Investor Guide

Style Premia Alternative Strategy

Key Ideas

- Alternative strategies seek to provide sources of returns different than those from stock and bond markets
- Style-based alternative strategies are an innovative type of alternative investing
- By incorporating style-based alternative strategies, investors may improve risk-adjusted returns and may mitigate losses during periods of stock and bond turmoil
- Style premia are the expected returns in addition to the risk-free rate (holding cash) for assuming an investment risk

Please read important disclosures at the end of this paper.

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What Are Alternatives?

Alternative investment strategies look beyond buying and holding stocks or bonds to help investors achieve their long-term goals. These strategies — which can include alternative assets like commodities or currencies, or alternative tactics such as taking a position that profits from an asset's decline — are generally more flexible, may offer better diversification and are increasingly accessible to individual investors.

Alternative strategies generally seek to capitalize on opportunities when misperceptions or a lack of information lead markets to over- or undervalue assets. While many traditional managers may try to do the same (for example, a mutual fund that attempts to beat the stock market), they often face constraints that may prevent them from fully capturing opportunities. These constraints may include being limited to investing in just one or a handful of countries, or just one asset class, or they may be unable to take a position against securities that may be overpriced. By contrast, many alternative strategies seek to make money regardless of where opportunities present themselves or whether markets are rising or falling.

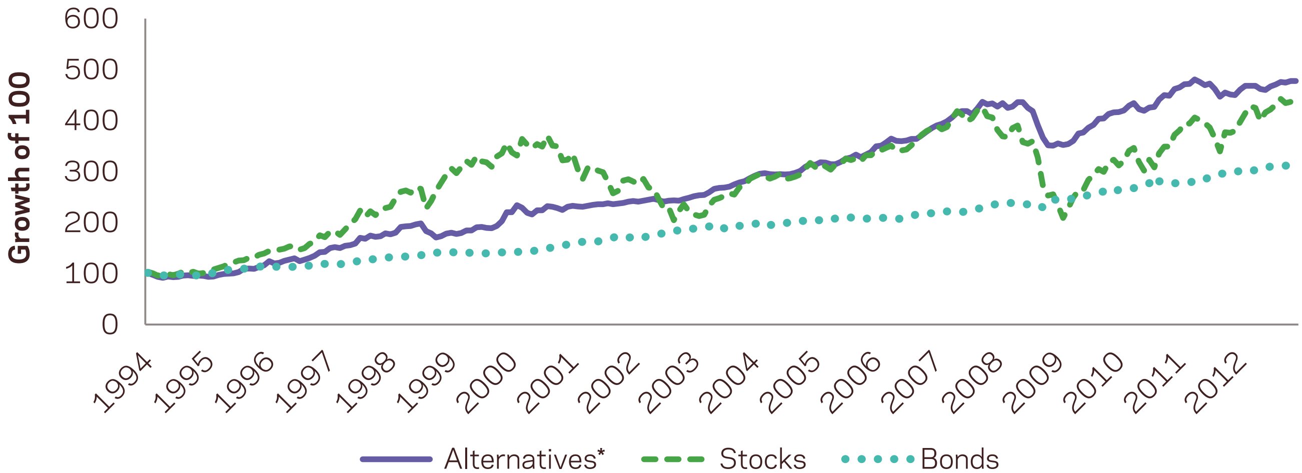
Alternative strategies have two tools they can use to try take advantage of varying market conditions. They can go either "long" or "short." Going long a security is simply buying an asset. Going short a security is selling a borrowed asset with the promise of returning it after buying it in the future (hopefully at a lower price). Most traditional mutual funds can only go long certain assets and cannot go short; this prevents them from seeking to take advantage of down markets.

Benefits of Adding Alternative Strategies

We believe the primary benefit of adding alternative strategies to a traditional 60% stock and 40% bond portfolio is that they can help reduce the portfolio's risk through diversification. To appreciate how diversification can help a portfolio, it is helpful to look at the primary measure of diversification, correlation. Correlation is a number between -1 and +1 that measures how in-sync two different movements are. For example, if bonds make money every time stocks make money (and if both lose money at the same time) then these two assets would have a correlation of +1. If the opposite were true (bonds lose money every time stocks make money, and vice versa), they would have a correlation of -1. A correlation of 0 means that these stocks and bonds behave independently, and there is no consistent relationship between them.

Investing in assets or styles that are very highly correlated is risky because the bad and good times tend to come together. Investing in assets with positive average returns but that are uncorrelated (a correlation near 0 or lower) is good for long-term performance because when certain assets in a portfolio are flat or suffer weak performance, other investments in the portfolio can still perform well. This is one of the primary goals of investing in alternative strategies. Below we show the growth of $100 invested in alternatives, stocks and bonds beginning in January of 1994. As the graph below shows, significant losses in stocks have had smaller effects on alternatives (specifically from 2000 to 2003, and 2008 to 2009).

Exhibit 1 | *Comparison of Growth: Alternatives, Stocks and Bonds (Jan. 1994–Dec. 2012)*
Alternatives Have Been Less Sensitive to Large Stock- and Bond-Market Returns



* Past performance does not guarantee future performance. Alternatives are represented by the Dow Jones Credit Suisse Hedge Fund Index, stocks are represented by the S&P 500 Index, and bonds by the Barclays U.S. Aggregate Bond Index. Sources: Datastream, Dow Jones Credit Suisse, AQR.

What Is the Style Premia Alternative Fund?

Like many other alternatives, the AQR Style Premia Alternative Fund invests long and short across countries and asset classes, seeking to capture alternative returns while trying to hedge out risks of any one market or asset class. The fund will always be long and short stocks, bonds, commodities, currencies and equity indices. What's innovative about this strategy is that it is designed to take advantage of academic "styles" that have been identified through decades of research and rigorous analysis. We believe all of these styles have economic or behavioral intuitions that support their historical success as well as their expected persistence in the future. A style is a systematic investment strategy that has long-term evidence of positive returns in all applicable asset classes and regions. We believe all styles should share four common characteristics; they should be:

- **Persistent** — there is evidence of multidecade positive returns and economic rationale
- **Pervasive** — they have historically made money across countries and asset classes
- **Dynamic** — they have no static exposure to any one market or asset class
- **Explainable** — they have a clearly designed process and strategy

The styles employed in the AQR Style Premia Alternative Fund are Value, Momentum, Carry and Defensive. Each of these styles seeks to generate returns that are independent of the other styles, but they all share the four characteristics above (these styles are described in Exhibit 2). Because they seek to generate returns that are independent, they have historically had low correlations to each other. We expect them to be profitable at different times for different reasons. Thus, a portfolio combining all four of them seeks to benefit from their expected low correlations and could help provide a more-robust, dependable stream of returns.

Exhibit 2 | *Four Major Styles*

Value	The tendency for relatively cheap assets to outperform relatively expensive ones
Momentum	The tendency for an asset's recent relative performance to continue in the near future
Carry	The tendency for higher-yielding assets to provide higher returns than lower-yielding assets
Defensive	The tendency for lower risk and higher-quality assets to generate higher risk-adjusted returns

Source: AQR

Why AQR?

We are among the pioneers in style investing, and in managing alternatives portfolios for mutual fund investors. We have also been managing alternative strategies in private funds for some of the largest institutional investors in the world since 1998. In building a style-based alternative portfolio, we seek to provide investors a collection of academic styles that capture a broad range of market opportunities. Although many other managers categorize themselves as value investors or trend followers, no other provider of investment solutions offers a market-neutral mutual fund that seeks to exploit the positive returns and diversification benefits of all four of these primary academic styles. The goals of the Style Premia Alternative Fund are to provide a strategy that helps to reduce the risk of an investor's total portfolio, enhance returns and provide additional diversification.

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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. AQR 005103 9-30-2016.

Diversification does not eliminate the risk of losses.

Definitions:

S&P 500 Index: a market value weighted index consisting of 500 stocks chosen for market size, liquidity, and industry grouping, and is meant to reflect the risk/return characteristics of the large cap universe.

Barclays Capital Aggregate Bond Index: is a broad-based index used to represent investment grade bonds being traded in the United States.

Dow Jones Credit Suisse Hedge Fund Index: a broadly-used index of hedge fund manager returns, weighted by assets under management.

One cannot invest directly in an index.

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