resistant to interest rates in a rising rates environment.

Real estate is indeed a compelling asset class in that it offers a unique combination of attributes. As its appeal continues to grow, more investors are taking a global approach.

WHY REAL ESTATE?

Some have called real estate one of the hottest investments of the last decade. As proof of its importance in the investment community, the S&P 500 Index split off equity real estate from the financial sector. It is the S&P's eleventh classification, comprising more than 222 U.S. equity REITS with a market capitalization, as of 12/31/2017, of $1.1 trillion.

The economic and investment reach of real estate investing has been felt by millions of investors throughout the years. According to the National Association of Real Estate Investment Trusts (NAREIT), as of 12/31/2017, 80 million Americans own real estate investment trusts (REITs) through their retirement savings and other investment funds. NAREIT also estimates that, as of 12/31/2017, REITS own approximately $3 trillion in gross assets.

Traditionally, real estate has been used as a long-term inflation hedge along with common stocks. One reason is that certain types of real estate have been shown to be less resistant to interest rates in a rising rates environment. As the costs of steel, sheetrock and glass rise, the intrinsic value of existing structures increase. Replacement costs also rise, reducing supply. Residential real estate, specifically those with yearly lease renewals, are particularly strong in protecting against inflation.

We believe that the cycle of real estate does not tend to coincide with that of other asset classes.

Another reason is that, historically, real estate investments have paid dividend yields greater than many other equity classes, providing a total return component to portfolios. Real estate has also had low correlation to fixed income and other equity asset segments. Though it tends to be sensitive to the same macro-economic factors that affect fixed income and equity markets, its cycle does not tend to coincide with that of other asset classes. This diversification was tested and proven during the recent financial crisis when real estate held up much better than other equity correlations. More recently, investors are realizing that a global approach to real estate offers further diversification opportunities.

Readers should be mindful that we do not include home ownership in this context, since it is financed with leverage (via a mortgage) that distorts capital appreciation both positively and negatively. Home ownership also requires additional capital on an ongoing basis in the form of insurance, real estate taxes and property maintenance, and rarely does it offer the liquidity of many real estate investment vehicles. In contrast, commercial real estate generates income from rental payments. The majority of real estate investments are well diversified across multiple properties and often across multiple locations and jurisdictions.

FlexShares has prepared this paper to help advisors and their clients better understand the real estate sector and, hopefully, develop a more informed comfort zone in including this asset class in a well-diversified portfolio.

TWO WAYS TO INVEST

In general, there are two different types of equity vehicles that are used to gain access to real estate:

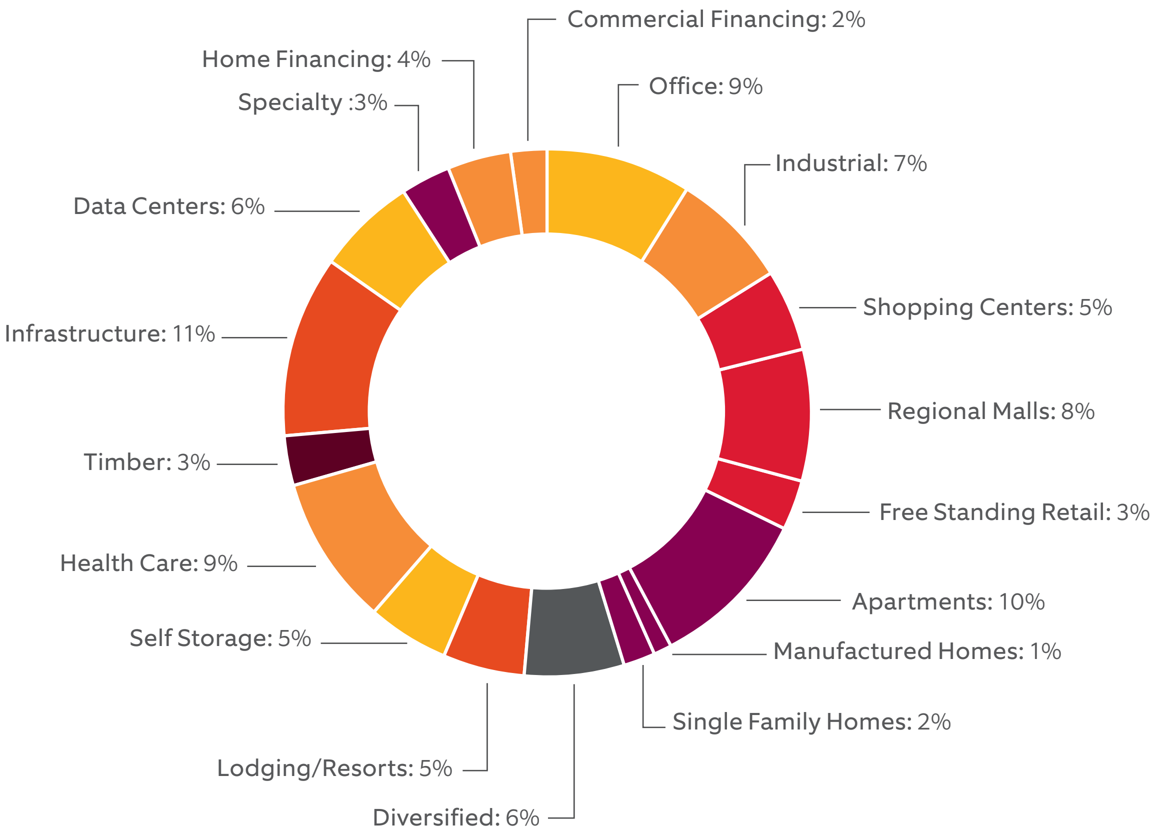
1. Real Estate Companies involved with the development or operation of real estate are accessed via common stock purchases. Often included in this category are tangential businesses such as realty and licensing companies, thrifts and mortgage finance companies and real estate websites such as Zillow or Trulia.

2. Real Estate Investment Trust (REITs) were created by Congress in 1960 to democratize real estate investment ownership. The new law gave individuals the ability to invest in large-scale commercial real estate.

WHAT EXACTLY IS A REIT?

Equity REITs invest in and own properties and derive revenue principally from property rents. As the chart below demonstrates, there are many different types of REITs in today's marketplace.

CONSTITUENT SECTORS OF THE FTSE/NAREIT ALL REITS INDEX



Source: REIT.com, data as of December 31, 2017

For investors with long time horizons, exchange-traded equity REITs represent important opportunities for total returns and, as history shows, more dependable returns than stocks have delivered.

To qualify as an REIT under U.S. tax code, a Real Estate Investment Trust needs to comply with several general and operational requirements.

General Rules

- Must be taxable as a Corporation (not a Partnership)
- Have a minimum of 100 shareholders
- Largest five shareholders cannot own more than 50% of the shares
- Shares must be transferable

Operational Rules

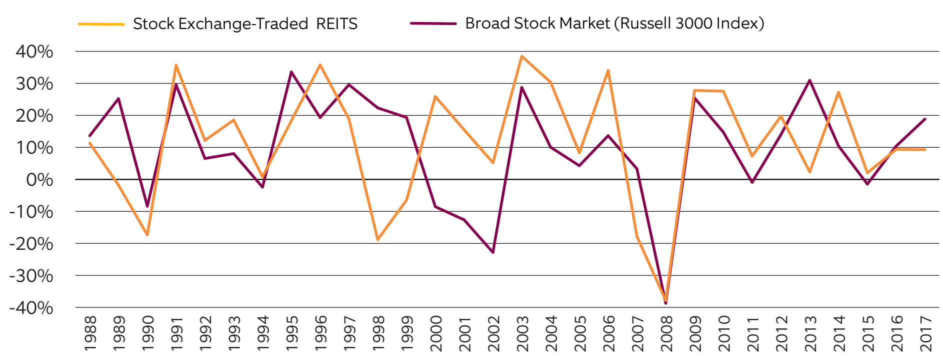
- Must invest at least 75% of total assets in real estate
- At least 75% of gross income must come from property rents or interest on mortgages financing property
- No more than 25% of assets can be in taxable REIT subsidies
- Must pay out 90% of taxable income to shareholders in the form of dividends

By complying with these rules, REITs do not pay corporate taxes on income and so, under U.S. tax code, dividends from REITs are generally not considered Qualified Dividend Income (QDI,) but rather ordinary income.

AN IMPRESSIVE PERFORMANCE TRACK RECORD

For investors with long time horizons, exchange-traded equity REITs represent important opportunities for total returns and, as history shows, more dependable returns than stocks have delivered. Comparing average annual total returns from December 1988 to December 2017, REIT average annual returns were lower than the Russell 3000 only 10 years out of the last 30.

AVERAGE ANNUAL RETURNS



Source: Bloomberg. January 1, 1998 - December 31, 2017. Indexes are gross of fees and indexes cannot be invested in directly. **Past performance is no guarantee of future results.** Returns for various asset classes used in the chart above are both on a quarterly and year-to-date basis.

Real Estate presents good breadth of global markets, along with strong depth in many markets.

REITS HAVE GONE GLOBAL

Though real estate is often grouped under the real assets umbrella, it is actually much more developed and "mature" as an asset class. The Real Assets classification (e.g., timber, water, infrastructure, natural resources, etc.) is continually evolving, influenced not only by democratization of new asset types, but also regulatory and issuance changes. Asset classes in different segments of the product lifecycle need to be handled differently.

For example, infrastructure is in its infancy, though in recent years a true informational edge is finally becoming reality. Commodities and natural resources are undergoing regulatory pressures as well as inflections in the futures curve, and international opportunities outside of a few markets are still sparse. Real Estate on the other hand, presents good breadth of global markets, along with strong depth in many markets. Today, it is a large marketplace with enough history (50+ years) that research and investment theory can be fully tested.

It is no surprise then that the REIT structure has expanded beyond the U.S. to countries around the globe. In fact, as of December 31, 2017, the FTSE EPRA/NAREIT Global Real Estate Index included 477 stock exchange-listed real estate companies in 37 countries with a total market capitalization, as of December 31, 2017, of $1.5 trillion.*

Below is a list of countries that have adopted or are considering the U.S. REIT structure and the length of time it has been in effect.

COUNTRIES AND REGIONS THAT HAVE ADOPTED THE U.S. REIT APPROACH

G7 Countries	Date
Canada	1993
France	2003
Germany	2007
Japan	2000
United Kingdom	2007
United States	1960

Country/Region	Date
Australia	1971
Bahrain	2015
Belgium	1995
Brazil	1993
Bulgaria	2005
Costa Rica	2009
Dubai	2006
Finland	2009
Greece	1999
Hong Kong	2003
Hungary	2011
India	2014
Ireland	2013
Israel	2006
Kenya	2014

Country/Region	Date
Malaysia	2005
Mexico	2010
Netherlands	1969
New Zealand	1969
Pakistan	2008
Philippines	2010
Saudi Arabia	2016
Singapore	1999
South Africa	2013
South Korea	2001
Spain	2009
Taiwan	1969
Thailand	2005
Turkey	1995
Vietnam	2015

Countries Considering REITs
Cambodia
China
Ghana
Indonesia
Malta
Nigeria
Poland
Sweden
Tanzania

Source: NAREIT®, Date indicates adoption year of REIT rules.

*Global Real Estate Investment. How is the Global Listed Property Market Configured? REIT.com Accessed April 15, 2018. https://www.reit.com/investing/reit-basics global-real-estate-investment

No matter the asset class, FlexShares managers first consider how best to achieve each goal. Which factors we choose and how they are tied to the goal, is critical.

While most of the Real Estate Investment Trusts in global markets are listed on the exchange, some remain private investment vehicles. Listed REITS have several benefits, chief among them liquidity and transparency. Also, the variety of listed REITs offers diversification in the forms of geography, type of real estate asset and company structure (operating company or REIT).

FLEXSHARES GQRE: OUR MULTIFACTOR APPROACH TO REAL ESTATE INVESTING

At FlexShares, we believe that a combination of traditional market-weighted and factor investing, using the right factors of course, works best to avoid risk and gain exposure for broader diversification and return. No matter the asset class, FlexShares managers first consider how best to achieve each goal. Which factors we choose and how they are tied to the goal, is critical.

The Northern Trust Global Real Estate Index is the parent index for Northern Trust's Global Quality Real Estate Index and the underlying Index for FlexShares Global Quality Real Estate Fund (GQRE). Its design offers a high-quality universe with broad-based exposure to companies operating in the real estate sector. Stocks eligible for inclusion in the index must meet strict parameters. Companies must be domiciled in a developed market and be ranked in the largest 97.5% of the world's float adjusted market capitalization. Only common stocks, preferred stocks and REITs are eligible. Each company must have free float greater than 10% and have traded 90% of the days in the quarter prior to reconstitution (which occurs in February and August). The methodology also includes several constraints that ensure proper diversification and mitigate systemic risk. These include weighting restrictions on single securities, as well as on industry group, country, region and style factors.

FlexShares GQRE incorporates the same Quality approach that drove the development of our growing stable of QDF products. In this "smart beta" methodology, we enhance our Quality score with a multifactor approach that examines Quality as a stand-alone factor, but adds Value and Momentum scores in a rules-based, quantitative process, to build a targeted index.

OUR APPROACH TO QUALITY

Quality is a persistent, statistically significant factor. It has a very low correlation to traditional risk-based factors (value, size, yield.) It has shown to smooth out the factor cycle, improving performance and mitigating drawdown when other factors are out of favor.

Our disciplined approach to targeting Enhanced Quality exposure, while attempting to mitigate risk and unintended concentrations in securities, countries, regions, etc., is built on Northern Trust's proprietary Quality Score, an empirically-tested quantitative model that assigns each stock a quality ranking based on firm management efficiency, profitability, and cash levels.

Value works particularly well with Quality due to investors implicitly putting a premium on top quality companies (those we define as top quintile).

The rationale:

- Quality firms have prudent investment management and will manage capital judiciously.
- Firms with a competitive advantage relative to their peer groups are likely to deliver excess return to their enterprise holders in the form of higher profitability and higher cash flows.
- Quality companies have more than enough cash on hand to meet their debt obligations and day-to-day liquidity needs.

We believe this multi-lens approach to Quality increases investor confidence that the company has a solid financial base.

OUR APPROACH TO VALUE

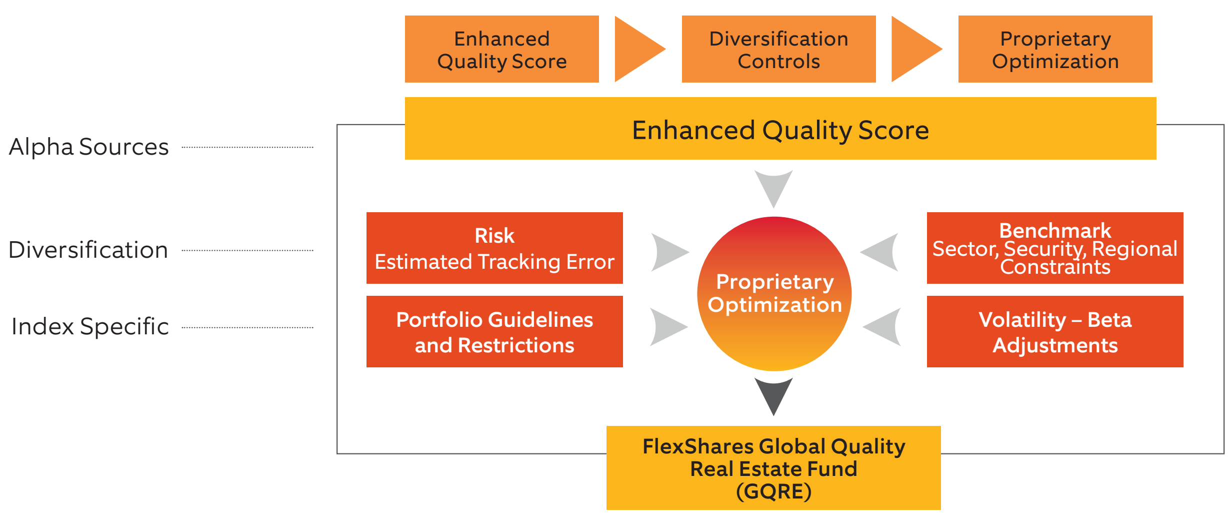
Value works particularly well with Quality due to investors implicitly putting a premium on top quality companies (those we define as top quintile). When determining value exposure, we look at traditional metrics similar to those any financial professional would use. Our methodology is unique, however, thanks to the examination of both contemporaneous and normalized valuation metrics. We examine valuation based on the most recently available data and then adjust values based on historical data. This gives a better understanding of where valuation stands compared to historical norms and helps offset the cyclical nature associated with some traditional metrics.

OUR APPROACH TO MOMENTUM

Momentum avoids value traps and offsets unintended exposures and so we apply the same proprietary process to our examination of the momentum factor. Positive intermediate/long-term momentum has been viewed as an indicator of future positive momentum; short-term momentum is negatively correlated to future positive returns. Our methodology takes into account both traditional momentum and the short-term reversal effect.

QUALITY REAL ESTATE INDEX METHODOLOGY:

Proprietary Optimization Process Produces Tracking Indices



DEFINITIONS

Alpha is a measure of performance on a risk adjusted basis. It's often considered the active return on an investment against a market index used as a benchmark, since they are often considered to represent the market's movement as a whole. Alpha is often used with beta.

Beta is a statistical measure of the volatility, or sensitivity, of rates of return on a portfolio or security compared to a market index. The beta for an ETF measures the expected change in return of the ETF relative to the return of a designated index. By definition, the beta of the Standard & Poor's (S&P) 500 Index is 1.00. Accordingly, a fund with a 1.10 beta is expected to perform 10% better than the S&P 500 Index in rising marketing and 10% worse in falling markets.

Tracking Error The divergence between the price behavior of a position or a portfolio and the price behavior of a benchmark. Tracking error is reported as a standard deviation percentage difference, which reports the difference between the return an investor receives and that of the benchmark that they were attempting to imitate.

FIND OUT MORE

The FlexShares approach to index-based investing is, first and foremost, investor-centric and goal oriented. We pride ourselves on our commitment to developing products that are designed to meet real-world objectives for both institutional and individual investors. If you would like to discuss the attributes of any of the ETFs discussed in this report in greater depth or find out more about the index methodology behind them please don't hesitate to call us at 1-855-FlexETF (1-855-353-9383) or visit **www. FlexShares.com**.

IMPORTANT INFORMATION

Before investing, carefully consider the FlexShares investment objectives, risks, charges and expenses. This and other information is in the prospectus and a summary prospectus, copies of which may be obtained by visiting www.flexshares.com. Read the prospectus carefully before you invest.

Foreside Fund Services, LLC, distributor.

An investment in FlexShares is subject to numerous risks, including possible loss of principal. Fund returns may not match the return of the respective indexes. A full description of risks is in the prospectus.

FlexShares Global Quality Real Estate Index Fund (GQRE) is passively managed and uses a representative sampling strategy to track its underlying index. Use of a representative sampling strategy creates tracking risk where the Fund's performance could vary substantially from the performance of the underlying index along with the risk of high portfolio turnover. It is subject to real estate sector risk in addition to the general risk of the stock market. Investments in foreign market securities involve certain risks such as currency volatility, political and social instability and reduced market liquidity. To the extent that the Fund invests in Emerging markets, those investments may be subject to increased price volatility and may be more susceptible to adverse economic, market, political or regulatory occurrences affecting that country, market, industry, sector or asset class. Investing in securities of real estate companies will make the Fund more susceptible to risks associated with the ownership of real estate and with the real estate industry in general, as well as risks that relate specifically to the way in which real estate companies are organized and operated. Real estate companies may have lower trading volumes and may be subject to more abrupt or erratic price movements than the overall securities markets. The value of real estate securities may underperform other sectors of the economy or broader equity markets. To the extent that the Fund concentrates its investments in the real estate sector, it may be subject to greater risk of loss than if it were diversified across different industry sectors. The Fund is also subject to the risk that its investments will be affected by factors that impact REITs and the real estate sector generally. Investing in REITs involves certain unique risks in addition to those risks associated with investing in the real estate industry in general. REITs whose underlying properties are concentrated in a particular industry or geographic region are also subject to risks affecting such industries and regions. By investing in REITs through the Fund, a shareholder will bear proportionate expenses of the REITs in addition to expenses of the Fund.

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