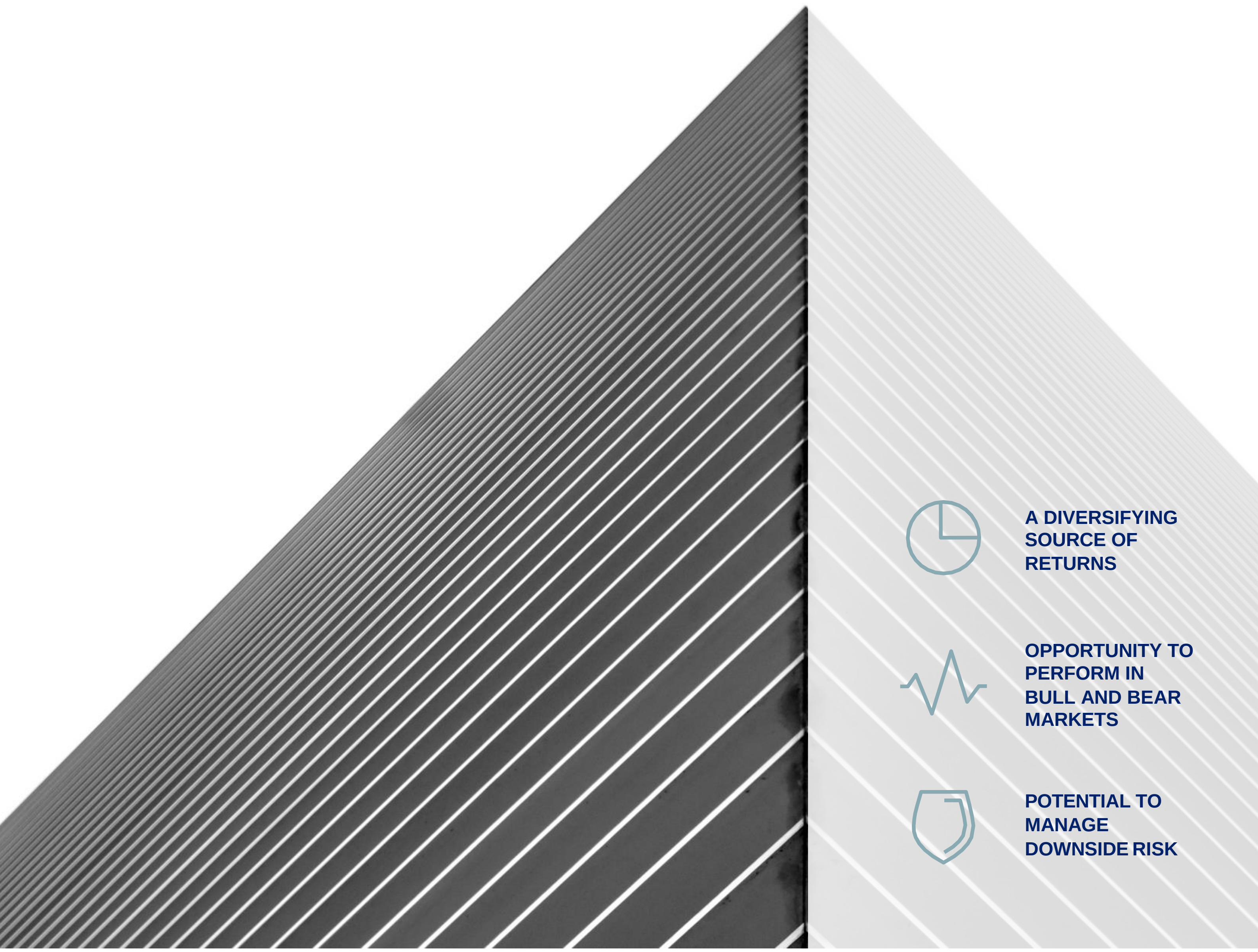
An Investor's Guide

Managed Futures

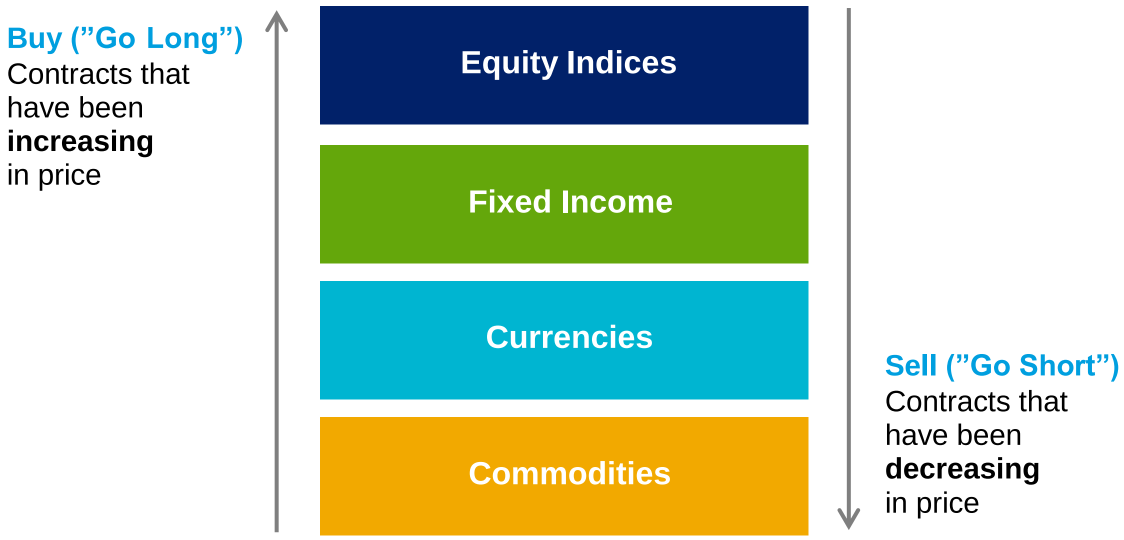


The AQR Investor Guides are designed to help investors develop a clearer understanding of how certain investment strategies work, and how AQR's distinctive approach to managing them may help investors achieve their long-term investment objectives. Please read important disclosures at the end of this paper. For distribution in Australia.

What is Managed Futures?

Managed Futures involves trading futures contracts — agreements to buy or sell a particular asset in the future at a price set in advance. The assets could be equity indices, fixed income, currencies or commodities, all of which are traded on liquid markets around the world. Investors who pursue Managed Futures generally buy ("go long") assets that have been rising in price and sell ("go short") assets that have been falling in price, betting that these trends will continue.

This approach, also referred to as trend following, is not new. Hedge funds and Commodity Trading Advisors (CTAs)[1] have been pursuing trends in futures markets since the 1970s.



Source: AQR. For illustrative purposes only. Past performance is not a reliable indicator of future performance.

Managed Futures relies on a systematic, rules-based process to identify trends as they develop. In doing so, the strategy eliminates human emotion from the decision-making process of when to buy and sell.

[1] A commodity trading advisor (CTA) is an individual or firm who provides individualized advice regarding the buying and selling of futures contracts, options on futures or certain foreign exchange contracts. The CTA registration is required by the National Futures Association, the self-regulatory organization for the industry.

How Does Managed Futures Work?

Managed Futures seeks to capitalize on price trends, or the tendency of markets to move in the same direction (either up or down) for a sustained period of time. There are a number of theories as to why this happens but studies in behavioral finance suggest that certain biases may explain the start and continuation of trends.

The cycle of investor under- and overreaction, depicted on the following page, is what sustains price trends in markets and creates an opportunity for investors who spot them early. Ultimately, trends come to an end as prices tend not to deviate from fair value indefinitely.

Having the flexibility to hold long and short positions enables Managed Futures to potentially benefit from both positive and negative price trends.

Start of Trend

Anchoring: Investors focus too heavily on historical data and underreact to new information, causing prices to move more slowly towards fair value.

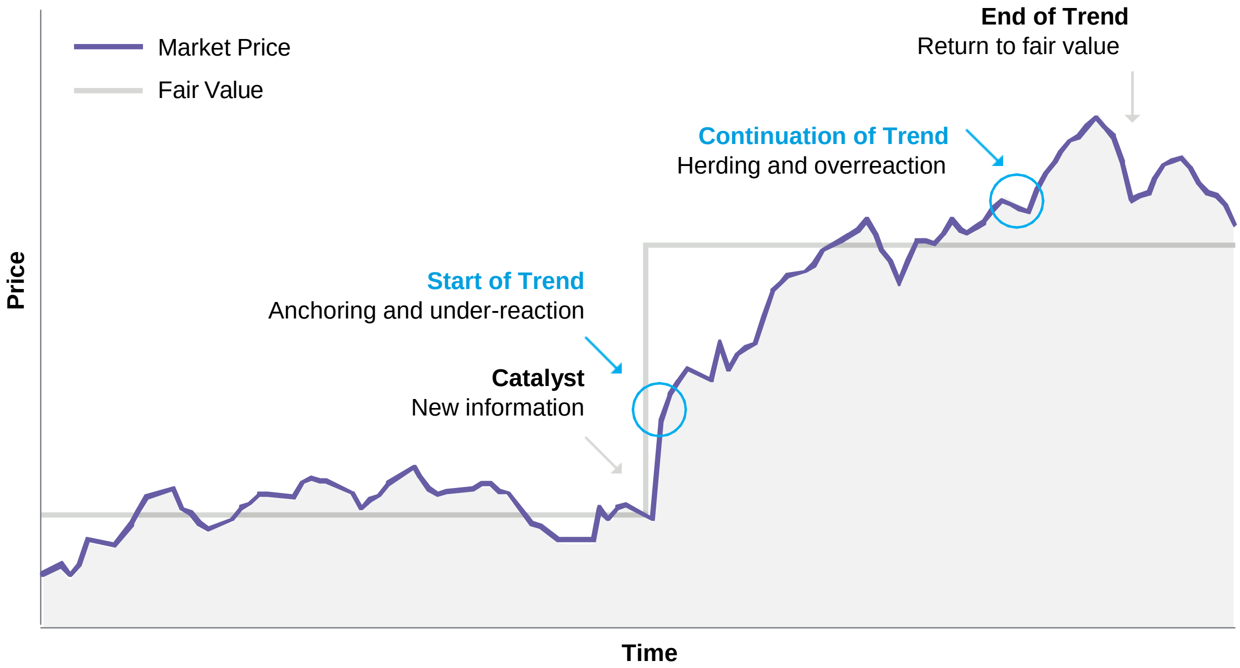
Disposition Effect: Investors may sell winners too early in an attempt to realize gains or may hold onto losers too long in an attempt to avoid losses.

Continuation of Trend

Herding: After prices have trended for a while, some investors jump on the bandwagon, prolonging trends and potentially pushing prices past the point of fair value.

Confirmation Bias: Investors tend to look for information that confirms what they already believe and view recent price moves as representative of the future.

Lifecycle of a Trend



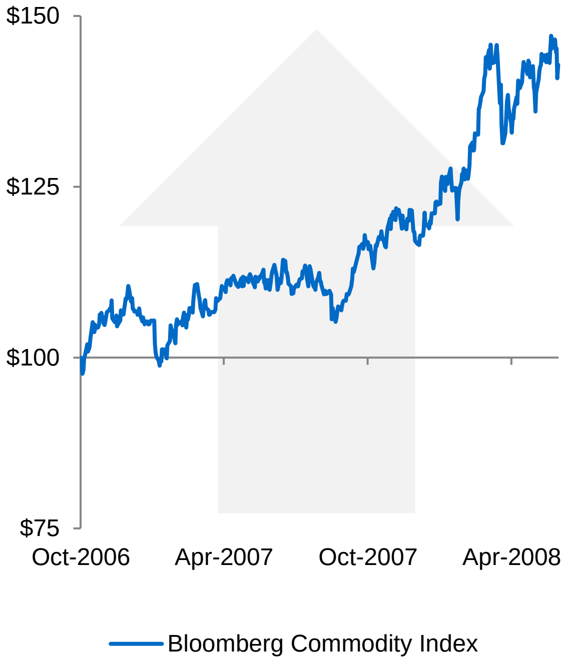
Source: AQR. The chart above is an illustration and not representative of an actual investment.

When Does Managed Futures Work?

Because the strategy relies on the presence of sustained price trends in markets, Managed Futures has historically performed best when markets go from good to great or bad to worse. Below are two examples of favorable environments for Managed Futures; periods marked by steadily rising or falling prices.

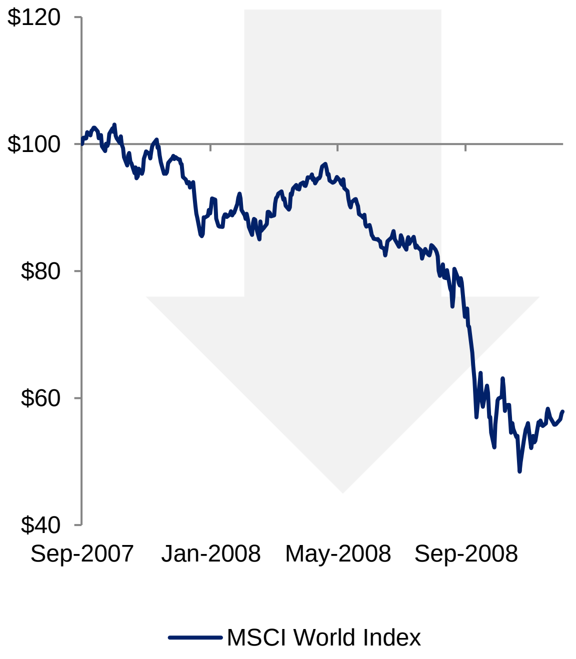
Good-to-Great

Commodity Markets mid-2000s
October 1, 2006 – May 31, 2008



Bad-to-Worse

Global Financial Crisis
September 30, 2007 – December 31, 2008



Source: Bloomberg. For illustrative purposes only. Past performance is not a reliable indicator of future results.

When Does It Struggle?

Conversely, in choppy or range-bound markets, or during trend reversals, Managed Futures tends to struggle. Over the long term, however, Managed Futures has a proven track record of delivering positive returns. What makes it potentially valuable to investors is its tendency to perform well when other asset classes are struggling.

What are the Potential Benefits of Managed Futures?

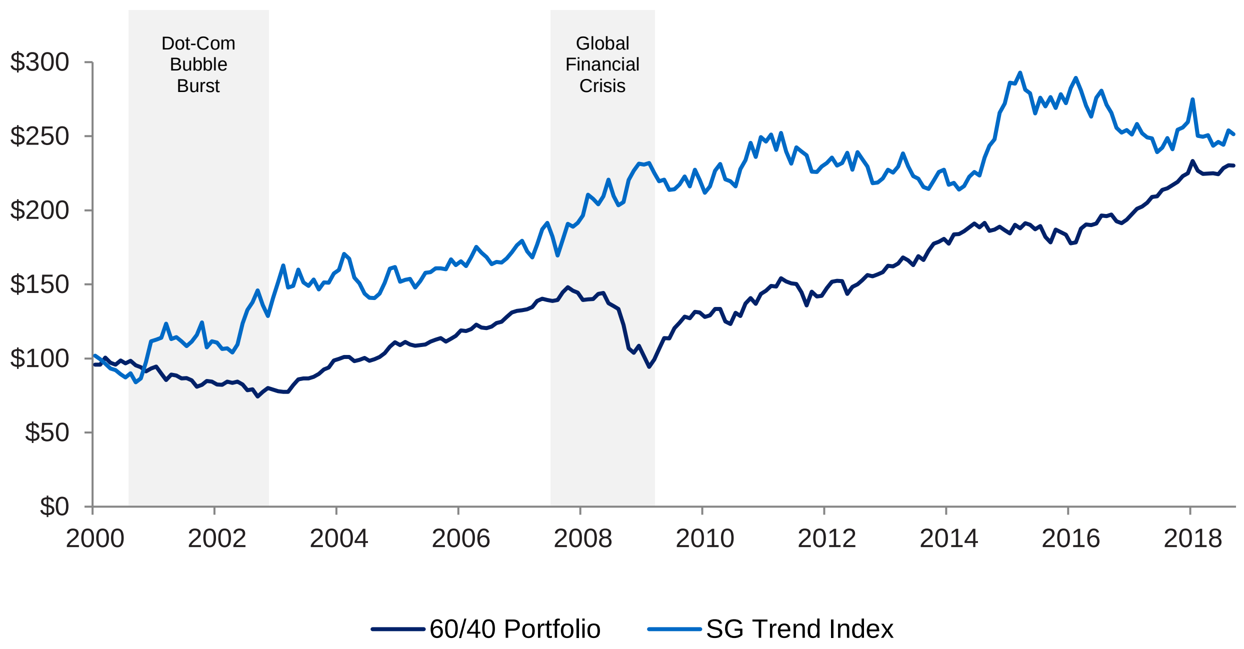
A Diversifying Source of Returns

Many investors' portfolios have traditionally relied on two sources of returns: stocks and bonds. Alternative strategies, such as Managed Futures, provide investors an additional opportunity for positive returns that may come at a time when traditional assets, such as stocks and bonds, are struggling. Adding diversifying sources of returns may help to reduce a portfolio's overall volatility as well as improve returns.

In the chart below, we show the returns of a 60% stock/40% bond portfolio versus the SG Trend Index, which tracks the performance (net of fees) of the ten largest managers of trend-following strategies. While the cumulative returns are similar, what is important to note are the highlighted periods which demonstrate the strategy's historical ability to perform well when stocks and bonds have struggled.

Managed Futures has delivered attractive historical returns

January 1, 2000 – September 30, 2018



Source: Bloomberg, Societe Generale. Inception date of January 1, 2000 is the inception of SG Trend Index. 60/40 Portfolio is 60% MSCI World Index and 40% Bloomberg Barclays Global Aggregate Bond Index, rebalanced monthly. Note: Individual managers in SG Trend Index may have significantly higher or lower levels of volatility and or returns. Past performance is not a reliable indicator of future results. Please read important disclosures at the end of this document.

Opportunity to Perform in Bull and Bear Markets

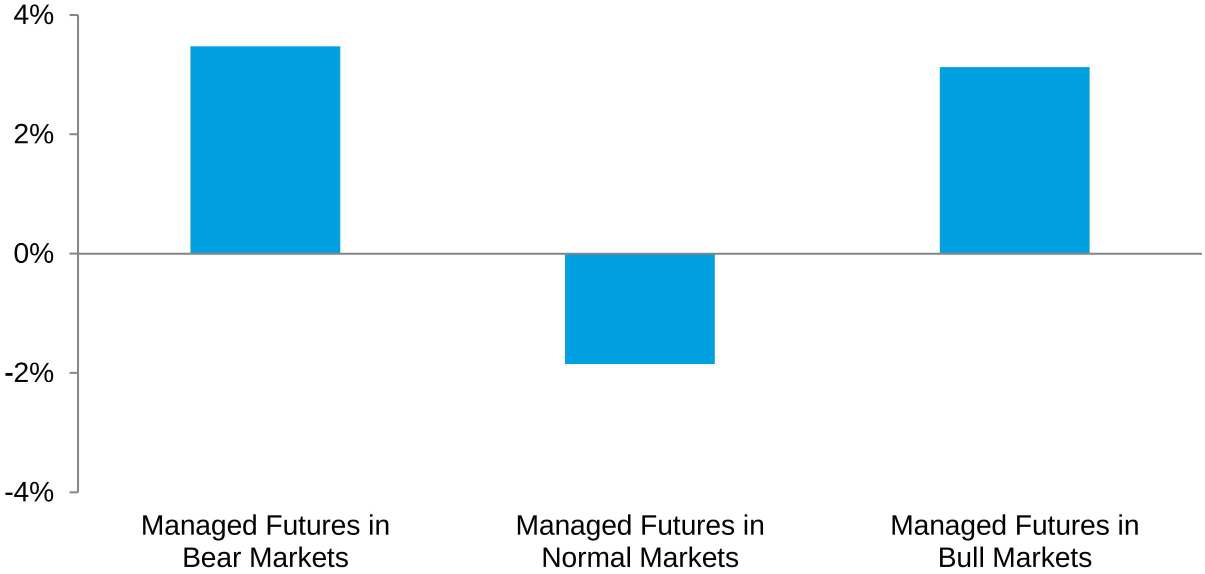
Another compelling attribute of Managed Futures is its tendency to do well in both strong ("bull") and weak ("bear") markets. This is largely explained by the fact that most extreme down or up markets have not happened overnight, but are the result of continued deterioration or improvement in economic conditions.

In prolonged down markets, Managed Futures tends to position itself "short" — that is, the strategy sells assets — as markets begin to decline and seeks to profit if markets continue to fall. Similarly, in sustained up markets, Managed Futures tends to position itself "long" — the strategy buys assets — and aims to profit if the rise continues.

When the returns of Managed Futures are compared to the returns of the global stock market below, the strategy has performed best during extremely strong or weak markets.

Managed Futures has historically performed well in bull and bear markets

Average Quarterly Returns
January 1, 2000 – September 30, 2018



Source: AQR, Bloomberg, Societe Generale. "Managed Futures" is represented by the SG Trend Index. Inception date of January 1, 2000 is the inception of SG Trend Index. Note: Individual managers in SG Trend Index may have significantly higher or lower levels of returns. "Bear Markets" represents the worst 30% of the MSCI World Index's quarterly returns, "Bull Markets" represents the best 30% of quarterly returns, and "Normal Markets" represents the middle 40% of quarterly returns. Past performance is not a reliable indicator of future results. Please read important disclosures at the end of this document.

Potential to Manage Downside Risk

The global financial crisis represents a classic example of how Managed Futures may perform in troubled markets. Going into the fourth quarter of 2008, equity and energy prices had been declining; government bond prices had been rising. This led to Managed Futures being positioned short equities, short energy commodities, and long government bonds. These positions profited as the same trends continued throughout the quarter, while the stock market and other strategies suffered.

On average, Managed Futures has helped when investors needed it the most, during those very difficult equity bear markets.

Managed Futures provided protection during the global financial crisis

October 1, 2008 – December 31, 2008

Source: Bloomberg, Societe Generale. “Managed Futures” is represented by the SG Trend Index. “Global Equities” is represented by the MSCI World Index. Note: Individual managers in SG Trend Index may have significantly higher or lower levels of returns. Please see page 7 for more details on the average performance of Managed Futures during equity bear markets. Past performance is not a reliable indicator of future results.

How Does Managed Futures Fit into a Portfolio?

Investors seek alternative investments — that is, alternatives to buying and holding traditional assets like stocks and bonds — in order to increase the expected return of their portfolios while improving diversification and reducing the magnitude of losses if global markets suffer. We believe Managed Futures has the potential to meet all of these criteria.

Given the strategy’s propensity to be diversifying to traditional assets, Managed Futures should be viewed as a valuable component of a long-term strategic asset allocation. Over time, the strategy may help to improve returns, reduce risk and mitigate the likelihood of large losses for the overall portfolio.

Like any investment strategy, Managed Futures can go through challenging periods of performance. We believe that investors who develop a clear understanding of how the strategy works and the role it’s designed to play in a portfolio will be better positioned to stay invested over the long term and reap the potential diversification benefits when they need it the most.

Source: AQR. Diversification does not eliminate the risk of experiencing investment losses.

About AQR

AQR is a global investment management firm dedicated to delivering results for our clients through an innovative and forward-thinking approach. Our ideas were born in academia, and education has been paramount ever since. Today, approximately half our employees hold advanced degrees.* We maintain ties with top universities, financial leaders and industry influencers around the globe.

As quantitative investors, AQR lives at the nexus of economics, behavioural finance, data and technology – continuously exploring what drives markets and applying our findings in a systematic and disciplined way to our clients' portfolios. Our senior management team has been managing complex hedge fund strategies since the early 1990s. Our innovative approach has one simple purpose: to help our clients succeed through more informed investment decisions.

A pioneer in quantitative investing

A leading provider of alternative strategies

Clients representing some of the largest and most sophisticated investors around the globe

Investment opportunities spanning most asset classes and markets throughout the world

*As of September 30, 2018

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Diversification does not eliminate the risk of experiencing investment losses. PAST PERFORMANCE IS NOT A RELIABLE INDICATOR OF FUTURE PERFORMANCE. 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.

There is a risk of substantial loss associated with trading commodities, futures, options, derivatives and other financial instruments. Before trading, investors should carefully consider their financial position and risk tolerance to determine if the proposed trading style is appropriate. Investors should realize that when trading futures, commodities, options, derivatives and other financial instruments one could lose the full balance of their account. It is also possible to lose more than the initial deposit when trading derivatives or using leverage. All funds committed to such a trading strategy should be purely risk capital.

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.

Foreign investing involves special risks such as currency fluctuations and political uncertainty. 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.

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Bloomberg Barclays Global Aggregate Bond Index: a market-weighted index of global government, government-related agencies, corporate and securitized fixed-income investments

Bloomberg Commodity Index: a broadly diversified commodity price index distributed by Bloomberg Indexes. It tracks 22 commodity futures contracts across seven sectors.

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

SG Trend Index: an index designed to track the 10 largest (by AUM) trend-following CTAs and to be representative of trend-followers in the managed futures space.

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