ALTERNATIVE INVESTING

Introducing the New AQR S.M.O.O.T.H. Fund

February 25, 2019

I do not usually introduce new investment products on this platform, but this is important enough to make an exception (note, for this post it is even more important than usual to read all the footnotes).

The new AQR S.M.O.O.T.H. Fund[1] is simply a superior offering to anything we have done before. It provides the same long-term attractive expected returns as our other offerings, yet at a fraction of the volatility, with very few to no embarrassing losses. For instance, while 2018 was a very painful year for many of our strategies, for many other liquid alternative products in general, and, to some degree, a poor one for virtually all traditional liquid asset classes and most geographies (e.g., long-only stocks and bonds), the S.M.O.O.T.H. Fund would've sailed through largely unscathed.

As with many of our other alternative strategies, it offers attempted low to zero correlation to traditional markets – but in this case we are also offering what we are dubbing "doubly uncorrelated"™© returns. The Fund's actual underlying liquid investments, as we do in most of our alternatives, strive to be uncorrelated to traditional markets (recall we do not think this is true for most hedge funds). But now, due to our new proprietary S.M.O.O.T.H. process,[2] even if we fail to deliver this lack of correlation, the S.M.O.O.T.H. Fund will still report[3] returns mostly unrelated to normal markets. It's next level belt and suspenders type diversification.

Of course, the same long-term returns, but delivered with way more stability, comes at a price (to you). These funds will not be offered at competitive fees, as is our norm, but rather will feature the traditional 2 and 20 fee model. In addition, we may charge some fees based on capital you have not invested with us yet but expect to later. We also might receive some additional fees from the underlying assets themselves (we're still working on how to do that as quants but are optimistic that we can get there). We think this is only fair given how smooth the S.M.O.O.T.H. Fund will be. This Fund will be amazingly easy to stick with, and the long-term should truly be great. That's worth a premium and we don't feel even slightly guilty about it.[4]

In addition, many of AQR's normal liquid alternatives make some use of leverage to hit their return targets (gearing up what we think is an attractive, but too conservative unlevered return). The funds underlying our new S.M.O.O.T.H. offering will do exactly the same thing. But, given the structure and designed opacity, investors will hardly notice! So, besides its masking of difficult to stomach volatility, the S.M.O.O.T.H. Fund also greatly reduces what we're calling "perceived leverage." In turn, this allows us to use even more actual leverage, so we do. It should be a very calming change.

Finally, because I know you care about us, we're working on how to get carried interest treatment on these high performance fees so we can pay the substantially lower tax rate that the world mistakenly still thinks we already pay (recall that managers like us are often believed to be getting this big tax break, but we pretty much don't). We know you understand that this tax cut will allow us to invest more in our business, including new and better smoothing techniques and high-end conferences where we'll bring in relevant speakers like the Dalai Lama and Sting, and permit us to offer the high-end perquisites necessary to attract the best pedigreed portfolio managers (we will not allow this portfolio not to be marked to market by just anyone). It's a win-win (except for the IRS).

OK, if you really want some insights into the world of smoothed returns, and some balanced analysis not just sarcasm and wishful jealousy, I suggest you read this real paper after reading this (hopefully obviously!) satirical one.

---

[1] "Systematic Multi-Operational Optimized Trading Hedged" Fund. Some mistakenly think the "S" stands for "Satirical."

[2] This very much satirical (i.e. non-existent) proprietary process involves implementing our normal hedged liquid alternative process, but only marking to market occasionally, and then reporting some combination of the weighted average of the prior few years' prices, with a healthy weight also given to our own unaudited estimates of what the Fund is likely worth (based on how we think it should've performed).

[3] The astute reader will notice the use of the word "report."

[4] Remember, you get the lack of liquidity and transparency you pay for!