

# Investing in Interesting Times

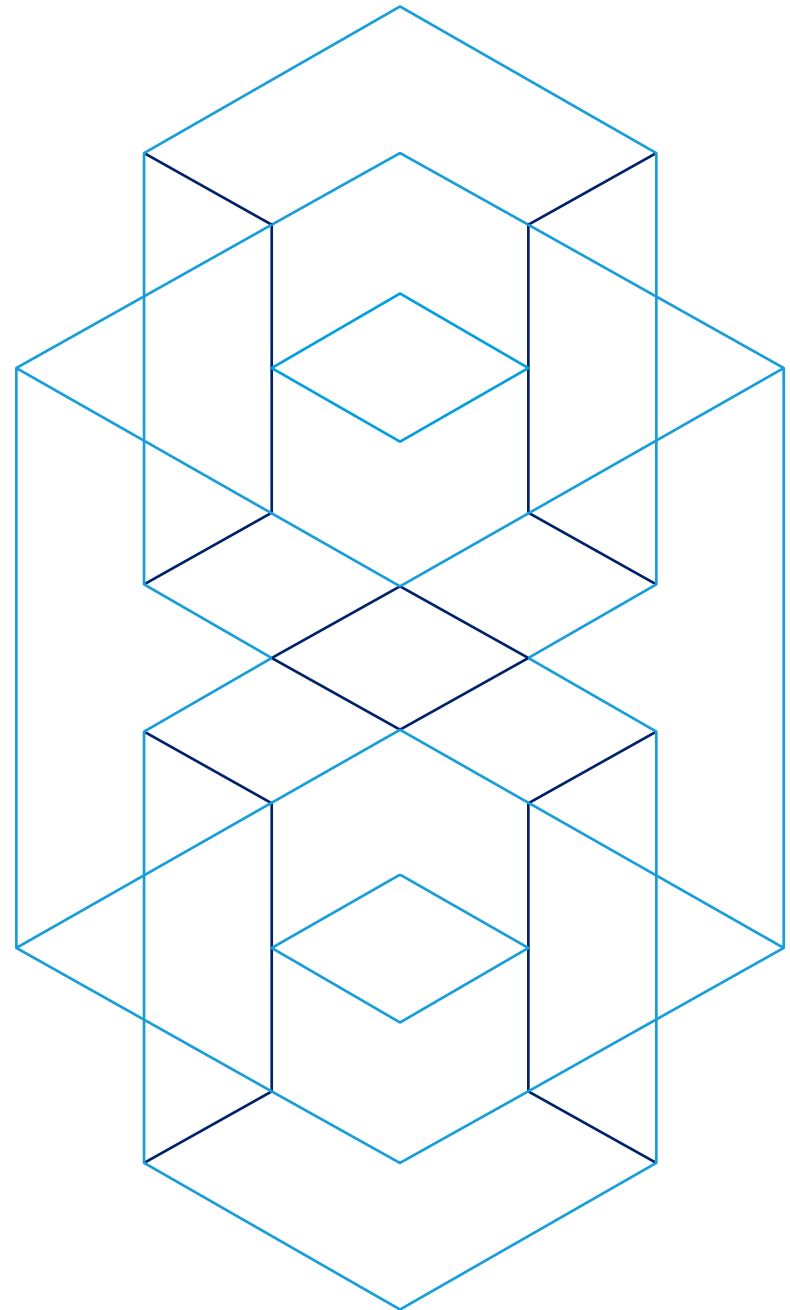
Timely and Timeless Observations

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Principal

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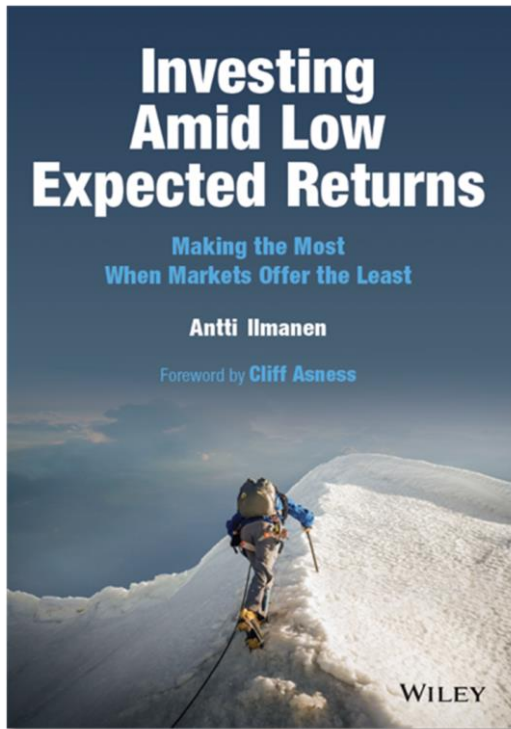
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# “May You Live in Interesting Times”

The apocryphal Chinese curse suits macro investors well

Written During 2021,  
Out in Early 2022



Update in JoPM,  
Out in Early 2023



Antti Ilmanen, Ph.D.  
*Principal*

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Antti has published many articles, for which he has received many awards, as well as two books, *Expected Returns* (2011) and *Investing Amid Low Expected Returns* (2022).

Antti received the CFA Institute's 2017 Leadership in Global Investment Award.

Antti has been reading BCA research since 1986.

An old Chinese curse (possibly apocryphal) says, “May you live in interesting times.” We certainly do. The year 2022 was pivotal and might go into history books as an even more important year than 2020 or competitors like 2016, 2008, and 2001. I will not discuss the huge geopolitical issues, such as war and reshoring, which of course contributed to economic and investment outcomes, but I will touch on the highest inflation for a generation and the central banks’ response

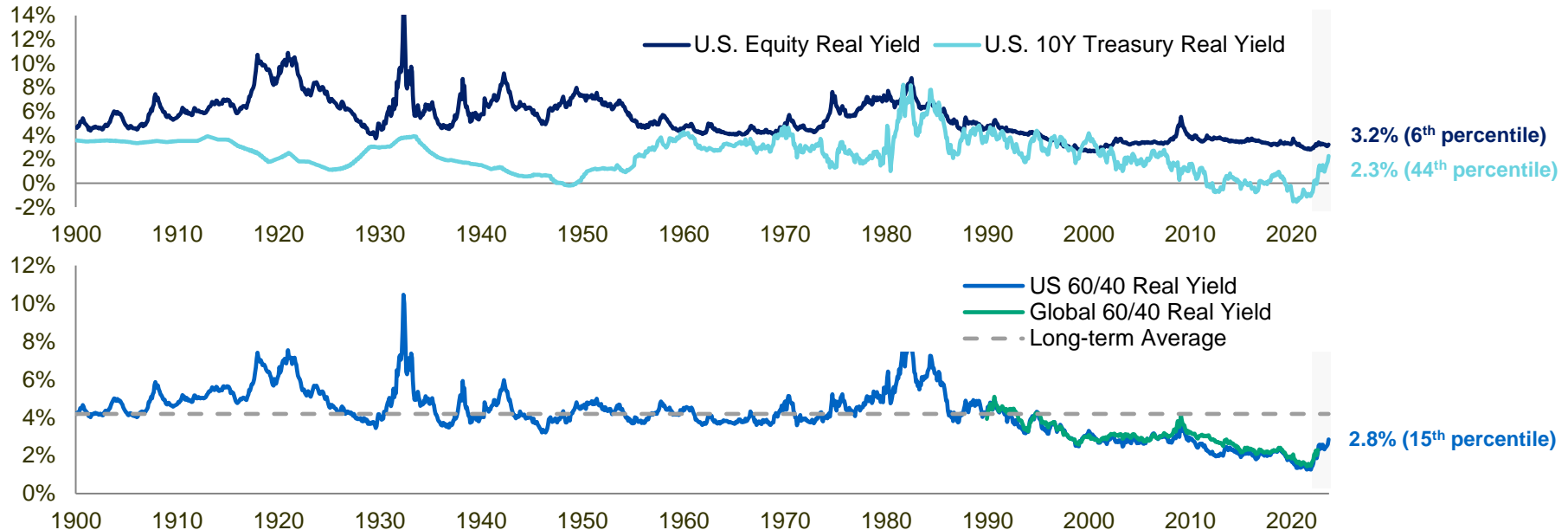


# Still a World of Low Expected Returns...on Most Assets

Low starting yields weigh down prospective returns (even after the 2022-3 repricing)

## Simple Expected Real Return of the U.S. Equity Market and 10-Year Treasuries

January 1, 1900 – September 30, 2023



Four decades of falling required real asset yields meant that we “borrowed returns from the future” (without persistent asset richening we would have had somewhat lower returns behind us and better returns ahead)

Danger of “rearview-mirror” expectations after an exceptional decade for most long-only assets (and doubts on diversifiers)

Riskless component of the discount rate had become extremely low by 2021, making most asset classes look historically rich

Some normalization (“fast pain”) occurred in 2022 as real bond yields rose (e.g., the 10yr TIPS yield rose from -1% to +1.5%)

Yet equities and especially illiquids hardly repriced enough given their riskless discount rate rises – premia are compressed

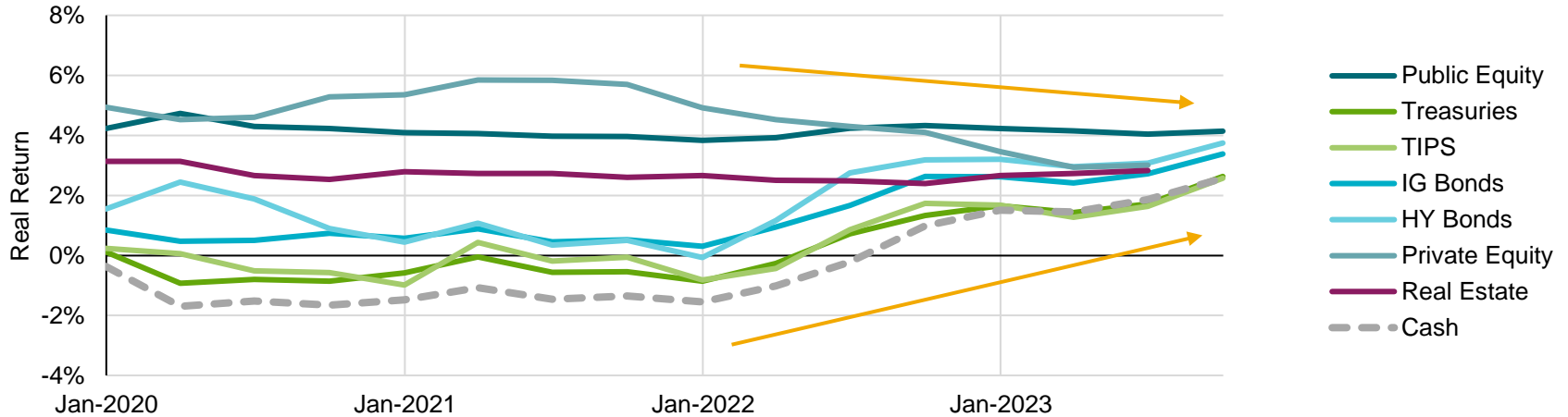


Source: AQR, Bloomberg, Robert Shiller's Data Library, Ibbotson Associates (Morningstar), Kozicki-Tinsley (2006), Federal Reserve Bank of Philadelphia, Blue Chip Economic Indicators, Consensus Economics. To have a 120-year history, this chart uses simpler expected return measures than our official CMAAs. Earnings data through 6/30/2022. U.S. 60/40 portfolio is 60% U.S. equities and 40% long-dated Treasuries. Real equity yield is simple average of two measures:  $(0.5 * \text{Shiller E/P} * 1.075) + 1.5\%$  and  $\text{Dividend/Price} + 1.5\%$ . The 1.5% term is assumed long term real earnings per share (EPS) growth. The 0.5 multiplier reflects the long-term payout ratio; the 1.075 multiplier accounts for EPS growth during the 10-year earnings window. The universe of stocks represented is the S&P 500. Real bond yield is yield on long-term U.S. Treasury bonds minus long-term expected inflation based on Blue Chip Economic Indicators, Consensus Economics and Federal Reserve Bank of Philadelphia. Before survey data became available in 1978, expected long-term inflation is based on statistical estimates and on 1-year ahead Livingston inflation forecasts. This is one set of estimates of ex-ante real yields for equities and bonds, but other reasonable specifications should tell broadly the same story. Chart is for illustrative purposes only. Past performance is not a guarantee of future performance. Please read important disclosures in the Appendix.

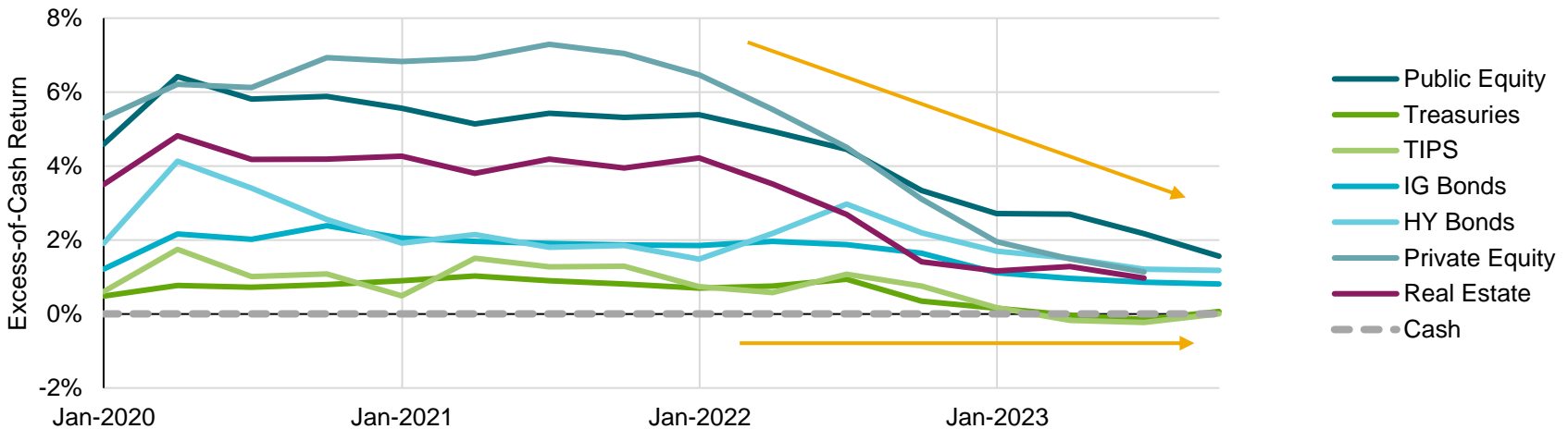
# From A World of Low Riskless Rates to Compressed Premia

## Equities and private assets have not repriced enough

Expected Real Returns for U.S. Asset Classes December 31, 2019 – September 30, 2023



Expected Excess-of-Cash Returns for U.S. Asset Classes December 31, 2019 – September 30, 2023

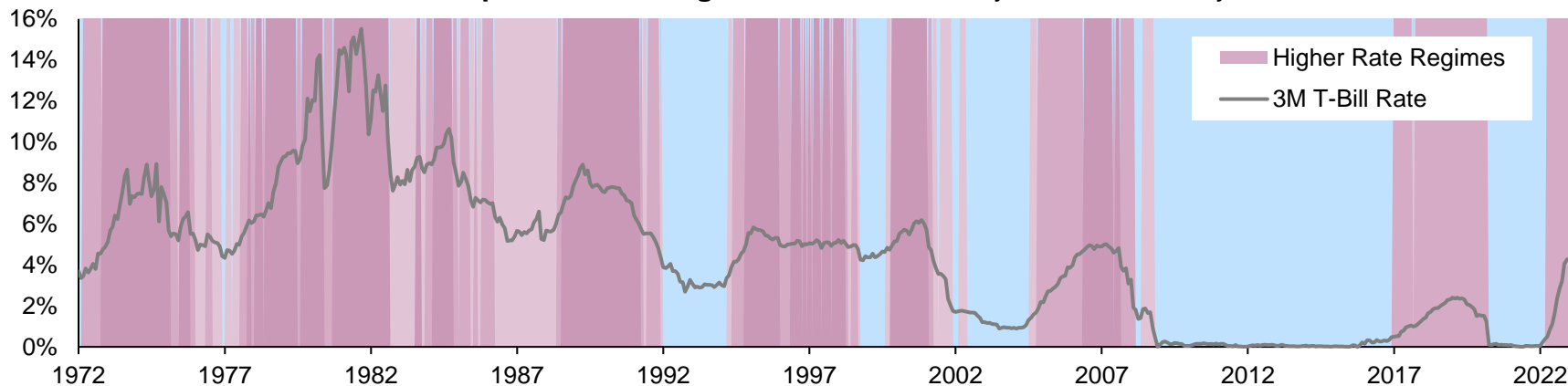


Source: AQR; see [AQR Alternative Thinking Q1 2023](#) for further details. Estimates are real and excess-of-cash annual compound rates of return for a horizon of 5 to 10 years. Latest private equity and real estate expected returns are for **September 30, 2023** due to data availability. Fixed income estimates relate to corresponding Bloomberg Barclays indices rather than single bonds. Estimates are for illustrative purposes only, are not a guarantee of performance and are subject to change. Not representative of any portfolio that AQR currently manages.

# Does a Higher Cash Rate Tide Lift All Asset Return Boats?

## Not historically – but liquid alts have benefitted from cash holdings

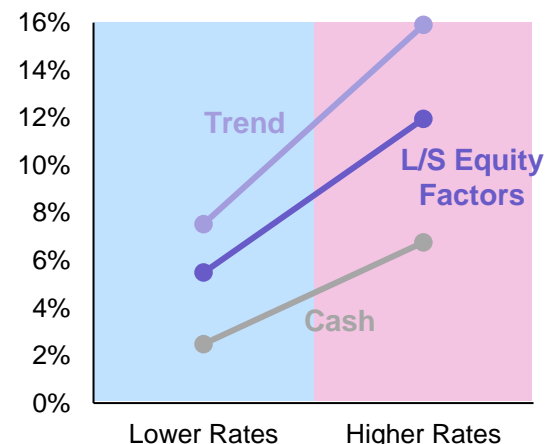
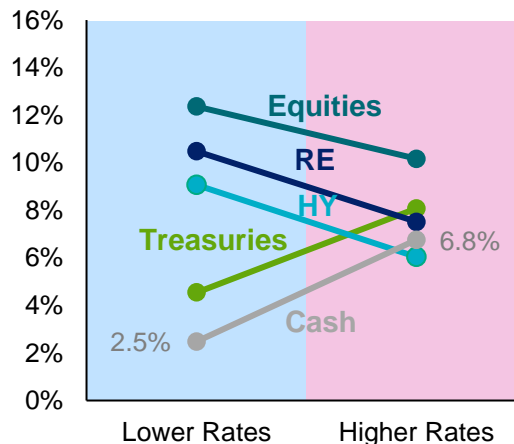
U.S. 3-Month T-Bill Rate and a Composite Level Regime Indicator January 1972 – February 2023



Since 1972, when starting **cash** rates were higher...

- **Equities, credit** and **real estate** earned *lower* total returns (tighter financial conditions)
- **Treasuries** earned higher total returns
- **Liquid alternatives** (or L/S ARP) that maintain cash holdings earned 'cash plus' returns

Average Total Return by Starting Rate Level

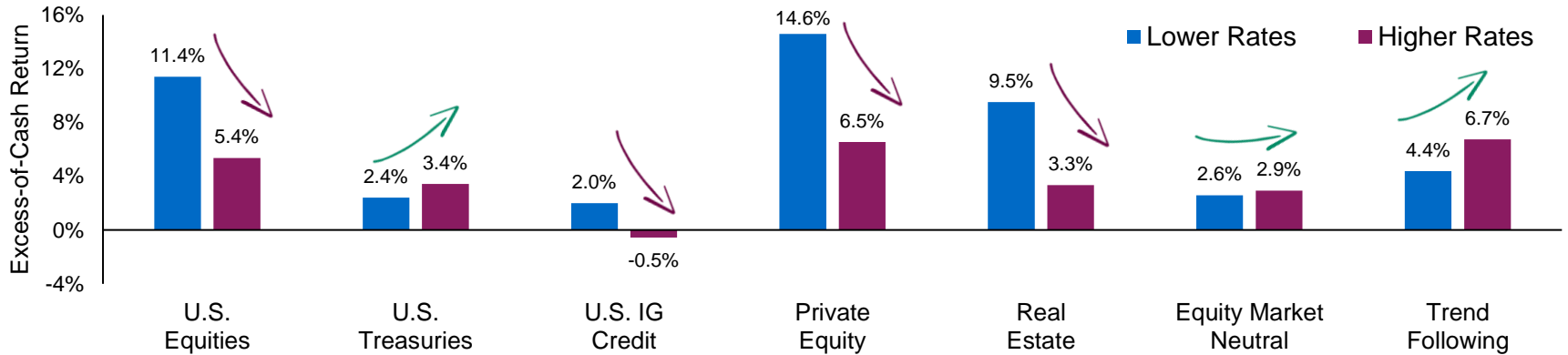


Sources: Federal Reserve, Global Financial Data, Bloomberg, AQR. Higher Rate Regime analysis shows the average of 3 different regime definitions: (1) months with starting 3-month rate higher than full sample median; (2) months with starting 3-month rate higher than the 40<sup>th</sup> percentile of the previous 60 months, and higher than 0.5%; and (3) months with starting 3-month rate higher than the 45<sup>th</sup> percentile of the 60 months centered on that month, and higher than 0.5%. Cash is 3-month T-Bills. See appendix for asset class proxies.

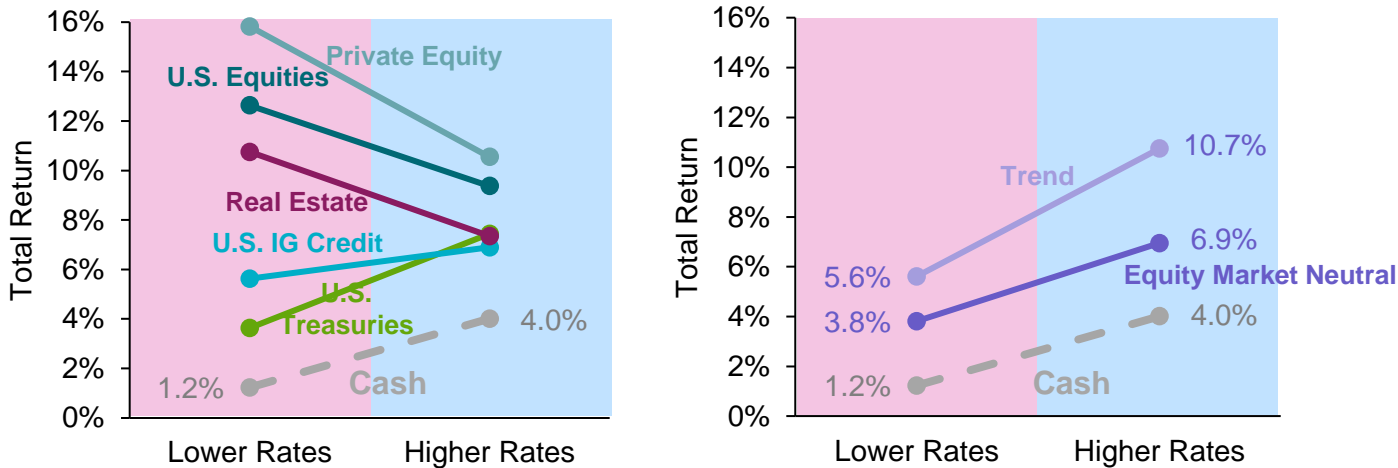
# Which Investments Maintained Their Edge Over Cash?

Cannot simply assume constant equity or illiquidity premia over cash

**Average Excess-of-Cash Returns (Averaged Across 1M, 12M, 36M Horizons) January 1, 1990 – June 30, 2023**



**Average Total Returns (Averaged Across 1M, 12M, 36M Horizons) January 1, 1990 – June 30, 2023**



Sources: Federal Reserve, Global Financial Data, Bloomberg, AQR. Equities is U.S. large cap equities; Treasuries is U.S. long-dated Treasuries; Cash is 3-month Treasury Bills. Higher Rate Regimes are defined by three different rules: (1) months with starting 3-month rate higher than full sample median; (2) months with starting 3-month rate higher than the 40<sup>th</sup> percentile of the previous 60 months, and higher than 0.5%; (3) months with starting 3-month rate higher than the 40<sup>th</sup> percentile of the 60 months centered on that month, and higher than 0.5%. Thresholds chosen to ensure approximately equal numbers of higher and lower rate observations for each rule. Hypothetical data has inherent limitations, some of which are disclosed in the appendix hereto. See appendix for details of asset class proxies.

# Understanding Treasury Yield Moves

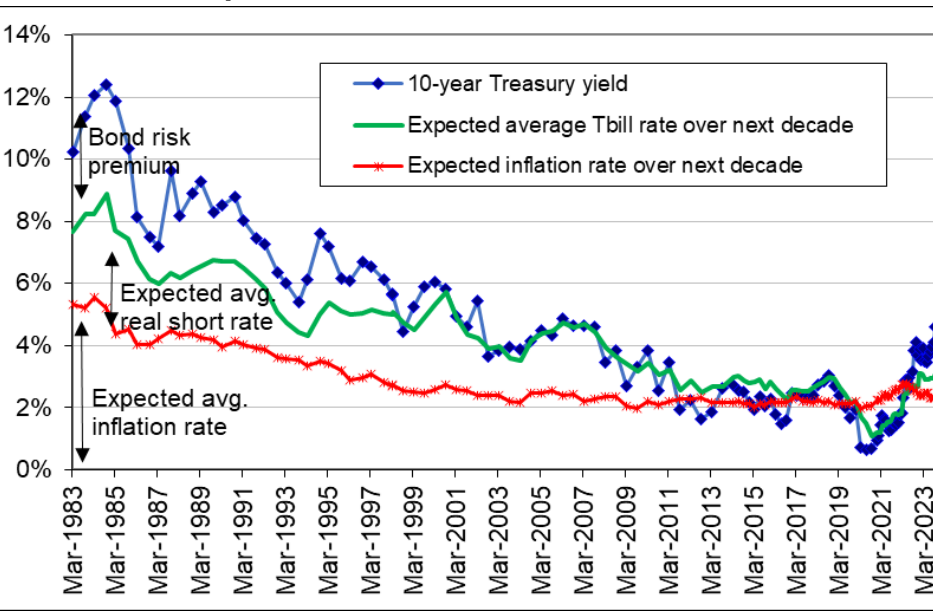
## Consensus forecasts of inflation and short rates help decompose yields

All three components of Treasury yield contributed to the 40-year decline and to the rise since the 2021 record-lows: inflation expectations, real policy rate expectations, and required bond risk premia

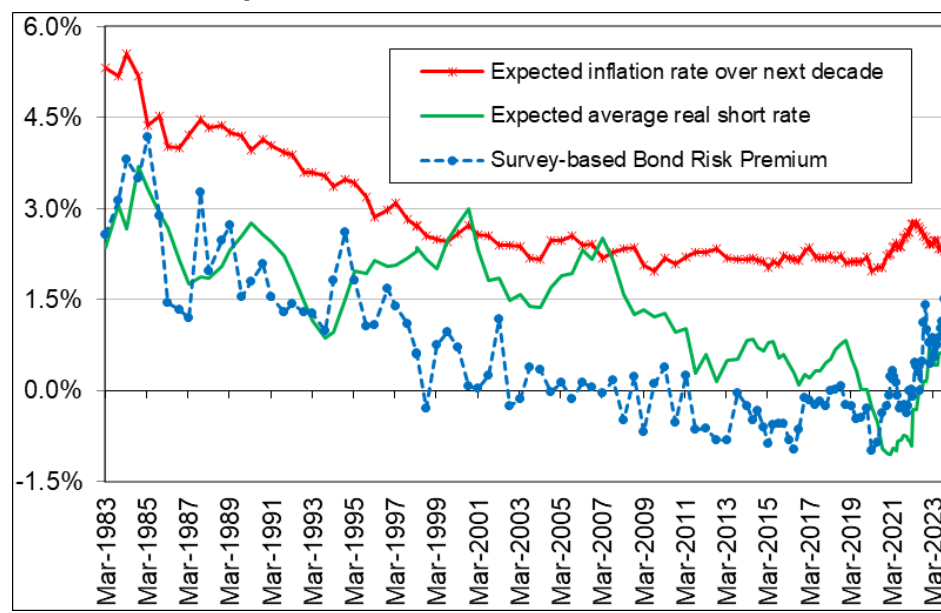
Both real policy rate expectations and required bond risk premia rose from negative to positive in 2022-3

Negative survey-based bond risk premia through the 2010s likely reflected lack of inflation risk premium, negative stock-bond correlation, and QE

**Decomposing the 10-Year Treasury Yield Using Survey Data, Mar 1983 – Sep 2023**



**The Three Components of the 10-Year Treasury Yield, Mar 1983 – Sep 2023**



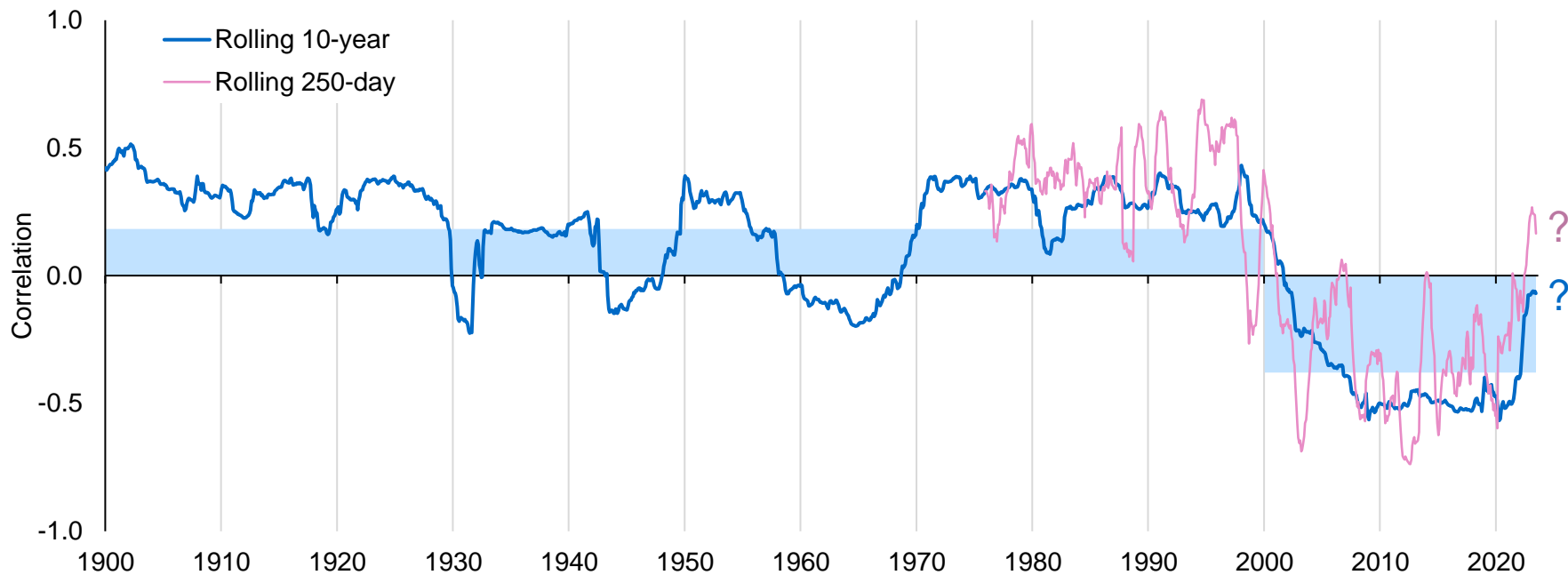


# End of an Era?

## Negative stock/bond correlation threatened by inflation uncertainty

### Rolling Correlation Between U.S. Equity and U.S. Treasury Returns

January 1, 1900 – June 30, 2023



Negative correlation from 2000 to 2020 was a consequence of low inflation risk and demand effects

Shift to sustained positive correlation IF we get longer-term inflation uncertainty and/or further supply-driven inflation shocks and/or monetary policy errors

This scenario remains a tail risk for investors



Source: Global Financial Data, Bloomberg and AQR. Rolling 10-year series based on overlapping 3-month returns at monthly frequency. Rolling 250-day series based on overlapping 3-day returns at daily frequency. Shading shows average correlations in 20th and 21st Centuries. For illustrative purposes only.

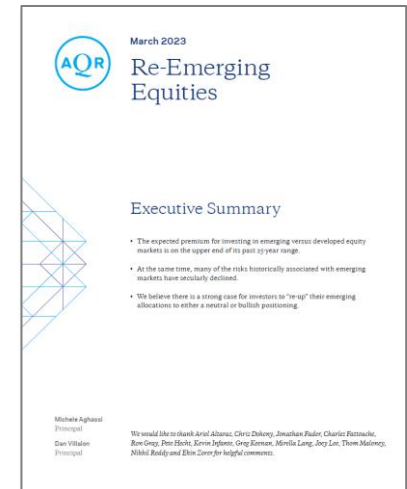
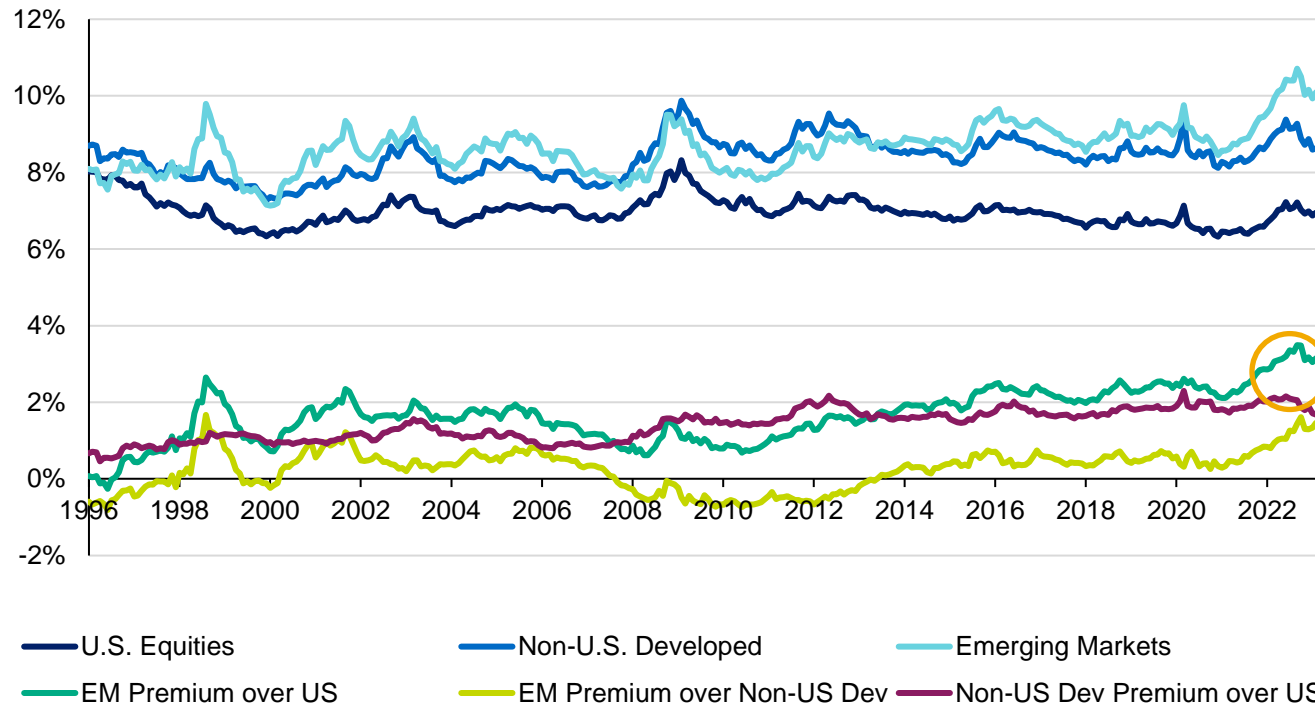
# The Last Contrarian Shoe To Drop: Equity Country Allocation

U.S. richness and emerging market cheapness are at multi-decade extremes

EM's expected return advantage over U.S. has kept widening for over a decade, largely reflecting persistent relative richening of U.S. equities

Many other contrarian opportunities – equity/bond market direction or value-based stock/industry selection and the US dollar – finally began to revert in 2021-2022

Expected Total USD Returns for Equity Regions January 1996 – March 2023



Sources: Bloomberg, Consensus Economics, Journal of Portfolio Management and AQR. EM refers to emerging markets. Chart shows nominal total arithmetic USD returns. Local real equity yield is calculated as expected payout + expected real growth, where expected payout is the simple average of two measures:  $0.5 \times \text{Shiller E/P} + 1.075 \times \text{Dividend/Price}$ . The 0.5 multiplier reflects the long-term payout ratio; the 1.075 multiplier accounts for EPS growth during the 10-year earnings window. Long term real EPS growth is assumed to be 1.5% for developed markets and 2% for emerging markets. Local real returns are converted to USD nominal returns by adding expected FX return (derived from long-term expected inflation differentials) and adding long-term expected US inflation, and then converted to arithmetic returns by adding a variance drag term.

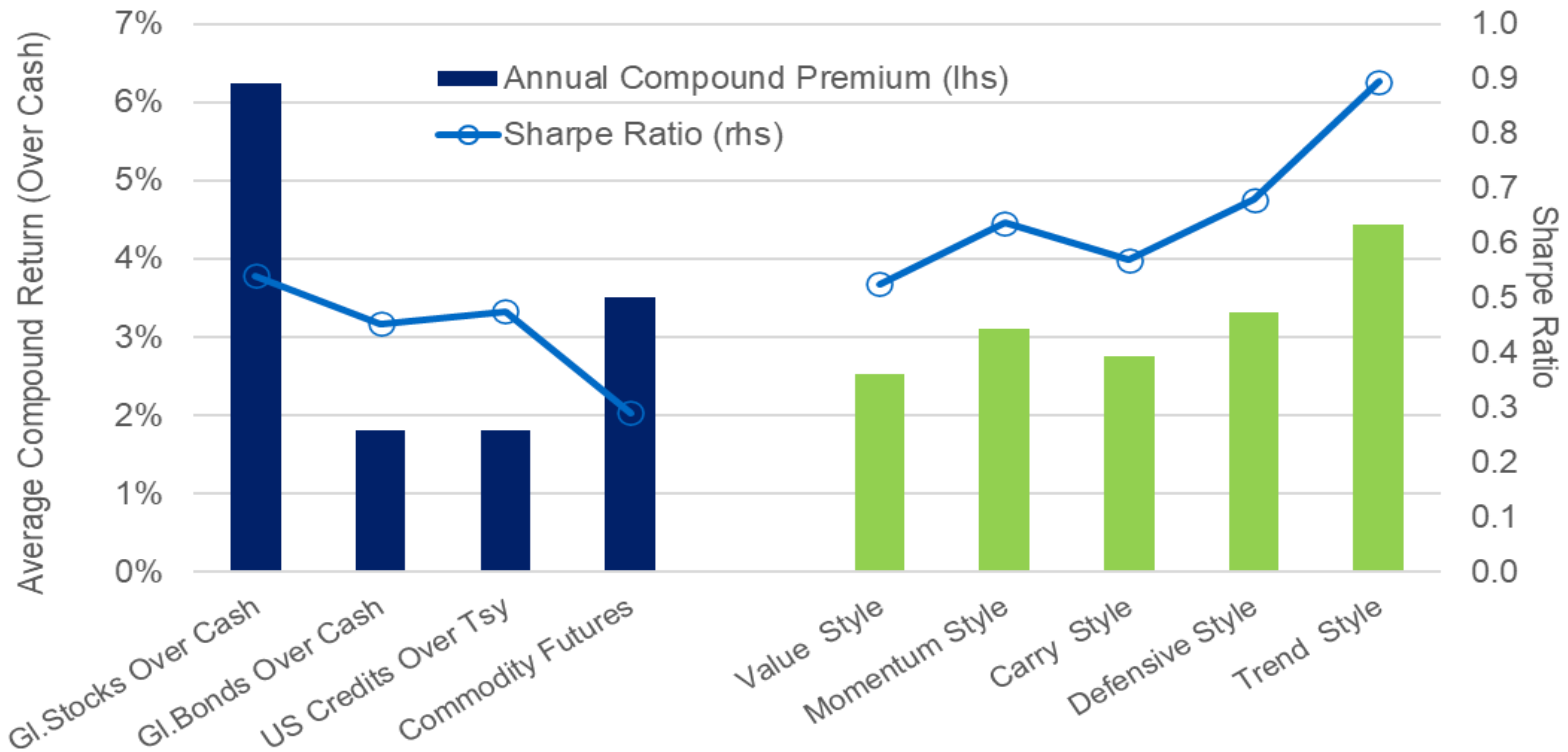
# Timeless Answers: A Menu of Market and Style Premia

## Return sources with most compelling long-run empirical support

Either harvest many premia (diversify risks) or let equity risk dominate (but then look for risk-mitigators)

- The latter approach is easier to stick with (patience advantage).

**Hypothetical Annual Excess Returns and Sharpe Ratios of Main Asset Class Premia and Style Premia, 1926-2020**



Source: Data from AQR. Diversification does not eliminate the risk of experiencing investment losses. Notes: Geometric means and Sharpe ratios of nine return series, which exclude cash return but are before subtracting trading costs and fees. Stocks and (government) bonds are GDP-weighted mix of multi-country returns. Credit is a US corporate portfolio over matching Treasury series. U.S. credit is the Bloomberg US Corporate Total Return Value Index until 1973, and before that we use the credit returns from the paper "Credit Risk Premium: Its existence and Implications for Asset Allocation" (Asvanunt and Richardson, 2015). Trend is the Hypothetical Price-Based Trend-Following Strategy as described in the appendix. Commodity is an equally-weighted portfolio of available commodity futures. The five long/short style premia use simple specifications applied in many asset classes (cf. Chapter 6 and Ilmanen et al. (2021a)) and one-month implementation lag, and are scaled to 5% volatility. See Century of Factor Premia Appendix slides for more details. Hypothetical performance has inherent limitations, some of which are described in the appendix.



# Why Illiquidity Premia on Private Assets May Be Overrated

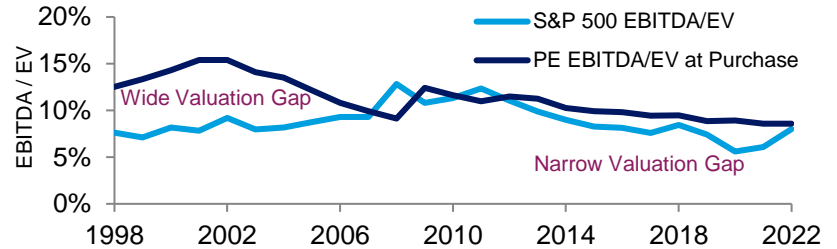
Prospects tempered by high valuations, even before the 2022 non-repricing

Limited long-run evidence for **illiquidity premium**, after adjusting for factor and sector exposures

Most PE outperformance occurred before popularity of endowment model, and narrowing of valuation gap

## Ex Ante Valuation Gap Between Public and Private Equity

January 1, 1998 – December 31, 2022



**Paying more for a “smoothing service”** may offset some of the fair illiquidity premium in private assets

Investors may know reported risks are understated, yet still value them for regulatory or accounting reasons

## Investors Prefer Smooth Sailing to a Bumpy Ride

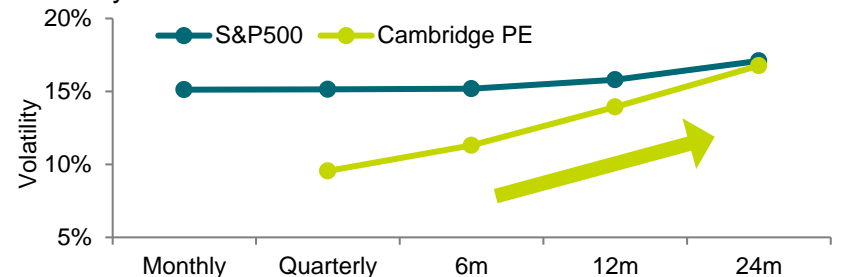


**Beware ‘slow beta’:** true risks of illiquids show up at longer horizons

Private equity is equity; private credit is credit

## Annualized Volatility at Different Frequencies of Return

January 1986 – June 2021



Source: Top chart uses data from PitchBook Data Inc., Bain & Company, Dan Rasmussen, Verdad, Bloomberg. The data shown is that used in the 2019 AQR paper “Demystifying Illiquid Assets: Expected Returns for Private Equity”. EBITDA/EVs from 2009 to 2019 are calendar-year averages of the median EBITDA/EV from Pitchbook and the average EBITDA/EV from Bain & Company (2020). PE EBITDA/EV from 1998 to 2008, and S&P 500 EBITDA/EV from 1998 to 2018 are proprietary datasets from Dan Rasmussen, Verdad. S&P 500 EBITDA/EV for 2019 is from Bloomberg. For illustrative purposes only and not representative of a strategy that AQR currently manages. The use of logos and pictures is for informational purposes only and is not authorized by, sponsored by or associated with the trademark owners. Please read important disclosures in the Appendix. Past performance is not a guarantee of future performance.

# Which Risk Mitigation Strategies Can Help When It Matters Most?

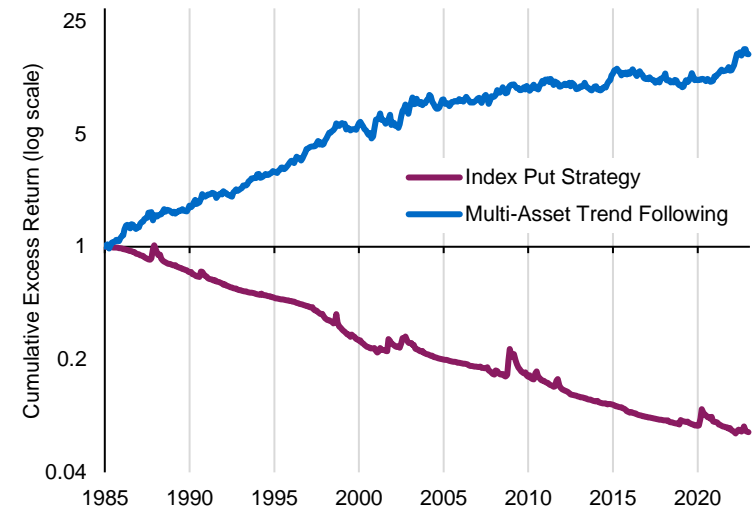
Equity risk dominates most investor portfolios, so we study equity drawdowns

## Risk-Mitigating Strategies' Performance in the 19 Largest Drawdowns of the U.S. Equity Market Over a Century

| Peak     | Trough   | Length P-T | Depth P-T | Put | Trend | Treasury | Gold | QMJ US SS |
|----------|----------|------------|-----------|-----|-------|----------|------|-----------|
| Mar-1920 | Aug-1921 | 17         | -26%      |     | 19%   | -4%      |      |           |
| Aug-1929 | Jun-1932 | 34         | -84%      |     | 50%   | -1%      |      |           |
| Jan-1937 | Mar-1938 | 13         | -50%      |     | -5%   | 6%       |      |           |
| May-1946 | Nov-1946 | 6          | -22%      |     | 6%    | -1%      |      |           |
| Jul-1956 | Dec-1957 | 17         | -18%      |     | 15%   | -1%      |      | 1%        |
| Nov-1961 | Jun-1962 | 7          | -23%      |     | 11%   | 0%       |      | 0%        |
| Jan-1966 | Sep-1966 | 8          | -18%      |     | 10%   | -2%      |      | 2%        |
| Nov-1968 | Jun-1970 | 19         | -37%      |     | 57%   | -13%     |      | 34%       |
| Dec-1972 | Sep-1974 | 21         | -50%      |     | 102%  | -11%     | 129% | 5%        |
| Nov-1980 | Jul-1982 | 20         | -35%      |     | 26%   | -6%      | -59% | 13%       |
| Jun-1983 | Jul-1984 | 12         | -15%      |     | 6%    | -6%      | -28% | 17%       |
| Aug-1987 | Nov-1987 | 3          | -31%      | 23% | -4%   | 0%       | 7%   | 4%        |
| Aug-1989 | Oct-1990 | 14         | -18%      | -6% | 24%   | -1%      | -4%  | 29%       |
| Apr-1998 | Aug-1998 | 4          | -15%      | 11% | 14%   | 4%       | -12% | 12%       |
| Mar-2000 | Sep-2002 | 30         | -49%      | 11% | 32%   | 23%      | 5%   | 96%       |
| Oct-2007 | Feb-2009 | 16         | -52%      | 31% | 25%   | 14%      | 14%  | 53%       |
| Apr-2011 | Sep-2011 | 5          | -16%      | 9%  | -2%   | 10%      | 4%   | 20%       |
| Dec-2019 | Mar-2020 | 3          | -20%      | 27% | 1%    | 10%      | 4%   | 1%        |
| Dec-2021 | Sep-2022 | 9          | -24%      | 3%  | 35%   | -14%     | -10% | 10%       |

## Contrasting Long-Term Performance of Hypothetical Put and Trend Strategies

January 1, 1985 – December 31, 2022



Source: AQR, Bloomberg, Commodity Systems Inc., and Option Metrics. The Hypothetical Put strategy is a backtest which involves buying a 5% out-of-the-money one-month put on the S&P 500 index (pre-1996 on the S&P100) at mid-month and rebalancing into a new put at expiry. Put returns are expressed as a percentage of the underlying index NAV, gross of trading costs and fees. For comparability, the series is scaled to 10% volatility based on the 6% volatility of the unlevered return over the full sample, implying a leverage of 1.67. Multi-Asset Trend Following is the Hypothetical Price-Based Trend-Following Strategy described in the Appendix until 12/31/1999. From 1/1/2000 onwards, Multi-Asset Trend Following is the SG Trend Index. Both Put and Trend returns are in excess of cash (US 3-month LIBOR) or using self-financed futures/forwards.

Source: AQR, Bloomberg, CBOE, Commodity Systems Inc., Datastream, Global Financial Data, and Option Metrics. All returns, including the S&P 500 index used to measure equity market drawdowns, are in excess of cash (US 3-month LIBOR) or using self-financed futures/forwards. All returns bar Trend are before trading costs. The list of drawdown episodes for the S&P500 index includes a few cases where the equity market excess return had not yet quite reached the past peak but had recovered most of the way before losing half of their value (1937-8, 1972-74, 2007-9 bear markets are such famous second legs). The Put Buying strategy is a backtest which involves buying a 5% out-of-the-money one-month put on the S&P 500 index (pre-1996 on the S&P100) at mid-month and rebalancing into a new put at expiry (using the CBOE Protective Put index in excess of the S&P 500 for 2022). Put returns are expressed as a percentage of the underlying index NAV, gross of trading costs and fees. For comparability, the series is scaled to 10% volatility based on the 6% volatility of the unlevered return over the full sample, implying a leverage of 1.67. The Trend return is a backtest, gross of fees but net of estimated transaction costs, as in Hurst-Ooi-Pedersen (2017) until 12/31/1999. From 1/1/2000 onwards, trend return is the SG Trend Index. The strategy applies trend following at 1-, 3- and 12-month windows in four asset classes and targets overall portfolio volatility of 10%. Treasury is the excess return of 10-year Treasuries over T-bills, sourced from Global Financial Data, Bloomberg, and Datastream. Gold is the Gold futures return (excluding cash) from Bloomberg. QMJ US SS, or the quality-minus-junk factor for U.S. stock selection, is a broad composite long/short portfolio based on 16 quality metrics within profitability, growth, and safety subgroups. The factor was developed by Asness-Frazzini-Pedersen (2019) and is regularly updated in aqr.com.) These are not the returns to an actual portfolio AQR manages and are for illustrative purposes only. Hypothetical data has certain inherent limitations, some of which are disclosed in the appendix hereto.



# Even More Relevant for Private Assets

## Trend strategies and private assets: a match made in heaven?

### Hypothetical Performance in Ten Worst 6-Month Periods for Private Equity

January 1, 1990 – March 31, 2023

| 6M Ending         | Private Equity | Private Credit | Real Estate | Price Trend | Econ Trend | Alt Trend | S&P 500 | 10Y Treasuries | Hedge Funds |
|-------------------|----------------|----------------|-------------|-------------|------------|-----------|---------|----------------|-------------|
| 12/31/2008        | -22.9%         | -13.3%         | -9.3%       | 17.4%       | 31.6%      | 12.4%     | -29.1%  | 14.3%          | -19.4%      |
| 3/31/2001         | -15.7%         | 0.7%           | 2.6%        | 12.2%       | 0.6%       | 20.4%     | -21.3%  | 5.9%           | -4.9%       |
| 12/31/2001        | -10.7%         | 4.7%           | 0.5%        | 2.6%        | 11.4%      | 16.4%     | -7.2%   | 3.0%           | 0.2%        |
| 9/30/2002         | -8.5%          | -3.3%          | 2.5%        | 14.1%       | 22.5%      | 21.8%     | -29.0%  | 16.1%          | -3.5%       |
| 3/31/2020         | -6.2%          | -8.2%          | 1.2%        | 1.4%        | -1.3%      | 7.2%      | -13.2%  | 6.1%           | -8.6%       |
| 9/30/2022         | -5.8%          | -1.5%          | 3.3%        | -1.3%       | 23.1%      | 10.5%     | -20.7%  | -8.3%          | -4.2%       |
| 9/30/1998         | -5.0%          | -12.2%         | 5.1%        | 9.7%        | 19.4%      | 3.0%      | -9.5%   | 7.6%           | -10.6%      |
| 9/30/2000         | -4.6%          | -1.6%          | 3.0%        | 2.2%        | -11.2%     | 1.0%      | -6.5%   | 2.4%           | -2.3%       |
| 6/30/2008         | -3.3%          | -1.3%          | 1.0%        | 1.3%        | 10.6%      | 14.3%     | -13.0%  | 3.3%           | -1.6%       |
| 12/31/1990        | -3.3%          | -8.2%          | -4.8%       | 7.5%        | 7.3%       | 19.2%     | -9.8%   | 1.8%           | -5.9%       |
| Average           | -8.6%          | -4.4%          | 0.5%        | 6.7%        | 11.4%      | 12.6%     | -15.9%  | 5.2%           | -6.1%       |
| LT Ann. Exc. Ret. | 11.9%          | 7.7%           | 7.6%        | 3.8%        | 5.6%       | 11.0%     | 7.0%    | 2.9%           | 6.0%        |

Sources: AQR, Cambridge Associates. Private equity is the Cambridge Associates U.S. Private Equity Index. Real Estate is the NCREIF Property Index. Private Credit is half the Cliffwater Direct Lending Index and half an equal-weighted average of HFRI RV: Fixed Income-Asset Backed Index, HFRI Credit Index, HFRI ED: Distressed/Restructuring Index, HFRI ED: Special Situations Index, Credit Suisse Distressed Index as they become available. Price Trend, Economic Trend, and Alt Trend are hypothetical strategies targeting 10% volatility, net of transaction costs and 1.25% fees, as described in the appendix. Hedge Funds is an average of the HFRI Fund Weighted Composite Index and the Credit Suisse Hedge Fund Index as they become available. Worst non-overlapping 6-month cumulative returns based on quarterly data. LT Ann. Exc. Ret. Is the average annual compound return (GM) in excess of cash between January 1, 1990 and March 31, 2023. Hypothetical data has inherent limitations, some of which are disclosed in the appendix. Diversification does not eliminate the risk of experiencing investment losses.

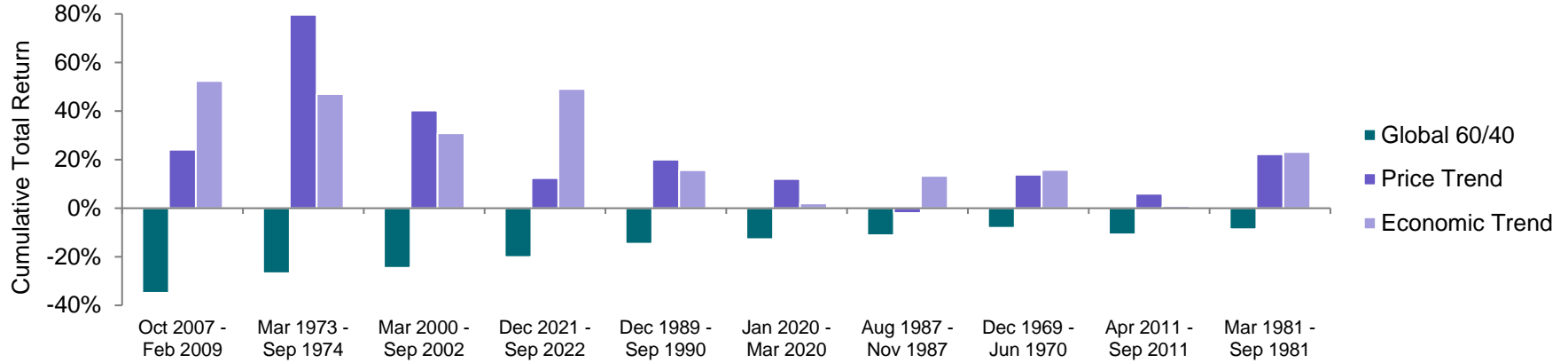


# Trend Following and Robust Macro Resilience

Trend strategies have tended to thrive in tough environments

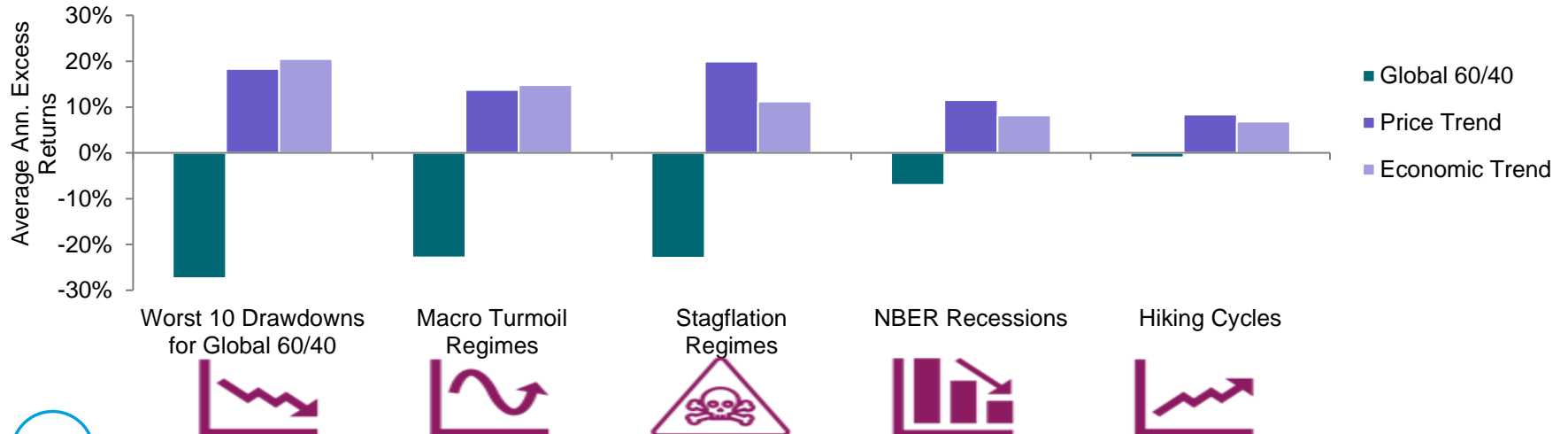
## Performance of Global 60/40 and Hypothetical Trend Strategies in Worst 10 Drawdowns for Global 60/40

January 1970 – March 2023



## Not Just 60/40 Drawdowns: Hypothetical Performance in Various Macroeconomic Regimes

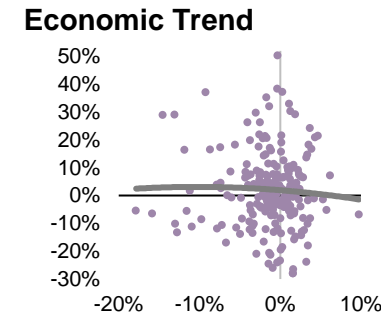
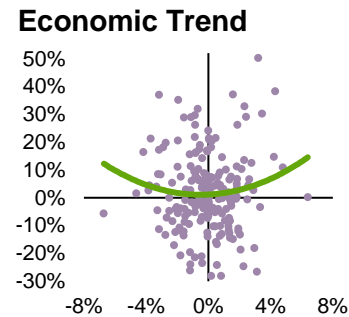
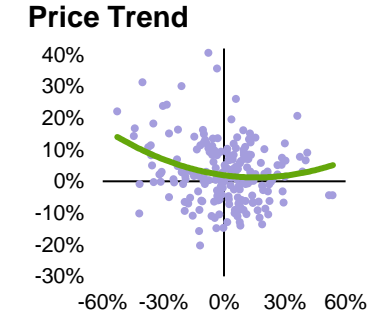
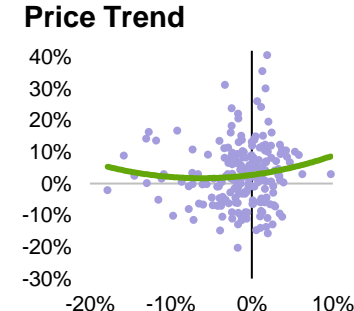
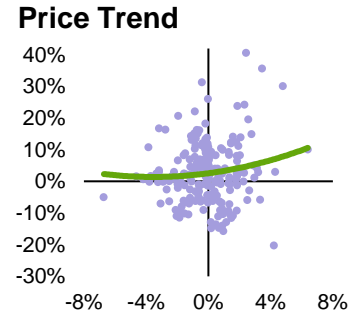
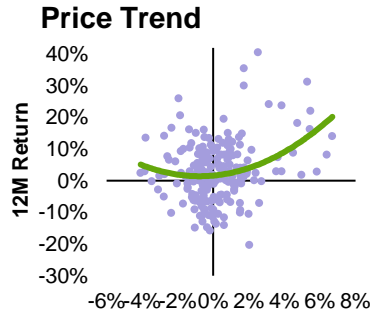
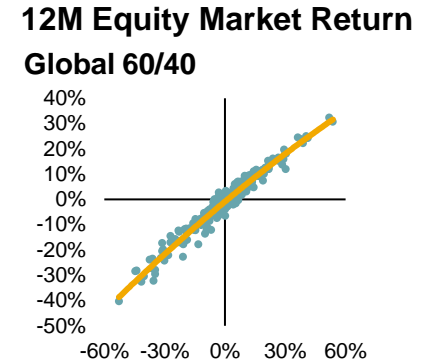
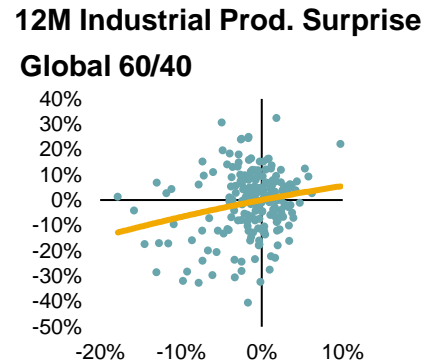
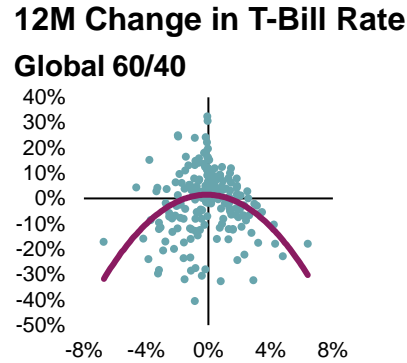
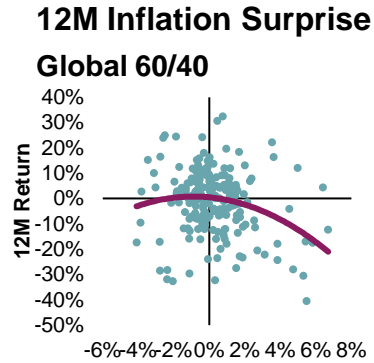
January 1970 – March 2023



Source: AQR, U.S. Bureau of Labor Statistics, Federal Reserve, Bloomberg. Global 60/40 is 60% MSCI World and 40% Barclays Global Aggregate. Price Trend and Economic Trend are hypothetical strategies targeting 10% volatility, net of transaction costs and 1.25% fees, as described in the appendix. Macro Turmoil is defined as 12-month period for which macro news magnitude exceeds full sample mean. Macro news magnitude measure is based on changes in RGDP growth, changes in inflation, inflation surprises, RGDP growth surprises and industrial production (IP) growth surprises. Stagflation regimes are periods where the 12-month change in growth was negative, and the 12-month change in inflation was positive. Hiking Cycle Indicator is triggered when current Fed Funds and T-Bill rates over- or undershoot their 12-month averages by a given margin. Hypothetical performance results have certain inherent limitations, some of which are disclosed in the Appendix. Past performance is not a guarantee of future performance.

# Trend Following and Macro Convexity

Opposite smiles explain strategic complementarity with core portfolios



Mapping non-linear sensitivities, January 1970 – March 2023. Source: AQR, U.S. Bureau of Labor Statistics, Federal Reserve, Bloomberg. X-axes from left to right plot 12-month: inflation surprise, change in 3-month T-Bill rate, industrial production surprise, and equity market return. Surprises are calculated as the difference between year-on-year inflation or growth and 1-year forecast 12 months earlier from Fed Survey of Professional Forecasters. Y-axes from top to bottom plot the 12-month excess return of: Global 60/40, hypothetical price trend, and hypothetical Economic Trend. Global 60/40 is 60% MSCI World and 40% Barclays Global Aggregate. Price Trend and Economic Trend are hypothetical strategies targeting 10% volatility, net of transaction costs and 1.25% fees, as described in the appendix. Hypothetical performance results have certain inherent limitations, some of which are disclosed in the Appendix. Past performance is not a guarantee of future performance.



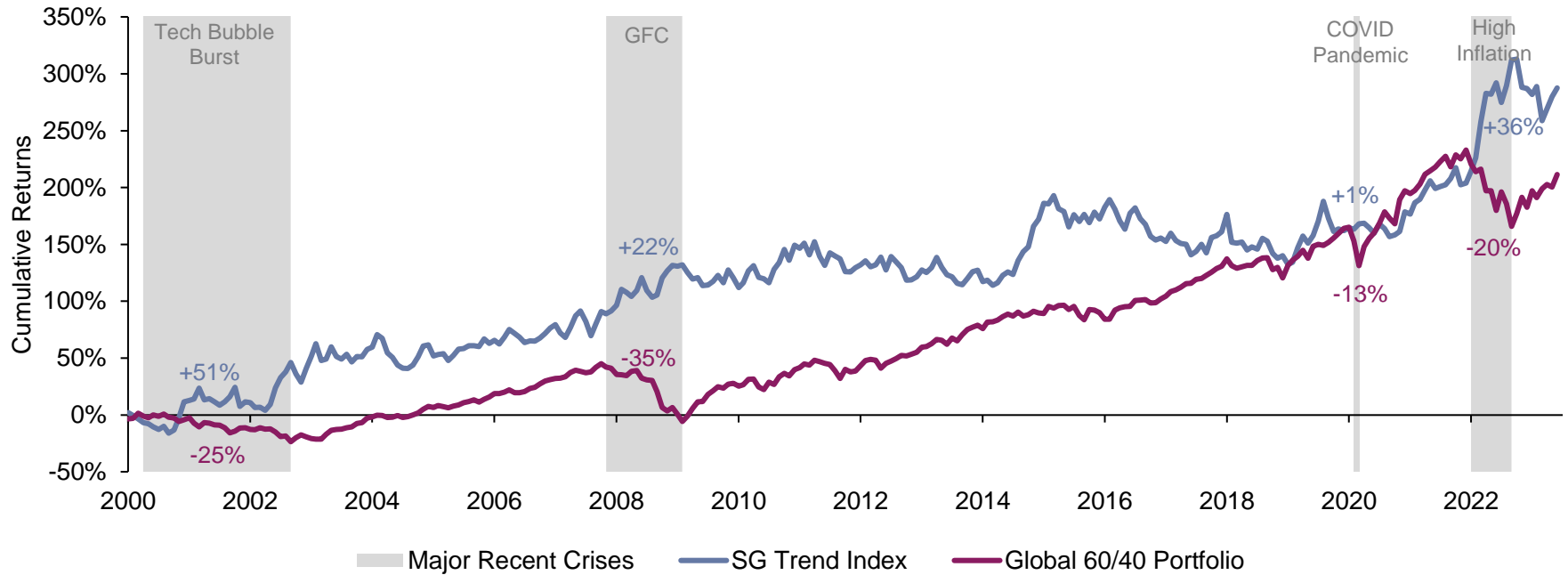
# Trend: A Look at Live Industry Results

Managers have delivered attractive returns and equity-downside protection

## Adding Trend Following to a Global 60/40 Portfolio

January 1, 2000 – June 30, 2023

|                           | Global 60/40 Portfolio | SG Trend Index | Global 60/40 +20% SG Trend Index |
|---------------------------|------------------------|----------------|----------------------------------|
| Annualized Returns        | 5.0%                   | 5.9%           | 5.4%                             |
| Annualized Volatility     | 9.6%                   | 13.6%          | 7.9%                             |
| Sharpe Ratio              | 0.33                   | 0.31           | 0.46                             |
| Worst Drawdown            | -34.9%                 | -20.7%         | -25.8%                           |
| Correlation to MSCI World | 0.99                   | -0.09          | 0.93                             |



Source: AQR, Bloomberg. Inception date of January 1, 2000 is the inception of SG Trend Index. The Global 60/40 Portfolio is based on a 60% weighting on the MSCI World Net Total Return USD Index and 40% weighting on the Bloomberg Barclays Global Aggregate Hedged Total Return Index, rebalanced monthly, gross of fees. Gross performance results do not reflect the deduction of investment advisory fees and other expenses, which would reduce an investor's actual return. SG Trend Index is net of fees. Risk-free rate is the ICE BofAML U.S. 3-Month Treasury Bill Index, which is used to derive the Sharpe ratio. Past performance is not a guarantee of future performance.

# AQR Has Added Unique Enhancements to Traditional Price Trend

## Trend following on economic data and alternative markets can improve returns



### Trend Following on Economic Data

- Follows trends in macroeconomic data
- Key themes include growth, inflation, monetary policy, trade and risk aversion
- Diversifying to price-based trend-following signals, and delivers alpha to traditional and alternative investments
- Delivers the “dual mandate”

### Trend Following in Alternative Markets

- Follows price-based trends in harder to access, less liquid, alternative assets
- Includes credit, niche commodities (e.g., Malaysian palm oil), and equity factors (e.g., global value)
- Source of alpha relative to equities, bonds, and traditional trend-following strategies
- Delivers the “dual mandate”

- *Many other CTAs “improved” their standalone performance by adding positive-beta strategies like carry to classic price trend, thereby hurting the dual mandate (risk mitigation ability)*
- *We, instead, added economic trend (think “systematic macro”) and extended the asset universe*

Source: AQR. Diversification does not eliminate the risk of experiencing investment losses. Dual Mandate refers to trend following’s ability to provide long-term positive returns as well as portfolio protection when most needed.

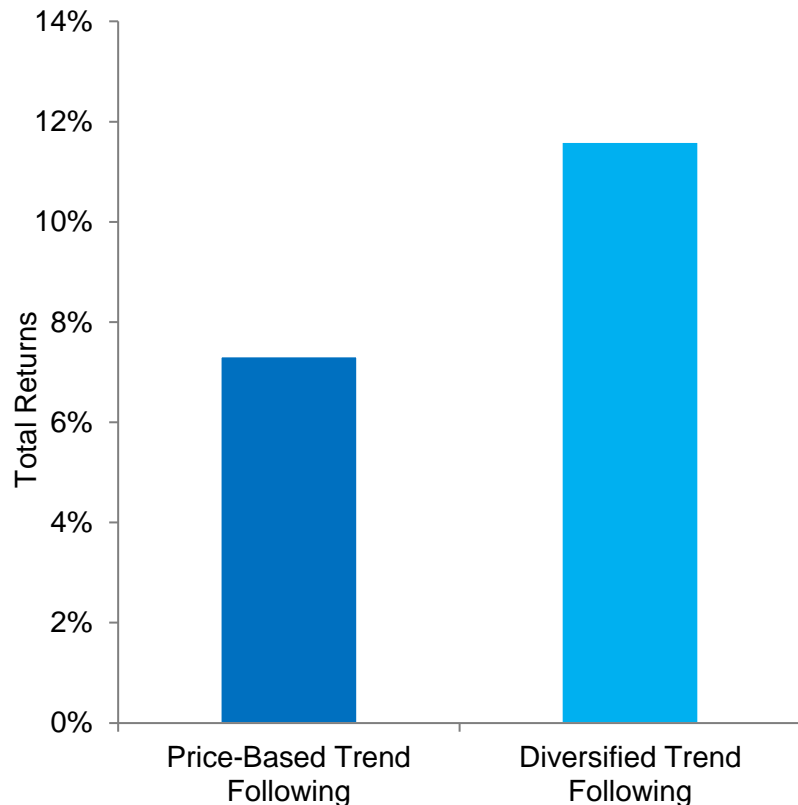


# Diversified Trend-Following Relying on Old and New

## Seeking to enhance long-term returns while maintaining tail protection

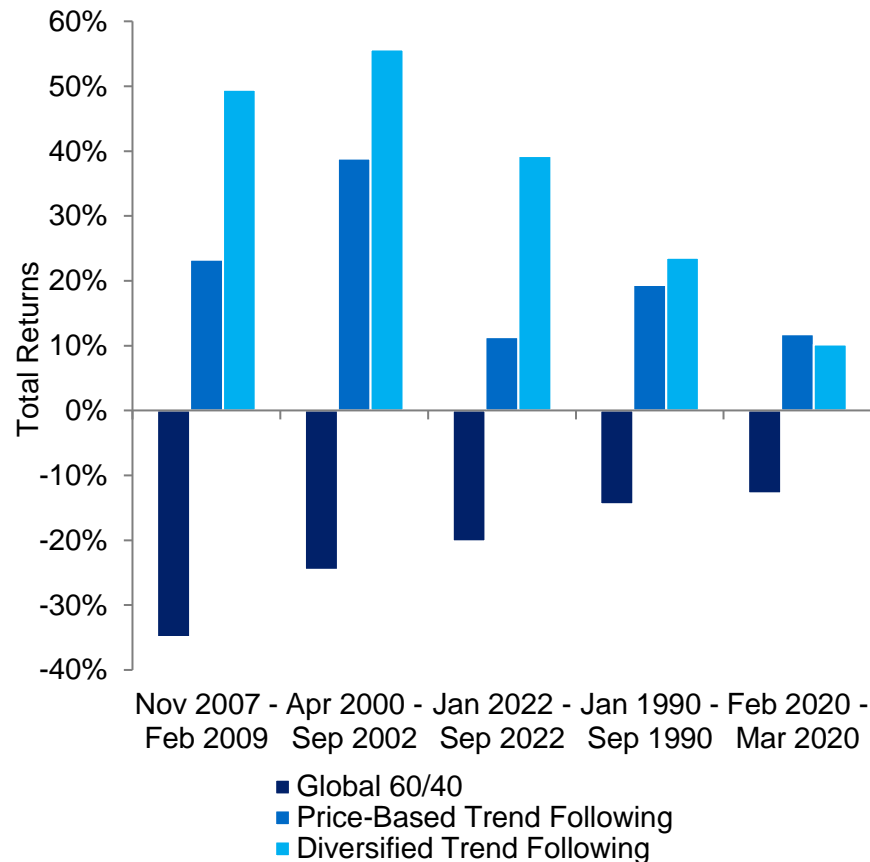
### Mandate #1: Positive Returns (Hypothetical)

January 1, 1990 – September 30, 2022



### Mandate #2: Performance When Most-Needed (Hypothetical)

January 1, 1990 – September 30, 2022

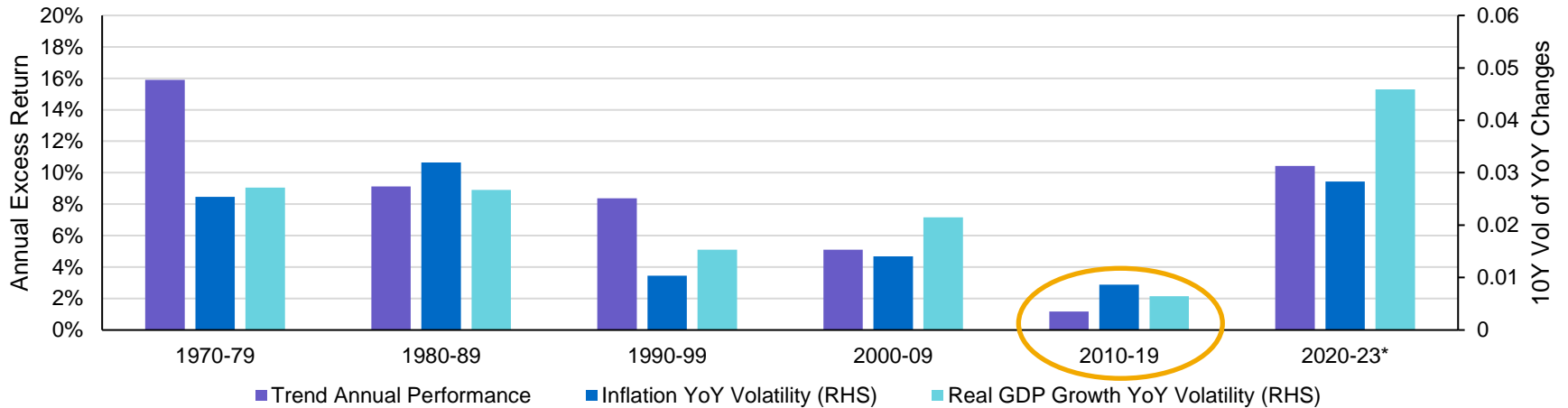


Source: AQR. The Hypothetical Diversified Trend-Following Strategy performance is a backtest that is 40% Price-Based Trend Following, 40% Economic Trend Following and 20% Alternative Trend Following. The returns are net of a 1.25% mgmt. fee and 20% performance fee, and net of estimated transaction costs. The 60/40 portfolio has 60% invested the MSCI World Net Total Return USD Index and 40% invested in the Bloomberg Barclays Global Aggregate Total Return Index. The portfolio is rebalanced monthly. The 3-Month T-Bill is the risk-free rate used to derive the Sharpe ratio. Please read performance disclosures in the Appendix for a description of the investment universe and the allocation methodology used to construct the Price-Based, Alternative and Economic Trend-Following Strategies. Markets considered only where data existed during the time period. Chart is provided for illustrative purposes only and is not based on an actual portfolio AQR manages. Hypothetical data has inherent limitations, some of which are disclosed in the Appendix. Diversification does not eliminate the risk of experiencing investment losses.

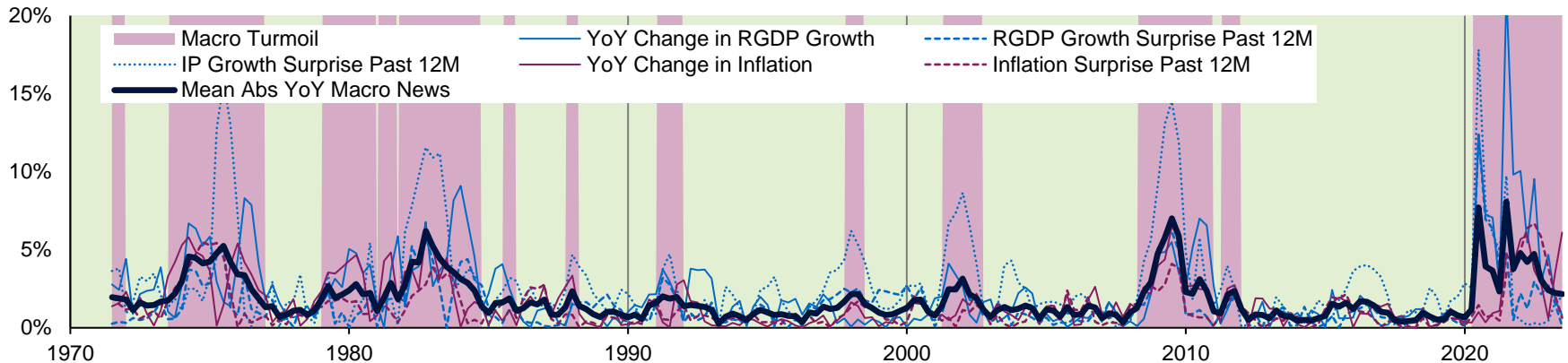
# Higher Macro Volatility Gives Tactical Tailwinds for Trend

## Historical analysis identifies trend strategies as pockets of resilience

Hypothetical U.S. Macro Volatility and Trend Performance Per Decade, January 1970 – June 2023

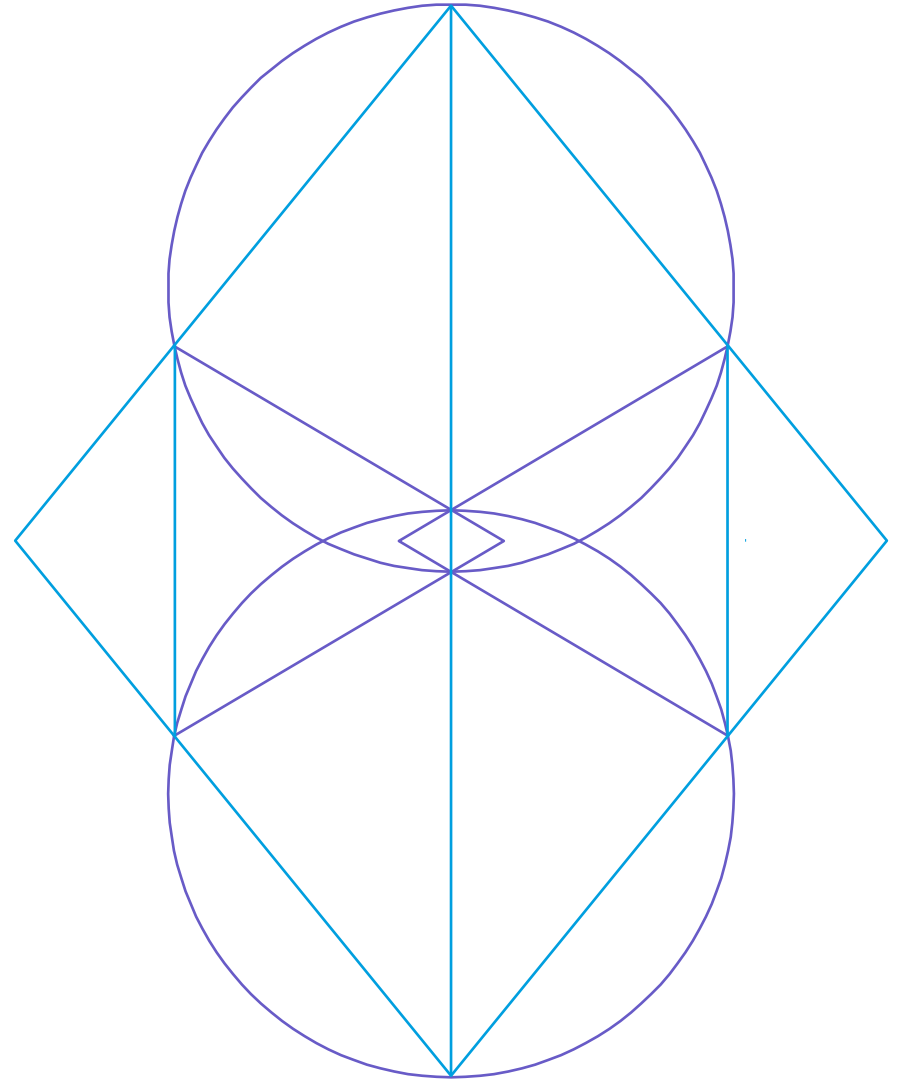


U.S. Growth and Inflation News and a Macro Turmoil Regime Indicator, January 1972 – June 2023



Sources: AQR, Federal Reserve, Bloomberg. Macro Turmoil is defined as 12-month period for which macro news magnitude exceeds full sample mean. Based on 12-month returns at quarterly frequency. Trend is Hypothetical Price-Based Trend-Following Strategy net of fees, as described in the appendix until 12/31/1999. From 1/1/2000 onwards, Trend is the SG Trend Index. Please see Asset Descriptions for Macro Analyses slide in the appendix for a description of the rest of the asset classes. Macro news magnitude measure is based on YoY Change in RGDP, YoY Change in CPI, CPI Surprise Past 12M, RGDP Surprise Past 12M and IP Surprise Past 12M.\* Last observation covers only 3.5 years. Hypothetical data has certain inherent limitations, some of which are disclosed in the appendix hereto.

# Appendix



# The “Serenity Prayer”

## And its lessons for long-term investors

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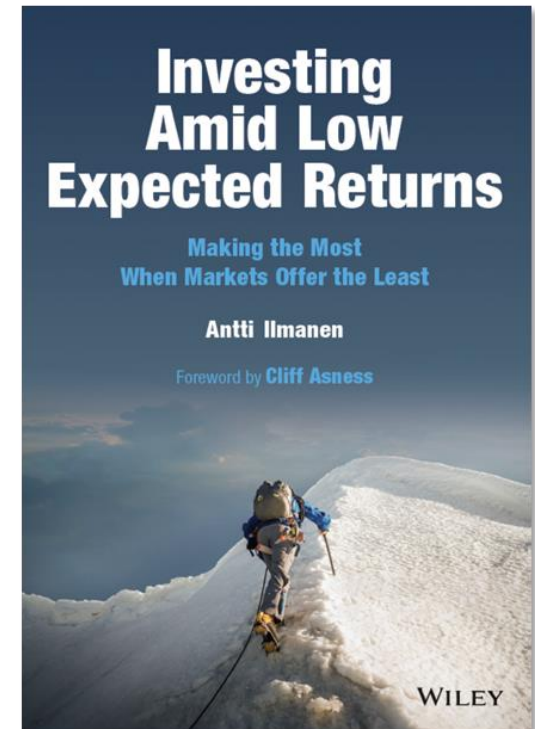
***God, grant me the serenity to accept the things I cannot change,  
the courage to change the things I can,  
and the wisdom to know the difference***

### Expected returns

- Few investors show the serenity to accept lower spending plans
- More of us display courage to raise risk taking
- Many follow St Augustine and pray: *Lord, make me chaste, but not yet.*

### Realized returns

- Few investors serenely accept an extended period of disappointing performance
- Even when we know that short/medium-term returns are dominated by luck, we often overreact to them, instead of focusing on the process we can control
- Outcome bias refers to the all-too-common tendency to equate the quality of a decision with the quality of its outcome



# Part I: Setting the Stage

## The secular low expected return challenge – and investors' responses

---

**Expected returns...** ...in all major asset classes fell to historic lows by the end of 2021 – due to negative real cash rates, the common part in all assets' discount rates

---

**Realized returns...** ...have been solid as falling yields have caused windfall gains

---

**Managing the disparity** The rearview mirror may breed complacency just when the low expected return challenge is greatest – we've borrowed returns from the future

---

**The path ahead** Low returns will eventually materialize through some mix of slow and fast pain  
We should be humble about timing the fast pain, but bubbly markets, inflation concerns, and less dovish central banks raise near-term risks

---

**What to do about it** Many investors have not serenely accepted low expected returns  
More have increased their portfolio risks than tried contrarian market timing  
Staying the course and moderating expectations is the realistic middle path  
Good investing practices matter more than ever: **making the most when markets offer the least**



# Part II: Building Blocks of Long-Term Expected Returns

## Covering historical and forward-looking returns

### 5. Alpha and its cousins

- Valuable, scarce, elusive ... or is it beta?

### 4. Alternative risk premia (value and other style premia)

- Great long-run evidence, mixed recent history

### 3. Illiquidity premia (private assets and other premia)

- Fair reward for illiquidity offset by smoothness preference?

### 2. Market risk premia (equity and other asset class premia)

- Dominant source of risk/reward; average or below-average today

### 1. Cash

- Expected inflation +/- something real
- Was at record lows until 2022's policy hikes
- The base of the pyramid is still underwater in some markets...



*Most investments are **blends** of the above*



Source: AQR and *Investing Amid Low Expected Returns* (Ilmanen, 2022). Diversification does not eliminate the risk of experiencing investment losses. ERP refers to Equity Risk Premium. BRP refers to Bond Risk Premium. CRP refers to Credit Risk Premium. CMP refers to Commodity Market Premium. Please see A Century of Multi-Asset Factor Premia slide in the appendix for a detailed description of Alternative Risk Premia.



# Part III: Putting It All Together

## ‘Alpha beyond expected returns’ – the whole investment process matters

- Diversification – its power, and its dark sides
- Portfolio construction
- Risk management
- ESG investing
- Costs and fees
- Tactical timing
- Bad habits and good practices

### Apple Harvesting Parable of Bad Investing Practices

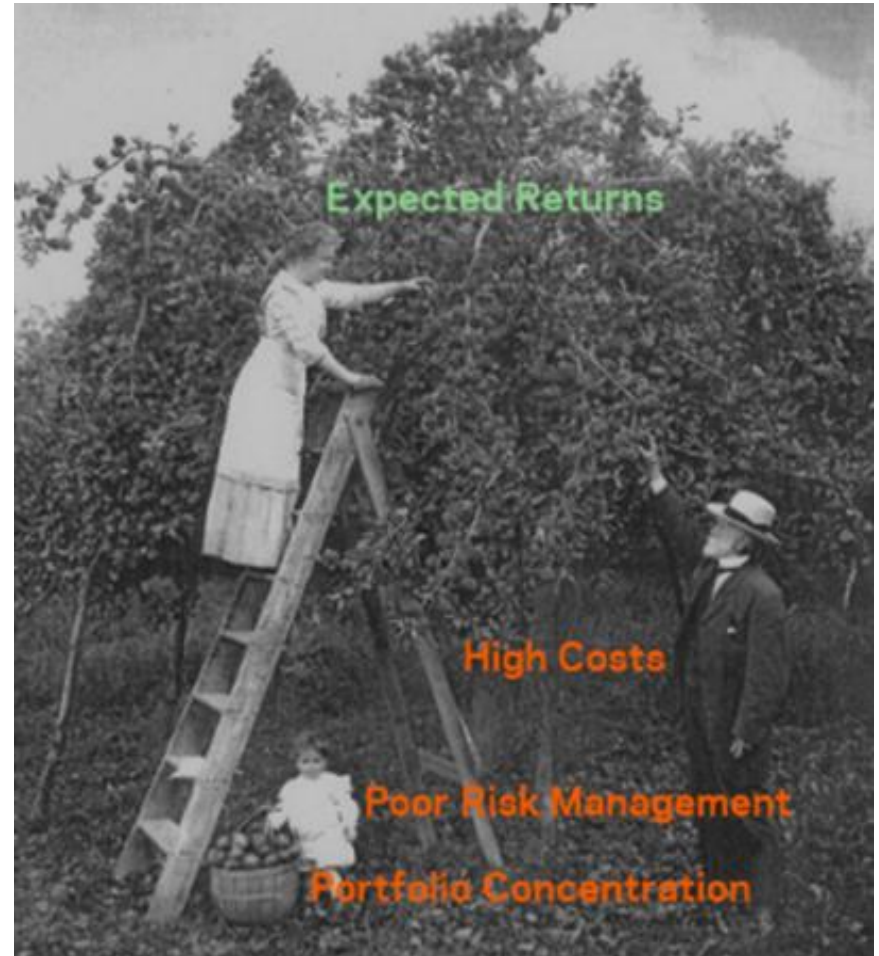


Image source: *Alpha Beyond Expected Returns*, AQR white paper in 2012. Original picture from the Penrose Chamber of Commerce. The use of the logos and pictures is for informational purposes only and is not authorized by, sponsored by or associated with the trademark owners. Diversification does not eliminate the risk of experiencing investment losses.

# Part III: Putting It All Together

## Key takeaways

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### Alpha beyond expected returns

A view on good building blocks is not enough – they need to be assembled efficiently

There is potential alpha in other parts of the investment process: portfolio construction, risk management, cost control, increasingly also ESG

---

### A good starting point

Diversify well across rewarded sources, diversify away unrewarded exposures

Constraints on illiquidity, leverage, and ESG often matter more than unconstrained mean-variance optimization

---

### Strategic diversification...

...trumps any long-run benefits from tactical timing

Empirical finding favors bold diversification and humble timing in most circumstances

---

### Good investing...

...requires both good investments and good investors

Understand and communicate what consistency is feasible in competitive markets

Multi-year return chasing and capitulations may be the premier bad habits to resist

---

### Investment beliefs

Setting out a clear set of investment beliefs makes it easier to be a serene and consistent investor...

...essential characteristics when a strategy is good only if you can stick with it

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# Windfall Gains in Realized Returns Conceal Low Prospects

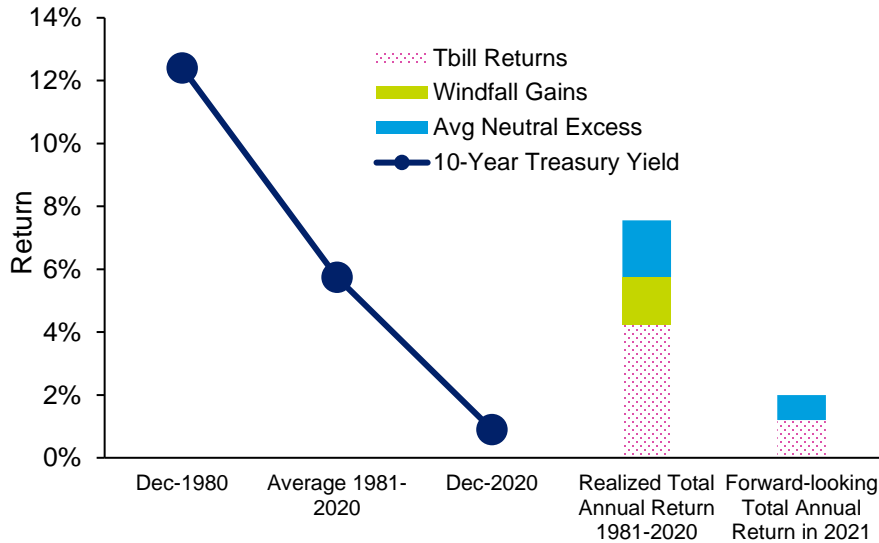
Beware complacent “rearview-mirror” expectations after bullish decades

Is the current yield or past average return a better forecast for Treasuries? What about for equities?

Discount rate effect explains how asset repricing caused both high realized returns and low expected returns

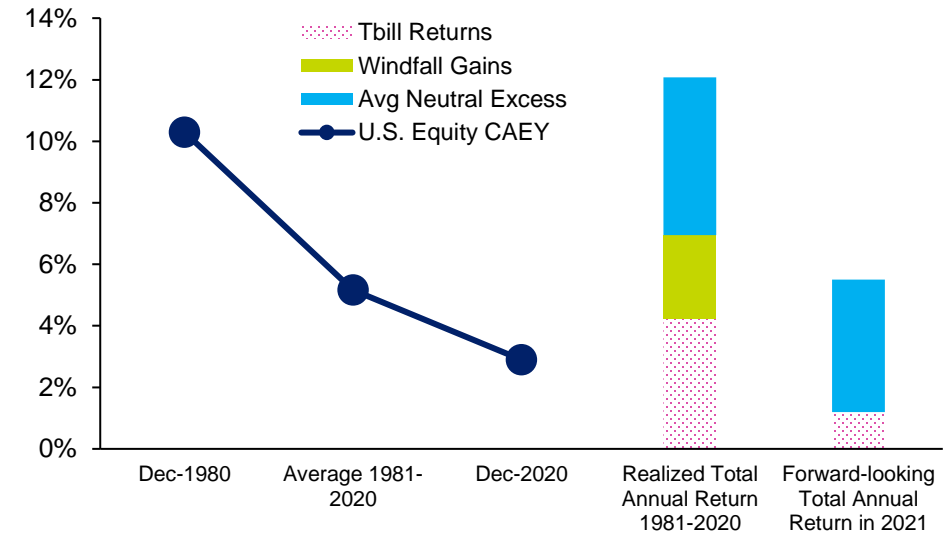
## Decomposing U.S. 10-Year Treasury Returns

January 1, 1981 – December 31, 2020



## Decomposing U.S. Equity Market Returns

January 1, 1981 – December 31, 2020



Source: AQR, Bloomberg. U.S. Equities represented by S&P 500 returns.

The LHS chart decomposes the realized bond return by regressing monthly excess bond returns on contemporaneous yield changes. The correlation is near -0.95 and the slope coefficient (-)5.3 gives the bond's average empirical duration. The product of the slope and the net yield change of -11.5%, pro-rated over 40 years, gives an annual windfall gain of 1.5%. The annualized regression intercept 1.8% is likely a better measure of the excess return investors expected on average during the sample period.

The RHS chart decomposes the realized equity return by regressing monthly excess equity returns on contemporaneous changes in the CAEY (the inverse of “the Shiller CAPE”). The correlation is near -0.9 and the slope coefficient (-)14.6 gives the equity market's empirical sensitivity to its own discount rate changes. The product of the slope and the net yield change of -7.4%, pro-rated over 40 years, gives the annual windfall gain of 2.7%. The annualized regression intercept 5.1% is likely a better measure of the excess return equity investors expected on average during the sample period. So the windfall gains have been larger for equities than bonds despite a less extreme yield fall, thanks to equities' longer “duration.” Comparing slope coefficients of 15 and 5 reminds that equities' distant cash flows give them a very long “duration” (in the sense of a high sensitivity to their own discount rate, not to bond yields). These are not the returns to an actual portfolio AQR manages and are for illustrative purposes only. Broad-based securities indices are unmanaged and are not subject to fees and expenses typically associated with managed accounts or investment funds. Investments cannot be made directly in an index. Past performance is not a guarantee of future performance.



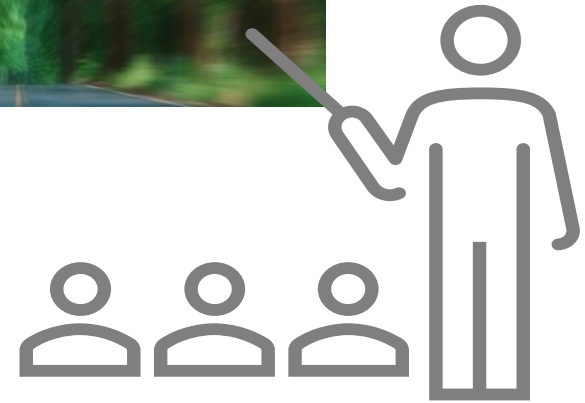
# Rearview Mirror Investing Can Be Dangerous

Lessons from the benign 2010s decade are hard to un-learn

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## Recent rearview lessons:

1. Rich assets can just keep getting richer
  - Asset yields can fall ever lower
  - Inflation is always benign
  - Central banks will come to aid when called
  - Buying the dip is safe
2. Contrarian strategies fail at every level
3. Diversification disappoints
4. Novelty assets breed big winners



*Really? The next decade might be different...*



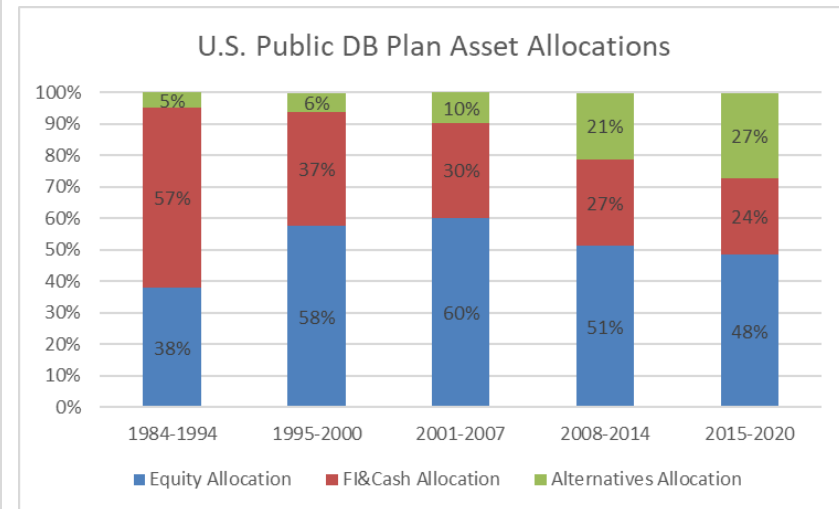
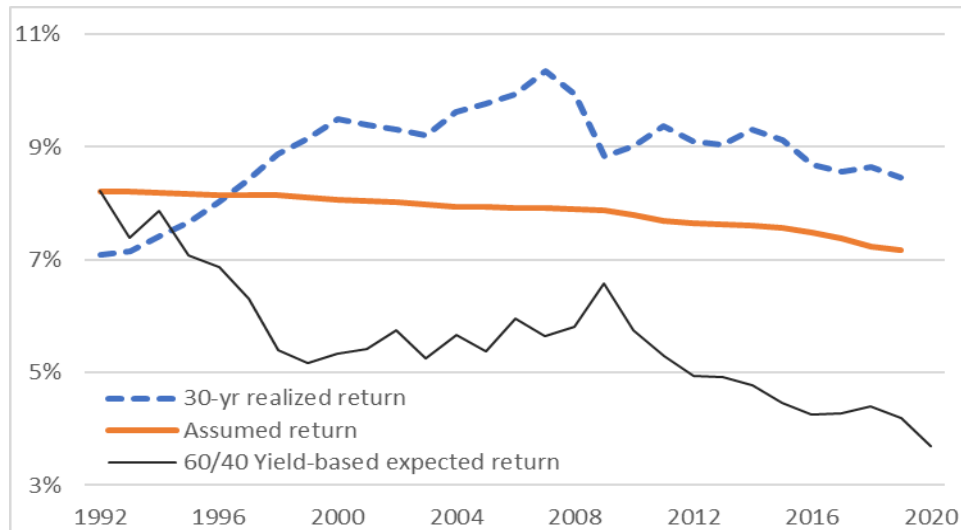
# US Public Pensions Face the Tension

## Anchor to past or prospective returns?

US public pensions have optimistic return assumptions compared to forward-looking yields, but look conservative versus the rearview mirror. Which perspective matters more?

To justify return assumptions amid lower expected returns, public pensions first raised equity allocations, then alternatives. Meanwhile, many corporate plans de-risked.

**US Public Pensions' Assumed Returns Compared to 30-Year Trailing Realized Returns and Yield-based 60/40 Expected Returns, 1992-2020**



Source, left chart: Sources: Census of Governments in <https://publicplansdata.org/quick-facts/national/#investments>, Robert Shiller's website, Survey of Professional Forecasters. Notes: FI refers to fixed income. DB refers to database. The 60/40 expected return is 60% of Shiller CAEY for the S&P500 index plus survey-based economist forecast of next-decade inflation and 40% of US 10-year Treasury yield. Source, right chart: Sources: Pionline until 2007, Center for Retirement Research since 2008. Past performance is not a guarantee of future performance.

# How Did Investors Respond to Low Expected Return Challenge?

## Reach for yield and other efforts to boost returns in the 2010s

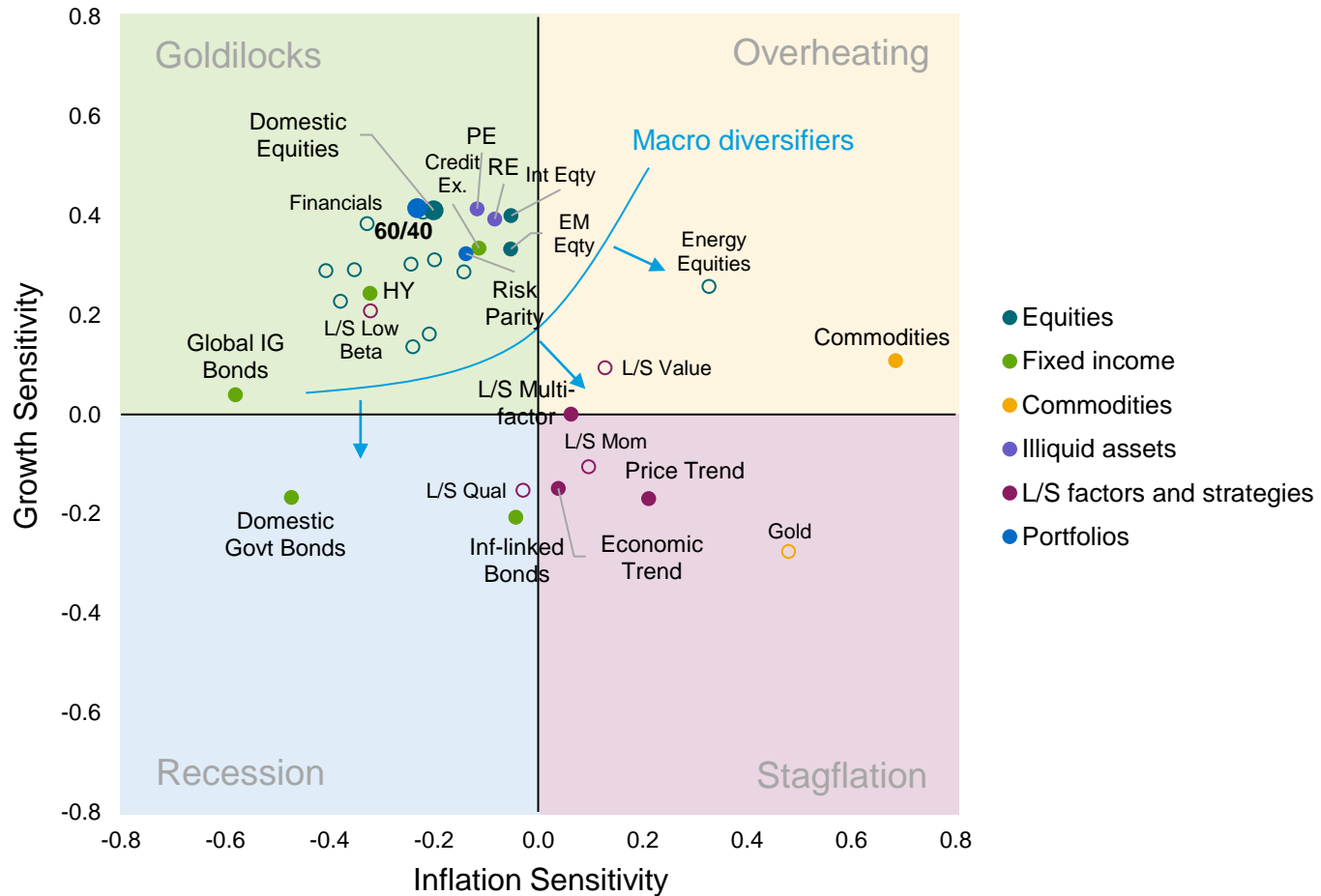
| Possible Solution                                      | Motivation   | Challenges   |
|--|--|--|
| <b>1. Even More Equities</b>                           | <b>Belief in Equity Premium:</b><br>Highest conviction exposure;<br>confidence in long horizon                         | <b>Concentration:</b> already dominant risk to many; not cheap; future returns may not match the past  |
| <b>2. More Illiquid Private Assets</b>                 | <b>'Endowment Model' Beliefs:</b><br>High returns historically;<br>perceived illiquidity premium                       | <b>Illiquidity;</b> contain much equity exposure; also historically rich; overrated illiquidity premia |
| <b>3. Add Factor Tilts and Alternative Risk Premia</b> | <b>Multi-Factor Beliefs:</b><br>Long-run evidence on multiple rewarded factors; long/short less affected by low yields | <b>Leverage</b> and other tools required to meet return targets; mixed performance in recent years     |



# Mapping Investments' Macroeconomic Sensitivities

## Most portfolios imply a bet on falling inflation and positive growth

**Growth and Inflation Sensitivities of Assets and Hypothetical Strategies**  
January 1972 – December 2022



Source: AQR, Bloomberg, Survey of Professional Forecasters, U.S. Bureau of Labor Statistics. Sensitivities are two-factor partial contemporaneous correlations to inflation and growth metrics, where each metric is an equal-risk combination of 12-month changes and 12-month surprises vs. survey forecasts. Based on rolling 12-month periods at quarterly frequency. Unfilled markers indicate sub-sectors or sub-strategies. 60/40 is 60% domestic equities, 40% domestic government bonds. Results for 11 GICS equity sectors (unfilled teal markers) are based on data from February 1974 to December 2022, with correlations adjusted to match full sample by subtracting the difference in market correlations over the two samples. See Appendix for asset class proxies and construction of hypothetical portfolios. Hypothetical performance results have certain inherent limitations, some of which are disclosed in the Appendix.

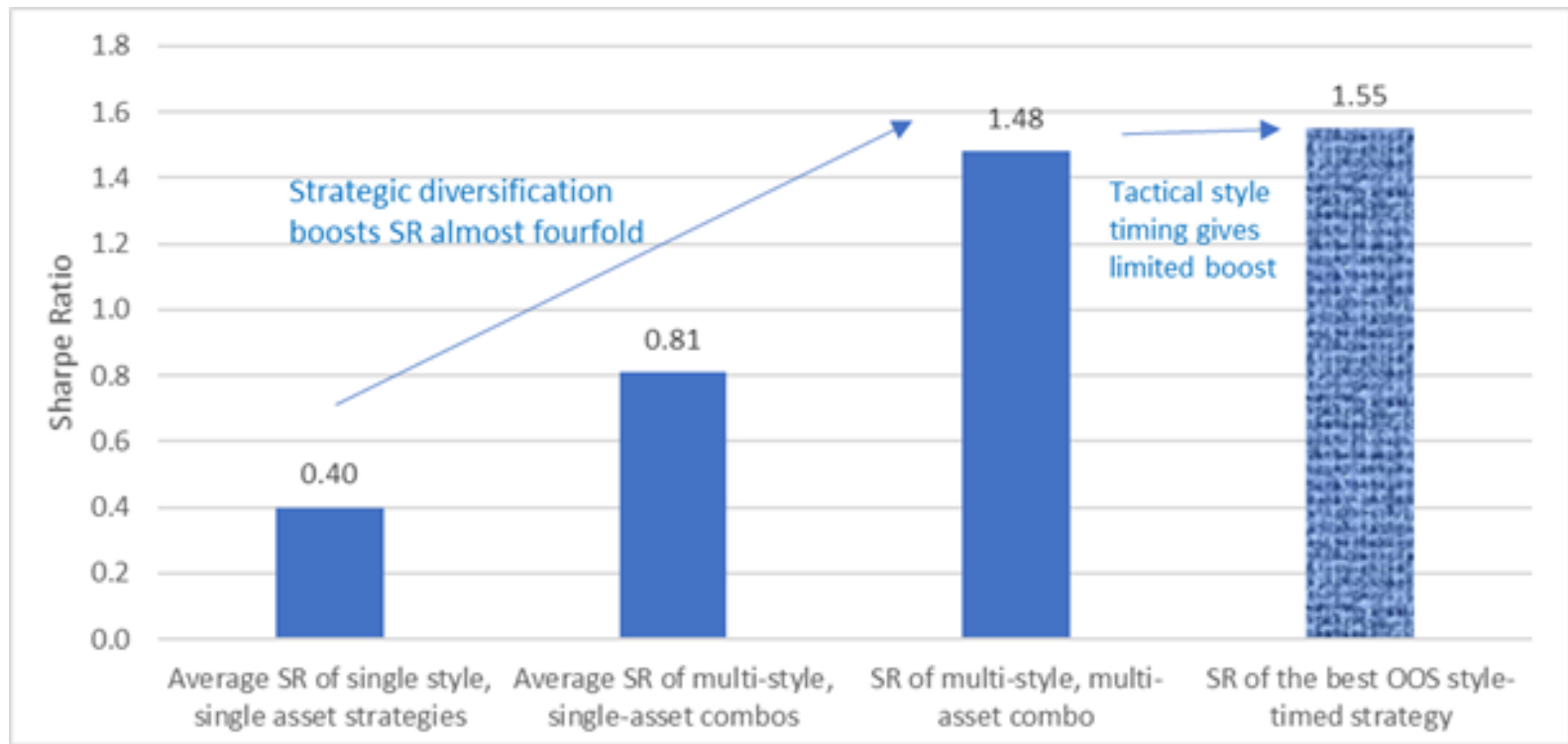


# Strategic Factor Diversification Trumps Tactical Factor Timing

Only extreme dislocations warrant aggressive timing

We tested tactical timing of style premia with the help of value spreads, factor momentum, macro signals, and more. Even the best variants gave so little extra that it would have been easily overcome by trading costs.

## Boosting Sharpe Ratio with Hypothetical Factor Diversification or Factor Timing, 1926-2020



Sources: AQR, Ilmanen-Israel-Lee-Moskowitz-Thapar (2021). See Century of Factor Premia Appendix slides for more details. These are not the returns to an actual portfolio AQR manages and are for illustrative purposes only. Hypothetical data has inherent limitations, some of which are disclosed in the Appendix. Diversification does not eliminate the risk of experiencing investment losses.



# Impatience and Other Bad Habits

Good investing results require good investments and good investors

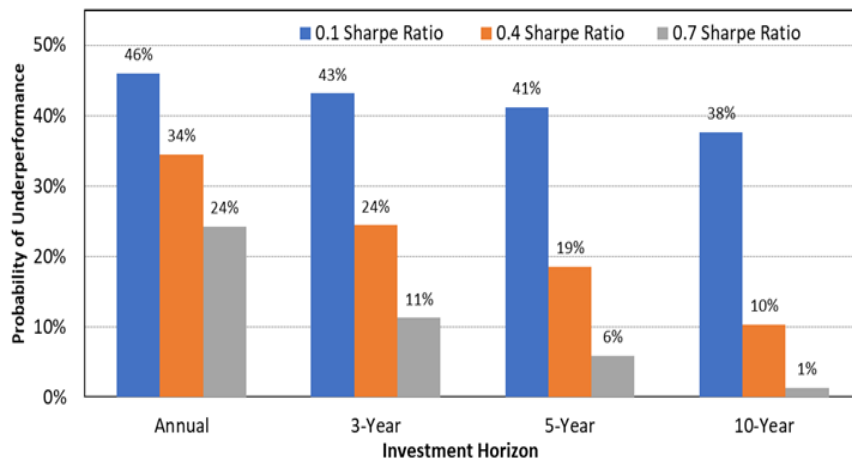
Patience is a virtue but hard to sustain

Investors often demand more performance consistency than is feasible in competitive markets (left chart)

Patience can be boosted by having solid economic rationale and empirical evidence, and by monitoring performance broadly and rarely

Multi-year return chasing in investor flows (right chart) may be the premier bad habit, especially given some multi-year mean-reversion tendencies in returns

**Hypothetical Frequency of Underperformance, for a Given Horizon and Sharpe Ratio**



**Performance Around US Pension Plan Sponsors' Hire and Fire Decisions, 1996-2003**

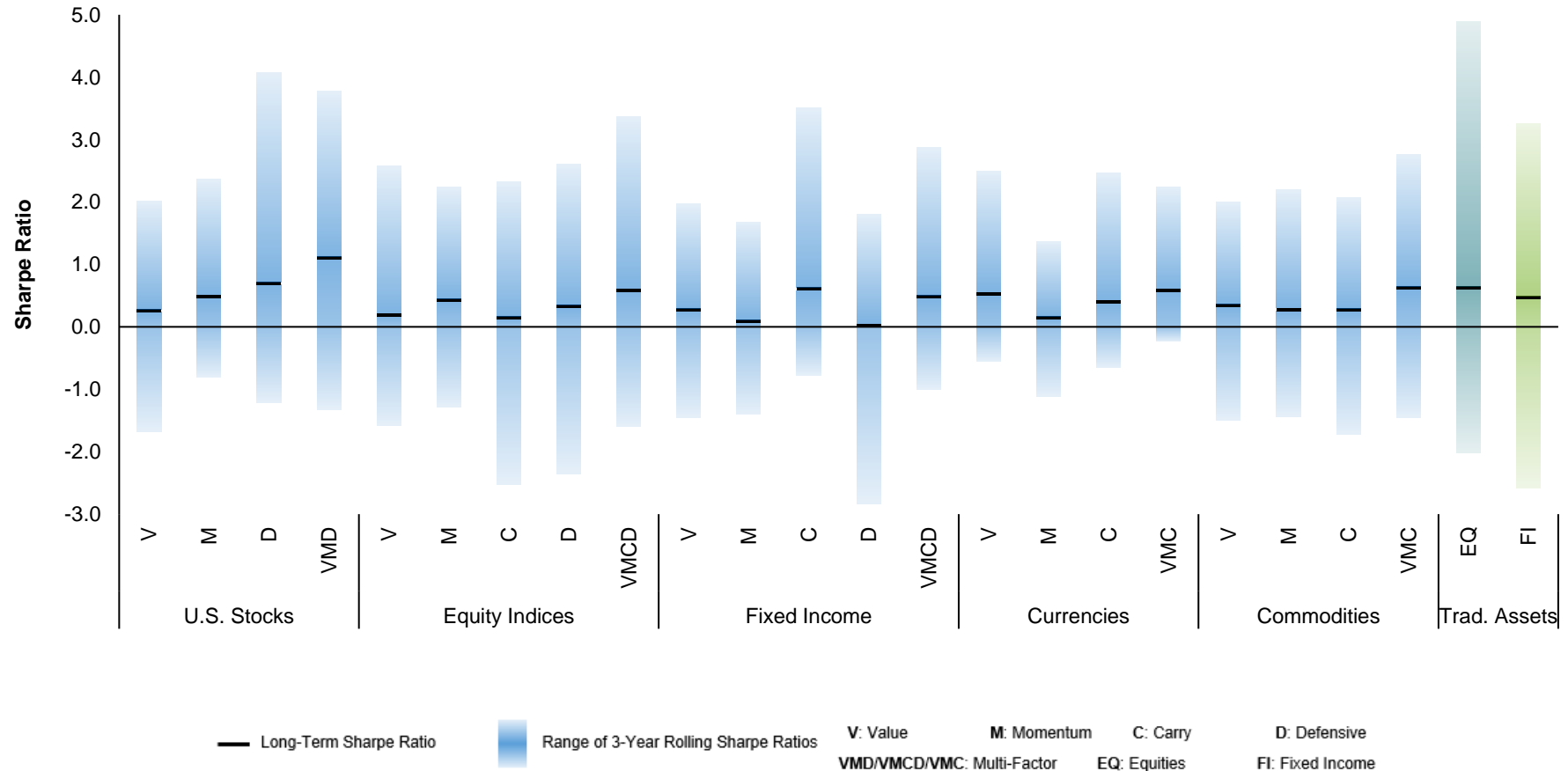


Sources, left chart: AQR. Notes: Hypothetical portfolio modelled assuming a normal distribution, no autocorrelation, independent portfolios.  
Sources, right chart: AQR, Goyal and Wahal (2008). Hypothetical performance has inherent limitations, some of which are described in the appendix.

# Multi-Year Bad Times Can Still Challenge Investor Patience

There can be painful variation around the good long-run performance

## Range of 3-Year Rolling Sharpe Ratios across Hypothetical Factors and Asset Classes



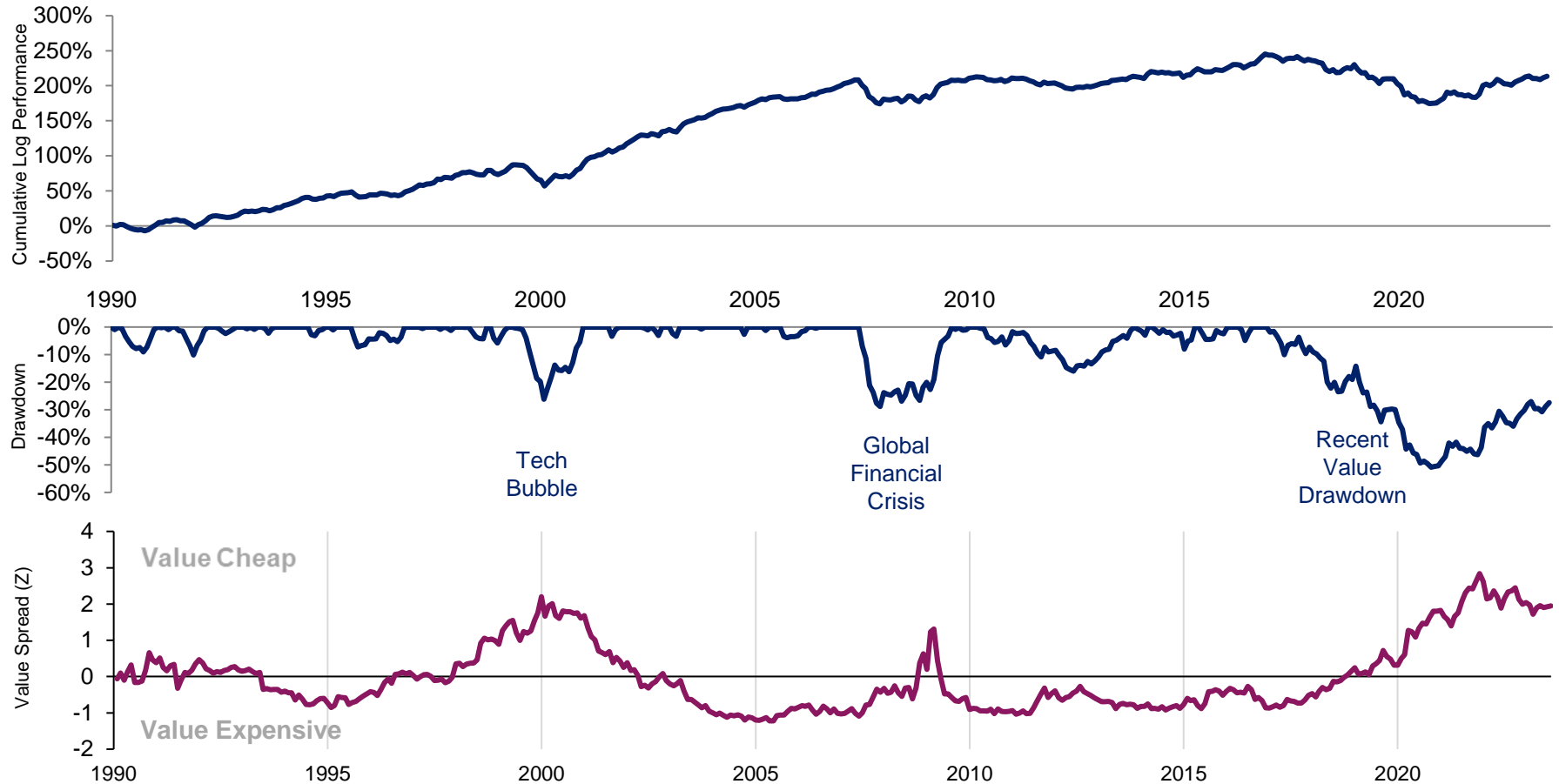
Source: AQR. "Fact, Fiction, and Factor Investing," Aghassi, Asness, Fattouche, Moskowitz (2022). Global Financial Data, Bloomberg, Datastream, Chicago Board of Trade, Commodity Systems Inc. Ranges of Sharpe ratios for styles within asset classes are based on maximum and minimum 3-year rolling Sharpe ratios over the full period. The full sample period starts January 1, 1920 and ends August 31, 2022. All returns are excess of U.S. treasury bills but gross of trading costs and fees. The risk-free rate is the BofAML U.S. 3 month treasury bill. For illustrative purposes only and not representative of an actual portfolio that AQR currently manages. Hypothetical data has inherent limitations some of which are discussed in the Appendix. Please refer to the Appendix for descriptions of the data sources used and definitions for each style.

# Value Style's Rollercoaster Years – and Exceptional Opportunity

Being on the wrong side of the growth-stock bubble in 2018-20 hurt Value

## Hypothetical Global Value Factor Cumulative Performance, Drawdown, and Value Spread

January 1, 1990 – July 31, 2023



Source: AQR. AQR factors are based on AQR style premia factor construction and based on factors that target 7% ex-ante volatility. Return data is Hypothetical AQR Style Premia Standalone Global Value Factor and AQR Hypothetical Emerging Markets Valuation Theme Model, please see descriptions in the Appendix. AQR Hypothetical Emerging Markets Valuation Theme Model begins in January 1996 and prior to that all data is for the Hypothetical AQR Style Premia Standalone Global Value Factor. From January 1996 onwards a 70% weight is used for the Hypothetical AQR Style Premia Standalone Global Value Factor and 30% weight for AQR Hypothetical Emerging Markets Valuation Theme Model. Value spread in lower chart relates to AQR Hypothetical Style Premia Standalone Global Value Factor, with 70% weight to developed markets and 30% to emerging markets. Hypothetical value composite includes four value measures: book-to-price, earnings-to-price, forecast earnings-to-price, and sales-to-enterprise value; spreads are measured based on ratios. Spreads are constructed to be industry-neutral by comparing the value measures within each industry, then aggregating to represent an entire portfolio. Hypothetical performance data has certain inherent limitations, some of which are discussed in disclosures. Gross performance results do not reflect the deduction of investment advisory fees and other expenses, which would reduce an investor's actual return. For illustrative purposes only and not representative of an actual portfolio AQR currently manages. Please read important disclosures in the Appendix. All hypothetical performance figures contained herein are in USD unless noted otherwise.



# Performance Disclosures

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# Performance Disclosures

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Broad-based securities indices are unmanaged and are not subject to fees and expenses typically associated with managed accounts or investment funds. Investments cannot be made directly in an index.

**The S&P 500 Index** is a market-capitalization-weighted index of 500 leading publicly traded companies in the U.S.

**The Bloomberg Barclays Global Aggregate Index** is a market-weighted index of global government, government-related agencies, corporate and securitized fixed-income investments.

**The MSCI World Index** is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed markets.

**The SG Trend Index** is designed to track the largest 10 (by AUM) CTAs and be representative of the managed futures trend-following space. The AQR Funds - AQR Managed Futures Strategy Fund is a constituent of the SG Trend Index.

**The Bloomberg Commodity Index** is made up of 23 exchange-traded futures on physical commodities, representing 21 commodities which are weighted to account for economic significance and market liquidity.

**The Bloomberg Dollar Spot Index** tracks the performance of a basket of 10 leading global currencies versus the U.S. Dollar. It has a dynamically updated composition and represents a diverse set of currencies that are important from trade and liquidity perspectives.

**The Bloomberg USD High-Yield Corporate Bond Index** is a rules-based, market-value-weighted index engineered to measure publicly issued non-investment grade USD fixed-rate, taxable and corporate bonds.

**The FTSE World Government Bond Index (WGBI)** measures the performance of fixed-rate, local currency, investment-grade sovereign bonds from over 20 countries, denominated in a variety of currencies, and has more than 30 years of history available. The WGBI is a broad benchmark providing coverage of the global sovereign fixed income market.

**The CBOE S&P 500 5% Put Protection Index<sup>SM</sup> (PPUT)** tracks the value of a hypothetical portfolio of securities (PPUT portfolio) designed to protect an investor from negative S&P 500 returns. The PPUT portfolio is composed of S&P 500<sup>®</sup> stocks and of a long position in a one-month 5% out-of-the-money put option on the S&P 500 (SPX put).

**The CBOE Eurekahedge Tail Risk Index** is an equally weighted index of 13 constituent funds. The index is designed to provide a broad measure of the performance of underlying hedge fund managers that specifically seek to achieve capital appreciation during periods of extreme market stress.

**The Bloomberg Barclays Global Treasury Index** tracks fixed-rate local currency government debt of investment grade countries.

**The Bloomberg Barclays US Aggregate Bond Index** is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS and CMBS (agency and non-agency).

**The FTSE 100 Index** is an index composed of the 100 largest companies by market capitalization listed on the London Stock Exchange.

**The MSCI Emerging Markets Index** is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets.

**The TOPIX Index** is a free-float adjusted market capitalization-weighted index that is calculated based on all the domestic common stocks listed on the TSE First Section.

**The KBW Bank Index** is designed to track the performance of a selection of leading banks and thrifts that are publicly traded in the U.S.

**The NASDAQ 100 Index** is a market capitalization-weighted index that tracks the 100 largest, most actively traded companies listed on the Nasdaq stock exchange.



# Performance Disclosures

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**The Cliffwater Direct Lending Index** is an asset weighted index of 12,000 + directly originated middle market loans.

**The NCREIF Property Index** is a quarterly, unleveraged composite total return for private commercial real estate properties held for investment purposes.

**The Cambridge US Private Equity Index** is calculated based on data compiled from over 1,000 US private equity and venture capital funds.

**The Credit Suisse Hedge Fund Index** is an asset-weighted hedge fund index that provides a rules-based measure of an investable portfolio

**The FTSE NAREIT Equity REITs Index** is a free-float adjusted, market capitalization-weighted index of U.S. equity REITs.

**The HFRI Fund Weighted Composite Index** is a global, equal-weighted index of single-manager funds that report to HFR database.

**The HFRI RV: Fixed Income Asset-Backed Index** includes strategies in which the investment thesis is predicated on realization of a spread between related instruments.

**The HFRI Credit Index** is a composite index of various strategies trading primarily in credit markets.

**The HFRI ED: Distressed/Restructuring Index** includes strategies which employ an investment process focused on credit instruments trading at significant discounts to their value at issuance because of either formal bankruptcy proceeding or financial market perception of near-term proceedings.

**The HFRI ED: Special Situations Index** includes strategies which employ an investment process focused on instruments in companies currently engaged in a corporate transaction.

**Credit Suisse Distressed Index** is designed to measure the aggregate performance of event driven funds that focus on distressed situations.

Request ID: 384074



# Performance Disclosures

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## Simple Yield-Based Forecasts of Expected Returns

Sources for historical equity and bond expected returns are AQR, Robert Shiller's data library, Kozicki-Tinsley (2006), Federal Reserve Bank of Philadelphia, Blue Chip Economic Indicators, Consensus Economics and Morningstar. Prior to 1926, stocks are represented by a reconstruction of the S&P 500 available on Robert Shiller's website which uses dividends and earnings data from Cowles and associates, interpolated from annual data. After that, stocks are the S&P 500. Bonds are represented by long-dated Treasuries. The equity yield is a 50/50 mix of two measures: 50% Shiller E/P \* 1.075 and 50% Dividend/Price + 1.5%. Scalars are used to account for long term real Earnings Per Share (EPS) Growth. Bond yield is 10-year real Treasury yield minus 10-year inflation forecast as in *Expected Returns* (Ilmanen, 2011), with no rolldown added.

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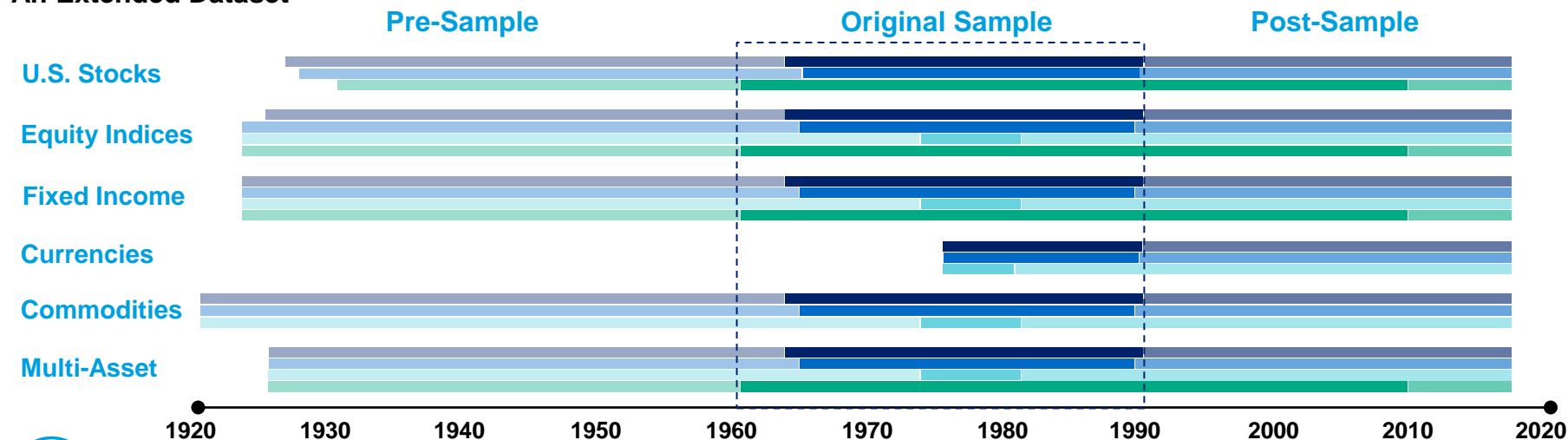
# A Century of Multi-Asset Factor Premia

## Simple factor definitions; pre- and post-sample data

### Style Premia Definitions by Asset Class

|           | U.S. Stocks  | Equity Indices                | Global Bonds      | Currencies               | Commodities            |
|-----------|--|-------------------------------|-------------------|--------------------------|------------------------|
| Value     | B/P  | Cyclically-Adjusted PE (CAPE) | Real Bond Yield   | Purchasing Power Parity  | 5-Year Reversal        |
| Momentum  | Past 12-Month Price Return (excluding Most Recent Month) |                               |                   |                          |                        |
| Carry     | —  | Dividend Yield                | Yield Curve Slope | Short-Term Interest Rate | Futures Curve Rolldown |
| Defensive | Beta   |                               |                   | —                        | —                      |

### An Extended Dataset



Source: AQR. For illustrative purposes only. Asset Class Data is subject to change at any time without notice. The full sample period starts 1/1920 and ends 9/2018. Time periods for pre-sample, post-sample, and original sample can be found in the Appendix. Darker shaded region of each horizontal bar represents original sample period. Please refer to the Appendix for descriptions of the data sources used and definitions for each style. Note that multi-asset composite is volatility-weighted combination of strategies in all asset classes, and also includes International Stocks for a shorter available history since 7/1984. Please refer to the Appendix for descriptions of the data sources used and definitions for each style in the Century of Factor Premia section.



# Asset Descriptions for Macro Analyses

## Asset class proxies and hypothetical strategy methodology

| Asset Class               | Proxy 1  | Start Date | Proxy 2  | Start Date | Proxy 3            | Start Date |
|---------------------------|--|------------|--|------------|--------------------|------------|
| Domestic Equity           | MSCI US Net TR Index   | 1/1/1972   |  |            |                    |            |
| International Dev. Equity | MSCI World ex US Net TR Unhedged Index   | 1/1/1972   |  |            |                    |            |
| Emerging Equity           | MSCI Emerging Markets Net TR Unhedged Index  | 1/1/1988   | MSCI EAFE Net TR Unhedged Index  | 1/1/1972   |                    |            |
| Domestic Govt Bonds       | U.S. 10-year Treasury  | 1/1/1972   |  |            |                    |            |
| Global IG Bonds           | Bloomberg Barclays Global Agg Bond Index Hedged  | 2/1/1990   | AQR Global Bond Series (vol adjusted)  | 1/1/1972   |                    |            |
| High Yield Bonds          | Bloomberg Barclays US High Yield Index   | 8/1/1983   | Barclays US Corporate Bond Index   | 2/1/1973   | AQR US Bond Series | 1/1/1972   |
| Inflation-Linked Bonds    | U.S. 10-Year TIPS  | 3/1/1997   | Synthetic returns based on nominal Treasury yields and survey-based expected inflation | 1/1/1972   |                    |            |
| Private Equity            | 50% Russell 2000 x 1.2 (levered listed small cap index), 50% Cambridge U.S. Buyout (unlisted)  | 4/1/1986   | 70% Russell 2000 x 1.2 (levered listed small cap index), 30% Cash                      | 1/1/1972   |                    |            |
| Real Estate               | 50% FTSE NAREIT All REITs Index (listed), 50% NCREIF Index (unlisted)  | 12/1/1977  | 60% FTSE NAREIT All REITs Index (listed), 40% Cash                                     | 1/1/1972   |                    |            |
| Commodities               | Bloomberg Commodities Index  | 1/1/1972   |  |            |                    |            |
| Gold                      | S&P GSCI Gold Total Return Index   | 1/1/1972   |  |            |                    |            |
| B/E Inflation             | Long 10-year U.S. TIPS as defined above, short 10-year U.S. Treasury   | 1/1/1972   |  |            |                    |            |
| Long/Short Equity Factors | Value is U.S. HML Devil factor based on B/P (Asness and Frazzini, 2013), constructed to be industry neutral. Momentum is U.S. 'Up Minus Down' factor based on 12M return excluding most recent month, constructed to be industry neutral. Low Beta is U.S. 'Betting Against Beta' factor (Frazzini and Pedersen, 2014), constructed to be industry neutral. Quality is U.S. 'Quality Minus Junk' factor (Asness, Frazzini and Pedersen, 2014), constructed to be industry neutral. All factors are cap-weighted long the 1/3 best stocks and short the 1/3 worst stocks following the methodology of Fama and French (1993), rebalanced annually every January. All factors except Low Beta are dollar long and short. For Low Beta the long side is levered to make the portfolio ex-ante beta-neutral as described in Frazzini and Pedersen (2014). Multi-factor Portfolio is equal-weighted combination of Value, Momentum and Defensive, where Defensive is 50% Low Beta and 50% Quality. Returns are gross of costs and fees. |            |  |            |                    |            |
| Trend Following           | Please see the Hypothetical Price-Based Trend-Following Strategy description on the Trend Following Backtest Descriptions slides.  |            |  |            |                    |            |
| Macro Momentum            | Hypothetical long/short and directional strategies applied to 15 equity indices, 9 government bond markets, and 9 currencies, with signals based on the following macro momentum themes as described in A Half Century of Macro Momentum by Brooks (2017): Business Cycle, International Trade, Monetary Policy, Risk Sentiment. The strategy goes long assets for which fundamental momentum is favorable and short assets for which it is unfavorable. Returns are net of estimated transaction costs and 2 & 20 fees.   |            |  |            |                    |            |
| Cash                      | Carry on 3m T-Bills  | 1/1/1972   |  |            |                    |            |



# A Century of Multi-Asset Factor Premia

## Data sources and definitions

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### Factor Premia Asset Data

**U.S. Stocks:** Individual stock-level data from the CRSP database from July 1926 for Value, July 1927 for Momentum, and July 1931 for Defensive strategies.

**Equity Indices:** Returns on equity indices from 23 equity markets international which include all countries in the MSCI World Index as of 10/31/2016. Since most countries have multiple equity indices, we use the index that is investable, has the most coverage of the total stock market of that country, and has the longest history. We source monthly total returns from Global Financial Data and futures returns from Bloomberg and Datastream.

**Fixed Income:** Nominal yield and total returns data of 10-year local currency government bonds as well as 3-month interest rates for 13 countries covering North America, Northern Europe, Japan, and Australia/New Zealand, sourced from Global Financial Data, Bloomberg, and Datastream.

**Currencies:** Spot and 1-, 2-, 3-, and 6-month forward exchange rates from AQR's production data base and interpolate the forward exchange rate for the next quarterly IMM date. This simulates a strategy of buying and holding the forward contract maturing at the near IMM date and rolling to the far contract 5 days before the maturity date. Before 1990, we use changes in spot exchange rates plus the carry of the currency for the total return. This includes data from 20 developed market currencies (Australia, Eurozone, Canada, Japan, Norway, New Zealand, Sweden, Switzerland, United Kingdom, and the U.S., and Belgium, Spain, Finland, France, Germany, Ireland, Italy, Netherlands, Austria, and Portugal).

**Commodities:** Monthly futures prices of 40 commodities starting in 1877, sourced from the Annual Report of the Trade and Commerce of the Chicago Board of Trade, Commodity Systems Inc., and Bloomberg. For base metals and platinum, rolled return series from the S&P, Goldman Sachs, and Bloomberg are used.

**U.S. Equity Market Data:** Prior to 1926, the U.S. Equity series is constructed by adding price-weighted capital appreciation returns of NYSE stocks collected by Goetzmann, Ibbotson, and Peng to U.S. equity dividend returns recorded by the Cowles commission. The series consists of returns of the S&P 90 from 1926 to 1957 and returns of the S&P 500 from 1957 onwards.

**Global Equities:** GDP-weighted return of equity index futures of 11 developed countries.

**Global Fixed Income:** GDP-weighted return of 15 government bond indices of 8 developed countries scaled to a constant duration of 4 years.

### Factor Premia Definitions

**U.S. Stocks:** Value: Book-to-Price Ratio; Momentum: Past 12 Month Return, Excluding Last Month; Defensive: Beta

**Equity Indices:** Value: Cyclically-Adjusted Earnings-to-Price Ratio; Momentum: Past 12 Month Return, Excluding Last Month; Carry: Dividend Yield; Defensive: Beta

**Fixed Income:** Value: Real Bond Yield; Momentum: Past 12 Month Return, Excluding Last Month; Carry: Term Premium; Defensive: Beta

**Currencies:** Value: Purchasing Power Parity; Momentum: Past 12 Month Return, Excluding Last Month; Carry: Short Term Interest Rate

**Commodities:** Value: 5 Year Reversal; Momentum: Past 12 Month Return, Excluding Last Month; Carry: Futures Curve Rolldown; Defensive: Beta

**Multi-style** is an equal weighted portfolio of the factor premia within each asset class.

The **multi-asset multi-style composite** is based on equal risk weights across asset classes, using long-run volatilities; it also includes a shorter history of International Stocks.



Source: AQR, Global Financial Data, Bloomberg, Datastream, Chicago Board of Trade, Commodity Systems Inc. The full sample period starts in 1/1920 (all assets become available in 1920s except for currencies in 1974). All factor premia reflect a backtest of theoretical long/short style components based on AQR definitions applied in several asset group contexts. The results shown do not include advisory fees or transaction costs but are in excess of cash (US treasury bills).

# A Century of Multi-Asset Factor Premia

## Methodology for macroeconomic sensitivity analysis and factor timing

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### Macroeconomic Indicator Definitions

Inflation: Average of the past 12 month change in CPI in the U.S. and the rate of change of the past 12 month CPI in the U.S

Growth: Average of the past 12 month change in real GDP in the U.S. and the rate of change of the past 12 month real GDP in the U.S

Volatility: Past 24 month realized volatility of developed equities

### Macroeconomic Sensitivity Analysis Methodology

First, we form the Inflation, Growth, and Volatility indicators by capping extreme values at the 95th and 5th percentiles for each indicator and then normalizing. The full sample is then split into two categories for each indicator. If the indicator is above its median for that period, it is classified as a “high” period (if it is less than or equal to its median, it is classified as a “low” period). This ensures there is an equal number of “high” and “low” periods in the analysis. Next, the style and market returns are converted to rolling annual returns. The returns are separated into two buckets for each indicator— returns in the “high” environments and returns in the “low” environments. We then calculate Sharpe ratios as the simple average of the rolling returns divided by the volatility of the rolling returns. We calculate Sharpe ratios in the full sample, the “high” and “low” inflation environments, the “high” and “low” growth environments, and finally the “high” and “low” volatility environments. We then compare these Sharpe ratios.

### Factor Timing Methodology

The timing backtest is based on an expanding panel regression of factor returns on four standalone timing variables: value spread, past 12-month returns, business cycle proxy \*based on U.S. real GDP growth level and change), and inverse volatility. The regression betas are used to compute predicted factor returns. The timing multiplier is based on the expanding z-score of predicted factor returns. The timing is applied to each style and asset class separately and these timed returns are then aggregated into a portfolio. The sign-constrained regressions impose non-negative sign for value spread, factor momentum and inverse volatility, thus implying no position if the regression shows a negative beta. The full model approach uses all of the above timing variables, while the other approaches use each signal standalone.

### Timing Strategies from Century Study

We use the following timing methodologies: z-score, out-of-sample regression with no sign restrictions, out-of-sample regression with the restriction that a given factor have the same sign across all asset classes for a given timing variable, out-of-sample regression with both an economic sign and factor restriction (e.g., value spreads should have a positive coefficient and be the same for a given factor across all asset classes), and finally a full sample regression (in-sample) that places no restrictions on any coefficients. The timing variables are the value spread, past 12-month return on each factor (factor momentum), average characteristic of the factor itself (factor spread), which is the value spread for value portfolios, the momentum for momentum portfolios, the average carry for the carry portfolios, and the average negative beta for the defensive portfolios, five-year reversals (negative of past five year return on the factor), inverse volatility (where volatility is estimated over the prior 36 months of returns), inverse variance, business cycle (an ex ante measure that seeks to identify stages of the business cycle – contraction, recovery, slowdown, expansion – where we use both the level and change of GDP growth, compute a rolling 10-year z-score of level and changes in GDP growth, and identify the turning point of a business cycle as whether the z-score breaks +/-1.0 to identify each of the four periods), growth momentum (moving average of annual GDP growth), inflation momentum (moving average of inflation growth), CAPE, and “VIX” (realized volatility of the market over the last 36 months). We also report a simple average of all the timing strategies as well as a timing strategy based on the “full model” that incorporates all timing variables into one model, under each methodology, to time the factors.



# Century of Factor Premia

## Dates of pre-, original, and post-sample periods

| Asset Class    | Style       | Pre-Sample Period   | Original Sample Period | Post-Sample Period  |
|----------------|-------------|---------------------|------------------------|---------------------|
| Multi-Asset    | Value       | Mar-1926 - Dec-1963 | Jan-1963 - Dec-1990    | Jan-1990 - Dec-2019 |
| Multi-Asset    | Momentum    | Feb-1926 - Dec-1964 | Jan-1964 - Dec-1989    | Jan-1989 - Dec-2019 |
| Multi-Asset    | Carry       | Feb-1926 - Dec-1973 | Jan-1973 - Dec-1981    | Jan-1981 - Dec-2019 |
| Multi-Asset    | Defensive   | Feb-1926 - Dec-1960 | Jan-1960 - Dec-2009    | Jan-2009 - Dec-2019 |
| Multi-Asset    | Multi-style | Feb-1926 - Dec-1960 | Jan-1960 - Dec-1990    | Jan-1990 - Dec-2019 |
| U.S. Stocks    | Value       | Jul-1927 - Dec-1963 | Jan-1963 - Dec-1990    | Jan-1990 - Dec-2019 |
| U.S. Stocks    | Momentum    | Feb-1928 - Dec-1964 | Jan-1964 - Dec-1989    | Jan-1989 - Dec-2019 |
| U.S. Stocks    | Defensive   | Mar-1928 - Dec-1960 | Jan-1960 - Dec-2009    | Jan-2009 - Dec-2019 |
| U.S. Stocks    | Multi-style | Jul-1927 - Dec-1960 | Jan-1960 - Dec-1990    | Jan-1990 - Dec-2019 |
| Commodities    | Value       | Jan-1920 - Dec-1963 | Jan-1963 - Dec-1990    | Jan-1990 - Dec-2019 |
| Commodities    | Momentum    | Jan-1920 - Dec-1964 | Jan-1964 - Dec-1989    | Jan-1989 - Dec-2019 |
| Commodities    | Carry       | Jan-1920 - Dec-1973 | Jan-1973 - Dec-1981    | Jan-1981 - Dec-2019 |
| Commodities    | Defensive   | Jan-1920 - Dec-1960 | Jan-1960 - Dec-2009    | Jan-2009 - Dec-2019 |
| Commodities    | Multi-style | Jan-1920 - Dec-1960 | Jan-1960 - Dec-1990    | Jan-1990 - Dec-2019 |
| Equity Indices | Value       | Feb-1925 - Dec-1963 | Jan-1963 - Dec-1990    | Jan-1990 - Dec-2019 |
| Equity Indices | Momentum    | Feb-1923 - Dec-1964 | Jan-1964 - Dec-1989    | Jan-1989 - Dec-2019 |
| Equity Indices | Carry       | Feb-1923 - Dec-1973 | Jan-1973 - Dec-1981    | Jan-1981 - Dec-2019 |
| Equity Indices | Defensive   | Feb-1923 - Dec-1960 | Jan-1960 - Dec-2009    | Jan-2009 - Dec-2019 |
| Equity Indices | Multi-style | Feb-1923 - Dec-1960 | Jan-1960 - Dec-1990    | Jan-1990 - Dec-2019 |
| Fixed Income   | Value       | Mar-1923 - Dec-1963 | Jan-1963 - Dec-1990    | Jan-1990 - Dec-2019 |
| Fixed Income   | Momentum    | Feb-1923 - Dec-1964 | Jan-1964 - Dec-1989    | Jan-1989 - Dec-2019 |
| Fixed Income   | Carry       | Feb-1923 - Dec-1973 | Jan-1973 - Dec-1981    | Jan-1981 - Dec-2019 |
| Fixed Income   | Defensive   | Feb-1923 - Dec-1960 | Jan-1960 - Dec-2009    | Jan-2009 - Dec-2019 |
| Fixed Income   | Multi-style | Feb-1923 - Dec-1960 | Jan-1960 - Dec-1990    | Jan-1990 - Dec-2019 |

| Asset Class | Style       | Original Sample Period | Post-Sample Period  |
|-------------|-------------|------------------------|---------------------|
| Currencies  | Value       | Jan-1974 - Dec-1990    | Jan-1990 - Dec-2019 |
| Currencies  | Momentum    | Jan-1974 - Dec-1989    | Jan-1989 - Dec-2019 |
| Currencies  | Carry       | Jan-1974 - Dec-1981    | Jan-1981 - Dec-2019 |
| Currencies  | Multi-style | Jan-1974 - Dec-1990    | Jan-1990 - Dec-2019 |



Source: AQR. Please refer to the Appendix for descriptions of the data sources used and definitions for each style.  
 Note: International stocks are added as another asset class since July 1984, but not included in the pre/post/original comparisons.

# Historical Long Run Risk Premia

## Data Sources and Definitions

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### Data Sources

Equities: GDP-weighted return of equity index futures of 11 developed countries

Bonds: GDP-weighted return of 15 government bond indices of 8 developed countries scaled to a constant duration of 4 years.

Commodities: equal weighted return of a basket of 29 commodities

Credit Excess: excess return of US corporate bonds over duration-matched US treasury bonds

Value: equal risk weight of a value strategy (as described in later slides) in equity indices, stocks, fixed income, commodities, and currencies

Momentum: equal risk weight of a momentum strategy (as described in later slides) in equity indices, stocks, fixed income, commodities, and currencies

Carry: equal risk weight of a carry strategy (as described in later slides) in equity indices, stocks, fixed income, commodities, and currencies

Defensive: equal risk weight of a defensive strategy (as described in later slides) in equity indices, stocks, fixed income, commodities, and currencies

Trend: equal weighted combination of 12-month time series momentum strategies for 67 markets across four major asset classes – 29 commodities, 11 equity indices, 15 bond markets, and 12 currency pairs.

### Descriptions of Style Premia in each asset class

U.S. Stocks: Value: Book-to-Price Ratio; Momentum: Past 12 Month Return, Excluding Last Month; Defensive: Beta

Equity Indices: Value: Cyclically-Adjusted Earnings-to-Price Ratio; Momentum: Past 12 Month Return, Excluding Last Month; Carry: Dividend Yield; Defensive: Beta

Fixed Income: Value: Real Bond Yield; Momentum: Past 12 Month Return, Excluding Last Month; Carry: Term Premium; Defensive: Beta

Commodities: Value: 5 Year Reversal; Momentum: Past 12 Month Return, Excluding Last Month; Carry: Futures Curve Rolldown; Defensive: Beta

### Asset class data descriptions for Style Premia

U.S. Stocks: Individual stock-level data from the CRSP database from July 1926 for Value, July 1927 for Momentum, and July 1931 for Defensive strategies.

Equity Indices: Returns on equity indices from 23 equity markets international which include all countries in the MSCI World Index as of 10/31/2016. Since most countries have multiple equity indices, we use the index that is investable, has the most coverage of the total stock market of that country, and has the longest history. We source monthly total returns from Global Financial Data and futures returns from Bloomberg and Datastream.

Fixed Income: Nominal yield and total returns data of 10-year local currency government bonds as well as 3-month interest rates for 13 countries covering North America, Northern Europe, Japan, and Australia/New Zealand, sourced from Global Financial Data, Bloomberg, and Datastream.

Commodities: Monthly futures prices of 40 commodities starting in 1877, sourced from the Annual Report of the Trade and Commerce of the Chicago Board of Trade, Commodity Systems Inc., and Bloomberg. For base metals and platinum, rolled return series from the S&P, Goldman Sachs, and Bloomberg are used.



Source: AQR, Global Financial Data, Bloomberg, Datastream, Chicago Board of Trade, Commodity Systems Inc. See Hurst-Ooi-Pedersen (2014) for global equities and government bonds (GDP-weighted composites of country indices), commodities (equal-weighted across and within sectors) and trend-following, Asvanunt-Richardson (2015) for U.S. credit (in excess of matched Treasuries), and Moskowitz, Katz, Thapar, and Wang (2017) for market-neutral style premia. The full sample period starts in 1/1920 and ends in 12/2016 (all assets become available in 1920s except for currencies in 1974). Value, Carry, Momentum, and Defensive all begin in March 1926, Credit excess begins in January 1926. All alternative risk premia reflect a backtest of theoretical long/short style components based on AQR definitions applied in several asset group contexts. The results shown do not include advisory fees or transaction costs but are in excess of cash (US treasury bills).

# Hypothetical Value Factor Descriptions

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## **Hypothetical AQR Global Style Premia Standalone Value Model:**

This is an AQR Global Style Premia Standalone Value Model is a theoretical long/short style portfolio is based on monthly returns, undiscounted, net of transaction costs, net of 2% model mgmt. fee and 20% performance fee, excess of a cash rate proxied by the ICE BofAML U.S. 3 Mo. T-bill, and scaled to 7% annualized volatility. The strategy is designed to take long positions in the assets with the strongest style attributes and short positions in the assets with the weakest style attributes, while seeking to ensure the portfolio is market-neutral. The portfolio only uses Value signals that are considered to be well-known, and does not include the full suite of proprietary signals AQR may include in some portfolios. The universe is approximately 2,000 stocks across Europe, Japan, and U.S. The risk model used is the Barra Developed Equity Risk Model.

## **Hypothetical AQR Developed and Emerging Global Value Factor Portfolio Description:**

The Hypothetical AQR Developed and Emerging Global Value Factor Portfolio utilizes the subset of underlying signals that compose the Valuation theme within AQR's Style Premia Equity strategies to evaluate stocks and create long-short, market-neutral equity portfolios based exclusively on these signals. The Valuation theme is designed to capture the tendency for relatively cheap assets to outperform relatively expensive ones. Factor returns are gross of advisory fees and net of transaction costs. Global factor returns start January 1, 1990 and emerging factor returns start January 1, 1996. The combined portfolio utilizes a monthly rebalancing schedule and targets an average annualized volatility of 16% over the long-term. The investment universe includes a broad subset of liquid tradeable large cap stocks within the Global and Emerging universes. The risk model used is the Barra Global Equity Risk Model (GEM2L) from January 1996 – March 2020, BIME\_noCURR\_301L



# Trend Following Backtest Descriptions

## Hypothetical Price-Based Trend-Following Strategy

The Hypothetical Price-Based Trend-Following Strategy model uses data from January 1880 onward. The investment strategy is based on trend-following investing which involves going long markets that have been rising and going short markets that have been falling, betting that those trends over the examined look-back periods will continue. The strategy was constructed with an equal-weighted combination of 1-month, 3-month, and 12-month trend-following strategies for 67 markets across 4 major asset classes: 29 commodities, 11 equity indices, 15 bond markets, and 12 currency pairs. Since not all markets have return data going back to 1880, we construct the strategies using the largest number of assets for which return data exist at each point in time. We use futures returns when they are available. Prior to the availability of futures data, we rely on cash index returns financed at local short rates for each country. Please see Figure 2 for additional details. The strategy targets a long-term volatility target of 10% but does not limit volatility during periods where realized volatility may be higher or lower than this number.

Hypothetical performance is net of fees and net of transaction costs. In order to calculate net-of-fee returns, we subtracted a 1.25% annual management fee and a 20% performance fee from the gross-of-fee, net-of-transaction-cost returns to the strategy. Actual fees may vary depending on, among other things, the applicable fee schedule. The transactions costs used in the strategy are based on estimates of average transaction costs for each of the four asset classes, including market impact and commissions. The transaction costs are assumed to be twice as high from 1993 to 2002 and six times as high from 1880–1992. The transaction costs used are shown in Figure 1.

This model is not based on an actual portfolio AQR manages.

The benchmark and relevant cash rate is assumed to be ICE BofAML 3-Month T-Bill. Prior to 1929 when 3-month Treasury bills became available, the benchmark and relevant cash rate is assumed to be the NYSE call money rates (the rates for collateralized loans) through 1920, and returns on short-term government debt (certificates of indebtedness) from 1920 until 1929.

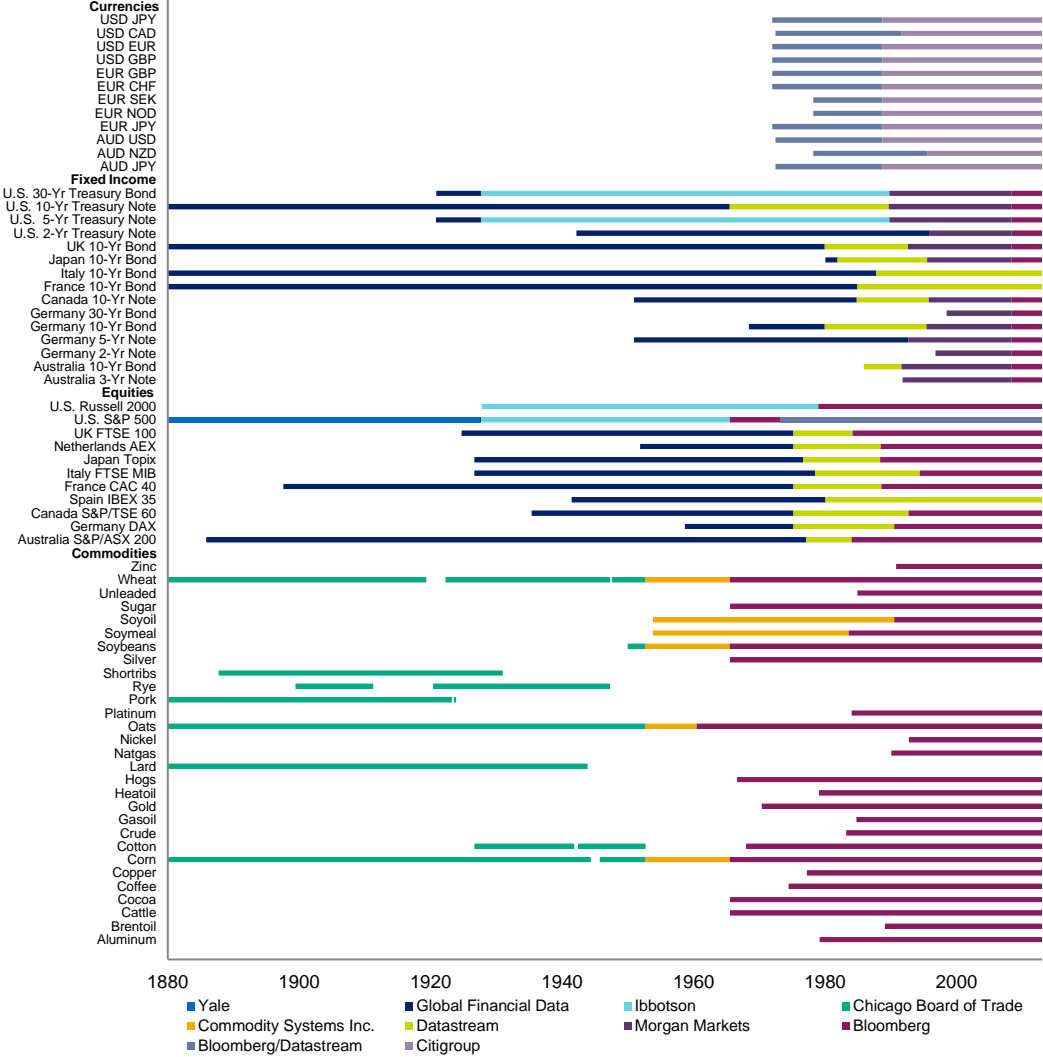
Figure 1

| Asset Class  | Time Period    | One-Way Transaction Costs<br>(as a % of notional traded) |
|--------------|----------------|--|
| Equities     | 1880 – 1992    | 0.34%  |
|              | 1993 – 2002    | 0.11%  |
|              | 2003 – Present | 0.06%  |
| Fixed Income | 1880 – 1992    | 0.06%  |
|              | 1993 – 2002    | 0.02%  |
|              | 2003 – Present | 0.01%  |
| Currencies   | 1880 – 1992    | 0.18%  |
|              | 1993 – 2002    | 0.06%  |
|              | 2003 – Present | 0.03%  |
| Commodities  | 1880 – 1992    | 0.58%  |
|              | 1993 – 2002    | 0.19%  |
|              | 2003 – Present | 0.10%  |



# Trend Following Backtest Descriptions

Figure 2





# Trend Following Backtest Descriptions

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**Limitations of Backtested Performance.** The returns presented reflect hypothetical performance an investor would have obtained had it invested in the manner shown and does not represent returns that any investor actually attained. The information presented is based upon the following hypothetical assumptions.

## **Hypothetical Economic Trend-Following Strategy**

The Hypothetical Economic Trend-Following Strategy uses data from February 1970 onward. The investment strategy is based on trend following which for each theme (Growth, Inflation, International Trade, Monetary Policy, Risk Aversion) and within each asset class, takes a long position in assets in which economic trends are improving and a short position in assets in which economic trends are deteriorating. Each individual position is sized to target the same amount of volatility, both to provide diversification and to limit the portfolio risk from any individual market. The theme portfolio across all assets is scaled to target 10% forecasted annual volatility.

Not all markets and assets have returns going back to 1970; details outlined on the following page.

**Growth:** Growth trends are captured using one-year changes in forecasts of real GDP growth. From 1990 onward forecast data is from Consensus Economics. Prior to 1990, we use one-year changes in realized year-on-year real GDP growth, lagged one quarter (this definition is equivalent to changes in forecasts assuming that real GDP growth follows a random walk). The series is from the OECD. Increasing growth is assumed to be bullish for equities (cash-flow impact), commodities (increasing demand), and currencies (Balassa-Samuelson hypothesis), and bearish for fixed income (both government bonds and interest rates) via both inflationary pressures and upward pressure on real interest rates.

**Inflation:** Inflation trends are captured using one-year changes in forecasts of CPI inflation. From 1990 onward forecast data is from Consensus Economics. Prior to 1990, we use one-year changes in realized year-on-year CPI inflation, lagged one quarter (this definition is equivalent to changes in forecasts assuming that CPI inflation follows a random walk). The series is from the OECD. Increasing inflation is assumed to be bearish for equities (see Katz and Lustig (2017)), bullish for currencies (see Clarida and Waldman (2008)), and bearish for fixed income.

**International Trade:** International trade trends are captured using one-year changes in spot exchange rates against an export-weighted basket. Data is from DataStream. A depreciating currency is bullish for equities (exports become more competitive), bearish for currencies (very similar to price momentum), bearish for fixed income (other things equal, a depreciating currency reduces the pressure on a central bank to reduce interest rates), and bearish for commodities (depreciation of the currencies of commodity consumers means commodities, which are generally priced in USD, are effectively more expensive).

**Monetary Policy:** Monetary policy trends are captured using one-year changes in the front end of the yield curve. From 1992 onwards, I use two-year yields, while prior to 1992 I use Libor and its international equivalents. Both data series are from Bloomberg. Expansionary monetary policy is bullish for equities (see Bernanke and Kuttner (2005)), bullish for currencies (see Eichenbaum and Evans (1995)), bullish for commodities, and bearish for fixed income.

**Risk Sentiment:** Changes in risk sentiment are captured using one-year equity market excess returns. Data is from DataStream. Increasing risk sentiment — i.e., strong equity market returns — is bullish for equities, commodities, and currencies, and bearish for fixed income.

The model employs relatively simple measures as they afford long data availability and are less susceptible to concerns about data mining. The strategy is therefore intended as a proof of concept, and can potentially be enhanced by employing additional and improved measures of economic trends.

Backtest returns are hypothetical gross of transaction costs and fees. Even after adjusting for transaction costs and fees, backtest returns are likely overstated, despite best effort to employ simple and transparent signals, due to unavoidable hindsight bias. Hypothetical data has inherent limitations, some of which are disclosed herein.

As the backtest is constructed to take a long position in assets in which economic trends are improving and a short position in assets in which economic trends are deteriorating, the strategy would likely underperform in a period of sharp reversals across asset classes and investment themes or in an environment in which price trends and economic trends diverge. However, due in part to the diversification benefits of the four asset classes and four investment themes, the performance of the backtest has been consistent over a wide variety of macroeconomic and financial environments over the last 50 years.



# Trend Following Backtest Descriptions

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## Hypothetical Economic Trend-Following Strategy Universe:

Equity index return data is from Bloomberg. Start dates are the earliest available date of the series:

- 1970: Australia, Germany, Canada, Spain, France, Italy, Japan, Netherlands, U.K., U.S.
- 1975: Switzerland
- 1980: Denmark, Hong Kong, Sweden
- 1988: New Zealand

Government bond return data is from Bloomberg and DataStream. Start dates are

- 1970: Germany, Canada, U.K., U.S.
- 1980: Japan
- 1981: Switzerland
- 1985: Denmark
- 1986: Australia
- 1987: Sweden

Currency return data is from Citi and Reuters. Start dates are

- 1971: Germany, Japan, Switzerland, U.K.
- 1972: Australia, Canada
- 1978: New Zealand, Sweden

Interest rate futures return data is from IFS. Start dates are

- 1987: U.S.
- 1988: U.K.
- 1989: Australia, Europe (Euribor)
- 1991: Canada, New Zealand, Switzerland

Commodity futures return data is from Bloomberg. Start dates are

- 1970: Cattle, Corn Cotton, Hogs, Soybeans, Soymeal, Soyoil, Sugar, Wheat
- 1974: Coffee
- 1979: Heat Oil
- 1983: Crude Oil
- 1984: Gas Oil
- 1985: Unleaded
- 1989: Brent Oil
- 1990: Natural Gas
- 1991: Zinc
- 1993: Nickel



# Trend Following Backtest Descriptions

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## **Hypothetical Alternative Trend-Following Strategy**

The Hypothetical Alternative Trend-Following The Hypothetical Alternative Trend-Following Strategy was constructed with an equal-weighted combination of 1-month, 3-month, and 12-month trend-following strategies for markets across 6 major asset groups – equity factor portfolios, credit indices, interest rate swaps, emerging currencies, alternative commodities, and volatility futures – from January 1990 onward. Since not all markets have the same length of historic return data available, we construct the strategies using the largest number of assets for which return data exist at each point in time. We use futures returns when they are available. The strategy targets long-term volatility target of 10%.

In order to calculate net-of-fee returns for the time series momentum strategy, we subtracted a 1.25% annual management fee and a 20% performance fee per annum from the gross-of-fee returns to the strategy. The performance fee is calculated and accrued on a monthly basis, but is subject to an annual high-water mark. In other words, a performance fee is subtracted from the gross returns in a given year only if the returns in the fund are large enough that the fund's NAV at the end of the year exceeds every previous end of year NAV. The transactions costs used in the strategy are based on proprietary estimates of transaction costs for each market traded, including market impact and commissions.

This model is not based on an actual portfolio AQR manages.

The benchmark and relevant cash rate is assumed to be 3-month Treasury bills



