

Fund Focus

FlexShares Global Quality Real Estate Index Fund

BUILDING QUALITY

For investors seeking the portfolio and income diversification potential of global REITS

Investing in the real estate sector offers the potential to add growth, diversification, income along with potential protection against the risk of long-term inflation to a portfolio. We believe that a well-diversified and global approach to real estate investing is a key factor in unlocking the full range of these potential benefits.

In this paper, we discuss important considerations around global real estate investments. We then explain the methodology the underlying index uses that the FlexShares Global Quality Real Estate Index Fund (GQRE) tracks in an attempt to add breadth and diversity to an investor's portfolio.



THE VALUE OF A GLOBAL PERSPECTIVE

Real estate equities can play an important role in a well-diversified portfolio—particularly when investors adopt a global approach.

Our research suggests that real estate equities have been used traditionally as a potential hedge against long-term inflation, as some types of real estate stocks have been shown to be less resistant to rising interest rates. Historically, our opinion is that real estate investments also have paid higher dividend yields than other equity classes, offering an alternative source of potential income. Finally, we believe that real estate historically has had a low correlation to both fixed income and other equity asset classes. As a result, real estate may add further diversification to an already well-diversified portfolio.

Investor demand for these investments led Standard & Poor's in 2017 to create a new sector classification for real estate, which previously had been included in the S&P 500 index's financials sector. As real estate's appeal continues to grow, we believe that taking full advantage of this sector's opportunities requires a broader focus than just U.S.-based assets. Our research suggests that a global approach to real estate investing can offer additional diversification opportunities and may include less volatility than U.S. real estate.

We also believe that a combination of a traditional market-weighted index and factor-based security selection may offer the opportunity to further mitigate risk and gain broader exposure to the potential benefits of real estate investments.



A MULTI-FACTOR APPROACH FOR A GLOBAL MARKET

The FlexShares Global Quality Real Estate Index Fund (GQRE) is an ETF that may provide an alternative source of income to investors searching for yield in a low interest rate environment. The Fund tracks the Northern Trust Global Quality Real Estate Index.¹ Northern Trust Investments Inc. (NTI) is the investment adviser for FlexShares ETFs.

The index employs a composite score ranking to assess global real estate assets, including REITs and real estate operating trusts, in developed U.S. and international markets. NTI evaluates those assets through a multi-factor approach, which examines quality as a stand-alone factor but adds value and momentum scores in a rules-based, quantitative process:



Quality Score

The quality score is an empirically tested quantitative model that assigns each stock a ranking based on firm management efficiency, profitability and cash levels. This multi-lens approach is designed to increase confidence that a company has a solid financial base.



Value Score

The value methodology examines a company's valuation based on the most current data and then adjusts values based on historical data. This approach helps provide a picture of where valuation stands compared to historical norms, which may help offset the cyclical nature associated with some traditional metrics.



Momentum Score

This lens looks for companies that have exhibited positive momentum relative to its peers. The methodology takes into account both traditional momentum and the short-term reversal effect, in which short-term momentum is negatively correlated to future positive returns.

The resulting Enhanced Quality Score is used to rank stocks in deciles, with decile 1 representing the highest scoring. All stocks in decile 5 are excluded from the index.

Next, the index applies diversification controls that include overweight/ underweight parameters, single-security maximums, and industry group, region, and country exposure. The index also minimizes style exposure and is rebalanced on a quarterly basis with a maximum targeted turnover of 12% to 15%.

During this final construction process, NTI adds another layer of optimization based on the enhanced quality score, to help provide good representation of the higher-ranking stocks within each industry, region and country.



HARNESSING THE VIRTUES OF DIVERSIFICATION

We believe the multi-factor methodology offers important benefits in the construction of the Global Quality Real Estate Fund’s underlying index. This disciplined approach recognizes that factors such as quality, value and momentum—when coupled with the use of strict parameters within the construction of the index—may help ensure proper diversification and mitigate systemic risk in the real estate sector.

Global real estate also may appeal to income-oriented investors as our research suggests that dividend payments distributed by real estate investment trusts (REITS) may add to overall portfolio income.

CONCLUSION

Investors seek out real estate investments for many reasons, including as potential protection against long-term inflation and as alternative sources of potential portfolio income. But we believe the full benefits of these investments can be better captured through a broad-based global approach that includes well-established real estate markets in developed countries around the world. Expanding an investment perspective to include these global opportunities may help investors more effectively meet their objectives.

The FlexShares Global Quality Real Estate Index Fund (GQRE) is designed to provide that broad-based exposure to global real estate markets. At the same time, we believe its multi-factor approach and screening strategies aims to reduce risk and boost exposure for broader diversification and return potential.

FIND OUT MORE

The FlexShares approach to 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).

FOOTNOTE

¹ Northern Trust Global Quality Real Estate Index is designed to maximize exposure to quality, value and momentum factors, within a universe of companies operating in the real estate sector.

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.