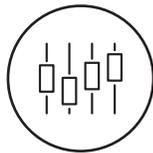


Successful Value Investing: How You Measure and Target Value Matters

Using multiple value signals and risk-aware portfolio-construction techniques may help strategies gain efficient value exposure



While all value investing strategies share the goal of identifying undervalued stocks, there are actually many different ways to define value. Advisors trying to meet their clients' goals may want to carefully examine how a given strategy measures value — and how the portfolio targets that value exposure.

Portfolio managers can use a range of value metrics, such as price-to-book, price-to-sales and price-to-cash flow. There's ample academic research showing that each may effectively identify stocks that historically have provided a long-term return premium. But it's important to remember that the value premium is a risk premium — and we believe that all investors should be compensated for the risks they take.

To avoid uncompensated risk in value investing, FlexShares recommends that advisors look for strategies that use:



A diversified mix of
multiple value metrics



Historical and current
valuation analysis



Portfolio construction
techniques that attempt
to efficiently gain
exposure to the
value factor



Analyzing companies across multiple valuation metrics may help better capture the value premium



Looking back over several years and calculating the average valuation for that stock may provide a normalized view that can help avoid short-term financial distortions

MULTIPLE METRICS CAPTURE A MORE COMPLETE VALUATION PICTURE

Common value metrics gauge how cheap or expensive a stock is based on some dimension of the company's finances, such as book value, earnings, sales or cash flow. Examining those elements in isolation, though, may provide a limited perspective on the stock's valuation.

FlexShares believes that value investors should fall back on the principle of diversification: Just as holding different types of assets helps improve a portfolio's risk-adjusted returns, analyzing companies across multiple valuation metrics may help better capture the value premium — and reduce the risk of mischaracterizing stocks:

- A stock that's considered a value investment based on one metric could look expensive according to others.
- The efficacy of valuation metrics can change over time. For example, price-to-book ratio historically has offered the best return premium when examining data back to 1927, it but may be less effective in today's economy, when companies increasingly rely on intangible assets such as intellectual property and goodwill.
- Some ratios can change quickly — such as price-to-earnings — which could cause unnecessary turnover in a portfolio.

For these reasons, FlexShares uses a composite value score based on price-to-earnings, price-to-book, price-to-cash flow and price-to-dividend yield. We believe this mix helps capture a more complete picture of valuation and reduces turnover.

HISTORICAL CONTEXT AND FUTURE CONSIDERATIONS HELP ASSESS CURRENT VALUATIONS

Another important dimension to consider is how a stock's current valuation compares both with its historical levels and where it might be in the future. Current valuations are often based on a company's most recent financial statements, but cyclical forces can quickly affect the earnings, sales, cash flow and book value of individual companies, sectors or even the entire market.

For example, oil company earnings historically move with macroeconomic forces that affect the price of oil. When oil prices are high, oil stocks may look extremely inexpensive based on current valuations. Looking back over several years and calculating the average valuation for that particular stock, however, may provide a normalized view that may help avoid short-term financial distortions that may not reflect ongoing operations of a business.

Likewise, using future estimates — such as analysts' earnings projections — may help gauge where the company might be going and whether those expectations are reflected in its current stock price. Taking a long-term view of company valuations in this way can potentially help a fund's strategy control for cyclicity in markets or sectors when identifying potential stocks to hold in a portfolio.



When combined with a diversified approach to measuring value, thoughtful portfolio-construction techniques like these may help strategies target their value exposure

PORTFOLIO CONSTRUCTION METHODS MAY HELP SMOOTH VALUE STRATEGY PERFORMANCE

Whatever signals a value strategy uses, how that portfolio obtains its value exposure may affect its risk and return profile.

One important consideration is that we believe the value factor's full cycle is quite long compared with other factors like low volatility and momentum. As a result, value may experience long periods of underperformance. One way to manage that cyclical risk is to combine value with other factors. For example:

- A strategy that combines value with quality — which are both powerful on their own — may provide smoother overall performance over long periods by avoiding low-quality value stocks that could reduce the portfolio's returns or increase its volatility.

Other portfolio-construction techniques may help reduce the risk that a value strategy is overly concentrated in specific stocks or sectors:

- Strategies that look for value stocks in every sector may help avoid overweighting traditional value sectors and provide better exposure to the value factor across the broader market. Likewise, holding a larger number of stocks may help reduce the idiosyncratic risk that may arise from concentrated value portfolios that only hold 30–50 stocks.

When combined with a diversified approach to measuring value, thoughtful portfolio-construction techniques like these may help strategies target their value exposure in a way that may help to capture the long-term return potential of the value premium.



For more on FlexShares' approach to value investing, see our Fund pages:

- [FlexShares Morningstar® U.S. Market Factor Tilt Index Fund \(TILT\)](#)
- [FlexShares US Quality Large Cap Index Fund \(QLC\)](#)

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).

DEFINITIONS

Price-to-book is a financial ratio used to compare a company's current market value to its book value (where book value is the value of all assets owned by a company).

Price-to-sales is a valuation metric for stocks and is calculated by dividing the company's market capitalization (where market capitalization is the market value of a publicly traded company's outstanding shares) by the revenue in the most recent year.

Price-to-cash flow is a ratio used to compare a company's market value to its cash flow and is calculated by dividing the company's market capitalization by the company's operating cash flow (where cash flow is payments into or out of a business) in the most recent fiscal year.

Price-to-dividend yield is financial ratio that expresses the percentage of a company's share price that it pays out in dividends each year.

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.

Forside Fund Services, LLC, distributor.

Please remember that all investments carry some level of risk, including the potential loss of principal invested. They do not typically grow at an even rate of return and may experience negative growth. As with any type of portfolio structuring, attempting to reduce risk and increase return could, at certain times, unintentionally reduce returns.

Past performance is no guarantee of future results. There is no guarantee these investment strategies will be successful. 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.

The views and information discussed in this paper are subject to change and may not reflect the current views of the writer(s). The views expressed represent an assessment of market conditions at a specific point in time, are opinions only and should not be relied upon as investment advice regarding a particular investment or markets in general. Such information does not constitute a recommendation to buy or sell specific securities or investment vehicles. It should not be assumed that any investment will be profitable or will equal the performance of the portfolios or any securities or any sectors mentioned herein. The subject matter contained herein has been derived from several sources believed to be reliable and accurate at the time of compilation.

FlexShares Morningstar® U.S. Market Factor Tilt Index Fund (TILT) 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 concentration risk. The Fund's investments are concentrated in the securities of issuers in a particular market, industry, sector or asset class. The Fund may be subject to increased price volatility and may be more susceptible to adverse economic, market, political or regulatory occurrences affecting that market, industry, sector or asset class. The Fund may also invest in derivative instruments. Changes in the value of the derivative may not correlate with the underlying asset, rate or index and the Fund could lose more than the principal amount invested.

The Morningstar® U.S. Market Factor Tilt Index is the intellectual property (including registered trademarks) of Morningstar® and/or its licensors ("Licensors"), which is used under license. The securities based on the Index are in no way sponsored, endorsed, sold or promoted by Morningstar® and its Licensors and neither of the Licensors shall have any liability with respect thereto.

FlexShares US Quality Large Cap Index Fund (QLC) 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. Additionally, the Fund is at increased dividend risk, as the issuers of the underlying stock might not declare a dividend, or the dividend rate may not remain at current levels. The Fund is also at increased risk of industry concentration, where it may be more than 25% invested in the assets of a single industry. Finally, the Fund may also be subject to increased volatility risk, where volatility may not equal the target of the underlying index.