PERSPECTIVE

Risk Parity Derangement Syndrome

February 7, 2018

You may have noticed the market turbulence lately. You may have also noticed the legion of commentators among the media, politicians, and famous investors, blaming this turbulence on “risk parity,” “trend-following strategies,” or my favorite, just “the machines.”

Poppycock. Yes, it’s come to this; they’ve driven me to swear like Mrs. Doubtfire.

To be clear, it’s not unreasonable to think that strategies that target volatility in a long-biased portfolio are likely to sell into the higher market volatility that often coincides with market losses. Nor is it unreasonable to think that strategies that explicitly follow trends are likely to sell into bear markets (that’s kind of obvious). So I guess they get the direction right. But, size matters. To make a statement about this you have to have a vague idea about how many dollars are in such strategies and what they are likely to sell in a down draft. You may notice a conspicuous lack of relevant estimates from the many “machine” haters. This isn’t surprising because the facts show “the machines” can’t possibly be the culprit.

If those blaming “the machines” (sorry, I seem to be compelled to keep using the air quotes) have different numbers and want to debate these findings, let’s do it. That’s always fair game. But if they just want to make accusations with nothing to support them, then they’re just irresponsible yentas throwing shade they can’t back up.

Okay, you may have noticed that I too have not offered anything concrete. Mea culpa. But, I got something up my sleeve: peeps. Well one peep. My partner Michael Mendelson, who, thankfully, is far less belligerent and snarky than me, has been on top of this issue for the last several years and he explains here why risk parity and trend-following strategies are not to blame — and unless someone wants to argue with his views on the actual sizes, which again we’d welcome because legit debate is always great, they should sit on it.

The views and opinions expressed herein are those of the author and do not necessarily reflect the views of AQR Capital Management, LLC, its affiliates or its employees.

This document has been provided to you solely for information purposes and does not constitute an offer or solicitation of an offer or any advice or recommendation to purchase any securities or other financial instruments and may not be construed as such.

The investment strategy and themes discussed herein may be unsuitable for investors depending on their specific investment objectives and financial situation. Diversification does not eliminate the risk of experiencing investment losses.

Please note that changes in the rate of exchange of a currency may affect the value, price or income of an investment adversely.

The factual information set forth herein has been obtained or derived from sources believed by the author and AQR Capital Management, LLC (“AQR”) to be reliable but it is not necessarily all-inclusive and is not guaranteed as to its accuracy and is not to be regarded as a representation or warranty, express or implied, as to the information’s accuracy or completeness, nor should the attached information serve as the basis of any investment decision.

Information contained on third party websites that AQR Capital Management, LLC, (“AQR”) may link to are not reviewed in their entirety for accuracy and AQR assumes no liability for the information contained on these websites.

No part of this material may be reproduced in any form, or referred to in any other publication, without express written permission from AQR.