Investor Guide

Equity Market Neutral

Key Ideas

- Equity Market Neutral is a well-established alternative strategy with a long and proven track record
- The strategy is generally designed to provide a source of returns that is lowly correlated to broad equity markets
- AQR's quantitative approach is a bottom-up, fundamentally driven strategy that targets a level of risk that is less than broad equity markets

Please read important disclosures at the end of this paper.

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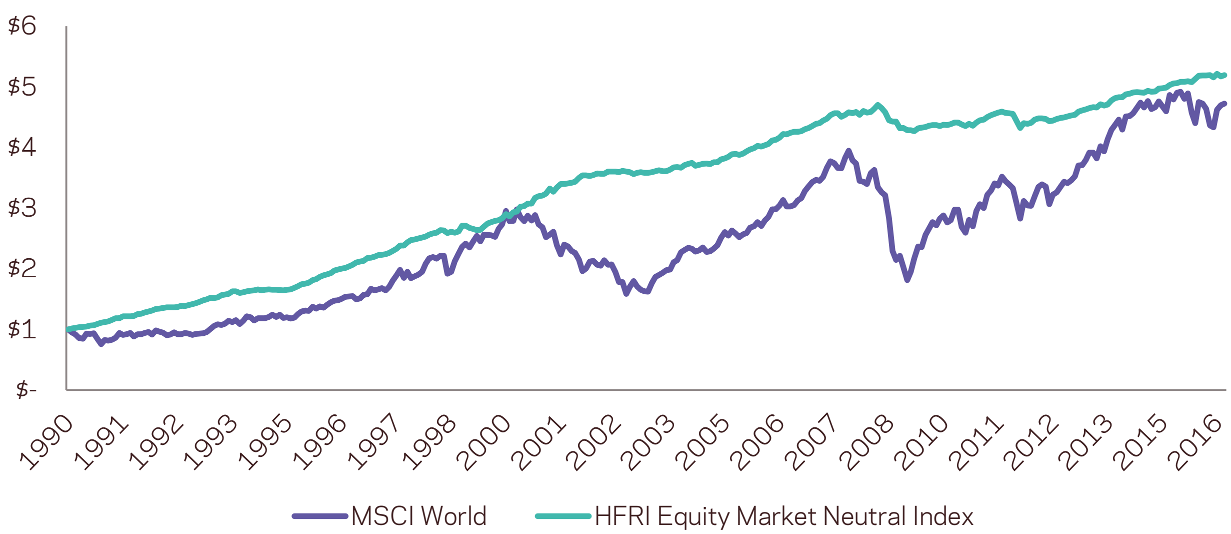
A Brief History of Equity Market Neutral

Traditional long-only active equity portfolios provide two sources of return for investors: one from passive exposure to the market and the other generated by manager skill by overweighting outperforming stocks and underweighting underperforming stocks. Most of the returns generated in traditional long-only portfolios are attributable to the passive market component. In equity market neutral portfolios, however, passive market exposure is effectively hedged out, allowing for the entirety of returns to be driven by manager skill.

Equity market neutral managers buy stocks they expect to outperform and sell stocks they expect to underperform, but they don't stop there. By balancing the amount of stocks that they buy and sell, the manager is able to create a portfolio that has zero net exposure to the market itself. The result is a strategy with a return stream that is unaffected as equity markets move up or down. In other words, the strategy's return is lowly correlated to equity markets.

Because the resulting portfolio has a zero net exposure to the market, it serves as an effective diversifier to traditional portfolios—whose overall risk is mostly driven by traditional equity markets. Uncorrelated sources of return are particularly valuable in periods of market stress, as they do not rise or fall with traditional markets, by design. Since 1990, equity market neutral funds (as measured by the HFRI Equity Market Neutral Index) have outperformed global equity markets, with less severe drawdowns (see Exhibit 1).

Exhibit 1: Growth of a Dollar, MSCI World vs. HFRI Equity Market Neutral Index
Jan 1, 1990–Jun 30, 2016



Source: AQR. **Past performance does not guarantee future results.**

A More Deliberate Approach to Equity Market Neutral

AQR has managed equity market neutral strategies since its inception in 1998. Our approach is to buy and sell stocks based on sound economic fundamentals (we like cheap, high quality companies that have improving fundamentals and price) and evaluate them in a systematic and disciplined manner. The relationship between these fundamentals and subsequent returns is thoroughly tested, and we require our research to be supported both by economic theory and empirical evidence.

Our approach is unique in various ways, chief among them being our focus on diversification. We strive for diversification not only in the breadth of investment themes we trade (such as favoring cheap stocks), but also in the number of securities and industries in which we invest and in the span of geographies included. The AQR Equity Market Neutral strategy invests in several hundred stocks across the global universe. Each position will have a low individual portfolio weight, with the maximum allocation to any one company being generally less than 2.5% of the portfolio's overall exposure. As such, any individual company's stock price performance is unlikely to have a meaningful impact on the overall portfolio.

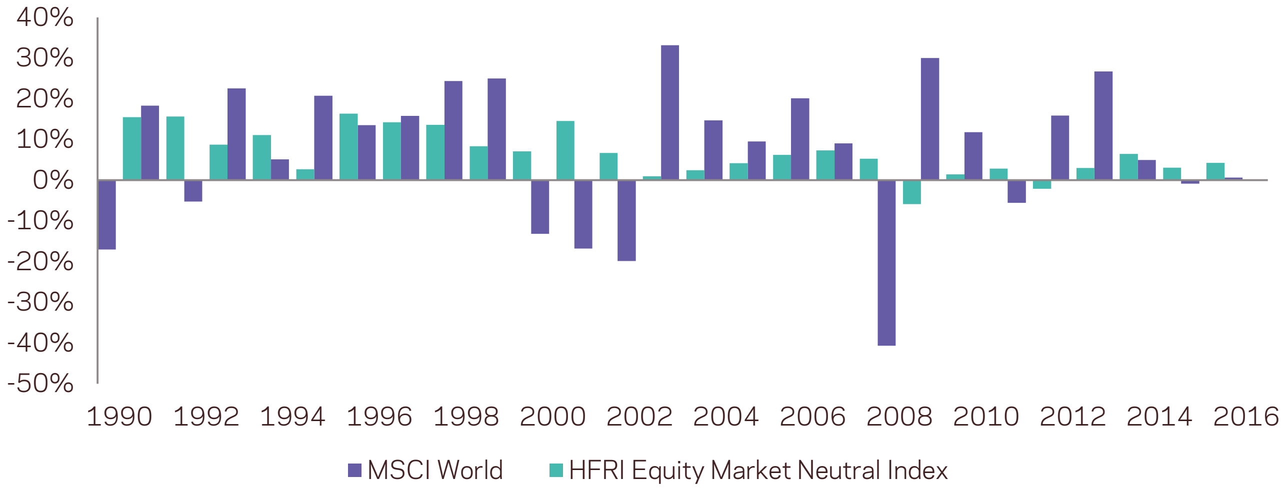
The strategy also targets a long-term average volatility of 6%. Volatility can be defined as a measure of the variation of a financial instrument's price over time, and is frequently used as a measurement of risk within financial products. The 6% long-term average volatility target within the AQR Equity Market Neutral strategy is approximately 60% lower than the realized volatility of global equity markets over the past twenty-five years (which has been approximately 15% annualized).

Equity Market Neutral in a Portfolio

In general, equity market neutral strategies are implemented with the goal of reducing a traditional portfolio's overall risk while improving its risk-adjusted returns.

Investors should realize that "market neutral" does not necessarily mean strong returns when markets are down (neither does it mean weak returns when markets are up!). The goal is for returns to be independent of equity markets over time. As seen in Exhibit 2, there may be times when both equity market neutral strategies and global equities underperform simultaneously. However, over time, the performance of the two should be unrelated.

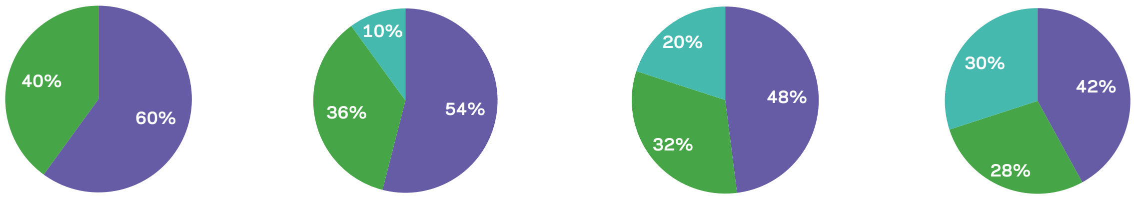
Exhibit 2: Performance of the MSCI World vs. HFRI Equity Market Neutral Index
Jan 1, 1990–Jun 30, 2016



Source: AQR. **Past performance does not guarantee future results.**

The addition of an equity market neutral strategy can have a positive impact on the risk/return characteristics of an overall portfolio. As Exhibit 3 shows, incorporating an equity market neutral strategy into a traditional 60/40 portfolio (consisting of a 60% allocation to global equities and a 40% allocation to global bonds) would have resulted in increased annualized returns, decreased annualized risk, improved drawdowns, and an increase in the portfolio's Sharpe ratio. Sharpe ratio measures how much return a strategy generates per unit of risk (volatility). Strategies with a high Sharpe ratio are considered more efficient because they provide greater return for a given unit of risk.

Exhibit 3: Hypothetical Benefits to a Portfolio
Jan 1, 1990 – Jun 30, 2016



	Global 60/40	+ 10% Equity Market Neutral	+ 20% Equity Market Neutral	+ 30% Equity Market Neutral
Average Return	6.4%	6.5%	6.5%	6.5%
Volatility	9.2%	8.4%	7.6%	6.8%
Sharpe Ratio	0.36	0.40	0.45	0.51
Maximum Drawdown	-34.9%	-32.4%	-29.9%	-27.2%

Source: AQR. Traditional portfolio is a 60/40 portfolio comprised of the MSCI World and the Barclays Capital Global Aggregate Bond index. Average return is calculated geometrically. Equity Market Neutral is the HFRI Equity Market Neutral Index. **Past performance does not guarantee future results.**

AQR seeks to improve the equity market neutral landscape by providing an option for investors that is more transparent, risk-conscious, and that takes advantage of more than 18 years of experience in managing alternative strategies.

About AQR

AQR Capital Management, LLC is a global provider of investment management services. Since 1998, we have managed assets for some of the largest institutional investors in the United States, Europe, Asia and Australia. Our investment offering ranges from market-neutral hedge funds to traditional equity funds. Both our alternative and traditional strategies employ a rigorous research process, managed by the same portfolio teams and implemented using the collective infrastructure of our firm.

AQR Funds were launched in 2009 to provide mutual fund investors access to these alternative and innovative strategies in order to help meet their investment goals.

Disclosures

Foreign investing involves special risks such as currency fluctuations and political uncertainty. The use of derivatives, forward and futures contracts, and commodities exposes the Fund to additional risks including increased volatility, lack of liquidity, and possible losses greater than the Fund's initial investment as well as increased transaction costs. This fund enters into a short sale by selling a security it has borrowed. If the market price of a security increases after the Fund borrows the security, the Fund will suffer a potentially unlimited loss when it replaces the borrowed security at the higher price. Short sales also involve transaction and other costs that will reduce potential Fund gains and increase potential Fund losses. When investing in bonds, yield and share price will vary with changes in interest rates and market conditions. Investors should note that if interest rates rise significantly from current levels, bond total returns will decline and may even turn negative in the short term. There is also a chance that some of the fund's holdings may have their credit rating downgraded or may default.

This Fund is not suitable for all investors. An investor considering the Funds should be able to tolerate potentially wide price fluctuations. The Funds may attempt to increase its income or total return through the use of securities lending, and they may be subject to the possibility of additional loss as a result of this investment technique. Risk allocation and attribution are based on estimated data, and may be subject to change.

Investors should carefully consider the investment objectives, risks, charges and expenses of the Funds before investing. To obtain a prospectus containing this and other important information, please call 1-866-290-2688 or visit www.aqrfunds.com to view or download a prospectus online. Read the prospectus carefully before you invest. There are risks involved with investing including the possible loss of principal. Past performance does not guarantee future results. AQR Funds are distributed by ALPS Distributors, Inc. AQR005387 12-31-2017.

Diversification does not eliminate the risk of losses.

Definitions:

Barclays Capital Global Aggregate Bond Index: a broad-based index used to represent global investment grade bonds being traded in 24 difference local currency markets.

MSCI World Index: a market capitalization weighted index that is designed to measure the equity market performance of developed markets. The MSCI World Index consists of the following 23 developed market indices: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, United Kingdom and the United States.

Sharpe Ratio: a performance measure that takes into account an investment's risk.

Volatility: a measure of variation of a price of a financial instrument over time.

Maximum Drawdown: a measure of the largest single drop from peak to trough in the value of an investment.

One cannot invest directly in an index.

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