



AN INVESTOR'S GUIDE

# Defensive Equity



SEEKS MARKET-LIKE  
RETURNS WITH LOWER RISK



SEEKS TO  
OUTPERFORM DURING  
DOWN MARKETS



EXPOSURE TO HIGH  
QUALITY COMPANIES



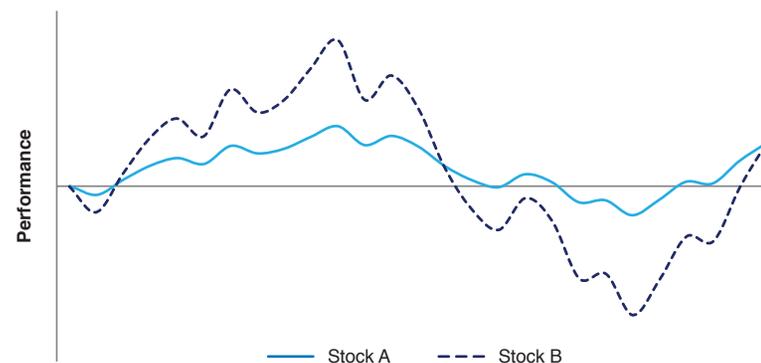
The AQR Investor Guides are designed to help investors develop a clearer understanding of how certain investment strategies work, and how AQR's distinctive approach to managing them may help investors achieve their long-term investment objectives.

## What is Defensive Equity?

Defensive Equity is an investment strategy that seeks to provide returns similar to equity markets, but with less risk. To achieve this, the strategy seeks to invest in stocks that are deemed to be lower-risk versus those that are considered riskier.

In the illustrative example to the right, we compare the performance of two stocks over the same time frame. While both experience periods of similar returns, Stock A exhibits relatively smaller and more gradual movements, making it less volatile (or more defensive) than Stock B.

**Defensive Equity aims to invest in stocks that may offer similar returns to the market but with a smoother, less volatile, ride over time.**



Source: AQR. For illustrative purposes only and not representative of an actual portfolio that AQR manages. **Past performance is not a guarantee of future results.**

# How does Defensive Equity work?

In seeking to achieve its goal of market-like returns with less risk, Defensive Equity invests in stocks that exhibit lower risk characteristics.

Defensive Equity generally prefers high quality companies that can endure smaller stock price fluctuations. There are a number of ways to evaluate whether a stock may be appropriate for a Defensive Equity investment. To the right are some examples of characteristics that these strategies look for in stocks.

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## Defensive Equity seeks companies with:

**Smaller Price Fluctuations**

**Higher Profit Margins**

**Stable Earnings**

**Lower Debt**

**Stronger Credit Quality**

Source: AQR.

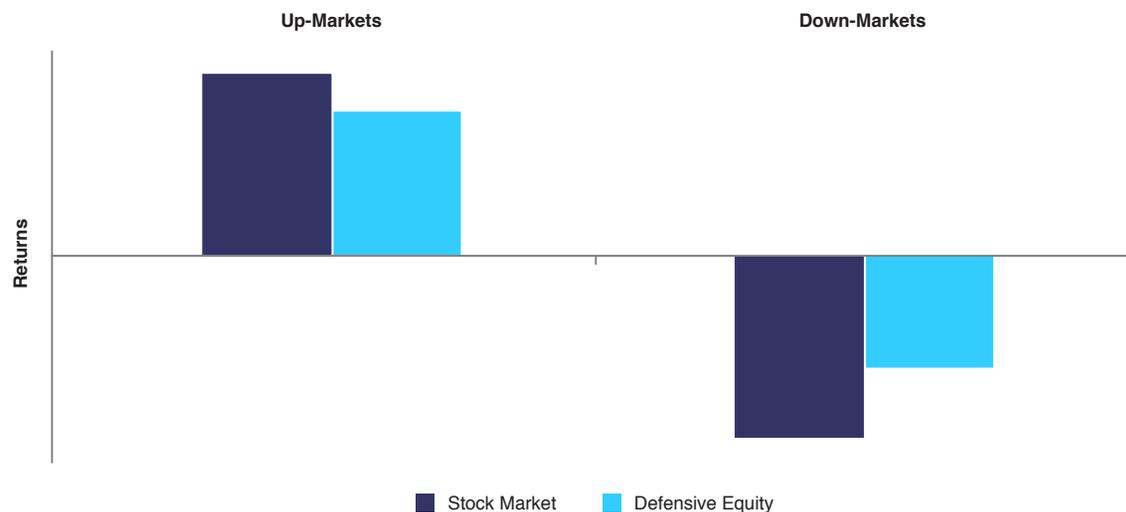
# When does it work?

Defensive Equity strategies can experience positive returns when the stock market is up and smaller losses than the market during downturns.

The potential for Defensive Equity to help mitigate losses during periods of market distress is one of its most compelling characteristics.

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**Defensive Equity seeks to provide much of the upside and less of the downside of equity markets.**



Source: AQR. For illustrative purposes only and not representative of an actual portfolio that AQR manages. "Stock Market" refers to a corresponding capitalization-weighted equity index in the same geographic region.

# When does it struggle?

In down markets, Defensive Equity strategies may experience negative returns, but potentially to a lesser degree than the overall equity market.

In up markets, these strategies may lag market returns because of their lower-risk profile.

Source: AQR. **Past performance is not a guarantee of future results.**

# What are the benefits of Defensive Equity?



## SEEKS MARKET-LIKE RETURNS WITH LOWER RISK

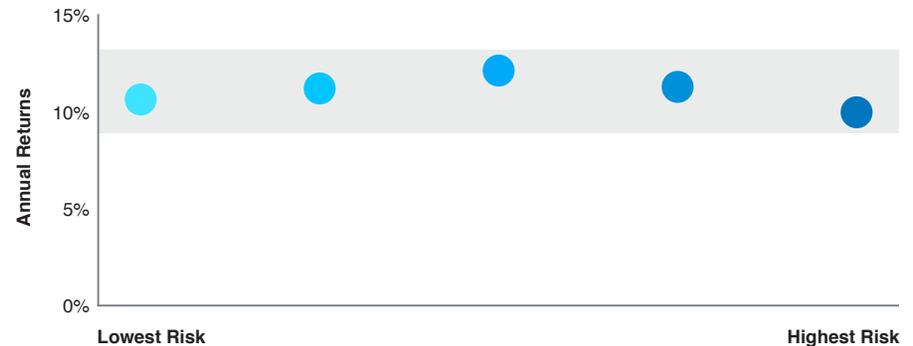
One might assume that there is a tradeoff associated with investing: higher risk should lead to higher returns. However, history has shown that investors have not received enough extra compensation for holding risky stocks relative to less risky ones.<sup>1</sup> This phenomenon is what can enable Defensive Equity strategies to deliver returns similar to traditional benchmarks but with lower volatility.

The chart to the right divides U.S. stocks into five groups from lowest risk (left) to highest risk (right) and compares the returns of each group over nearly a century. Low-risk stocks have performed similarly to riskier stocks over the long-term, suggesting that investors have not had to sacrifice significant returns when reducing risk in their portfolio.

<sup>1</sup> Source: *Betting against beta* (Frazzini and Pederson), 2014.

### U.S. Equities: Low-risk stocks have generated similar returns to riskier stocks over the long term.

April 1, 1927 - December 31, 2023



Source: AQR. From 1926 to 1980, the universe consists of all U.S. common stocks available on the Center for Research in Security Prices (CRSP) database. From 1981 onward, the universe is represented by the Russell 3000 Index, which after its inception in 1981 became a more widely-cited proxy for U.S. stocks. Portfolios are formed by sorting stocks on realized market beta and dividing the stocks into quintile portfolios; returns are excess of cash, as represented by ICE Bank of America ML 3-Month T-Bill Index. Lowest Risk refers to the lowest beta quintile and Highest Risk refers to the highest beta quintile. Quintile portfolio returns are equal-weighted annual returns of the stocks in that portfolio. These are not the returns of an actual portfolio AQR manages and are for illustrative purposes only. **Past performance is not a guarantee of future results.** Please read important disclosures in the back of this document.



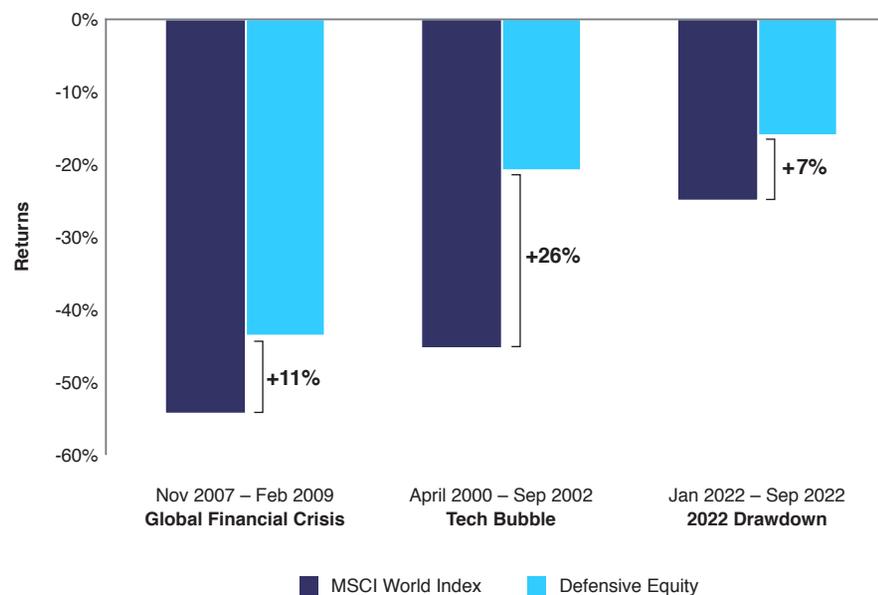
## SEEKS TO OUTPERFORM DURING DOWN MARKETS

In addition to favorable long-term returns, Defensive Equity strategies can provide investors with an attractive risk profile when they may need it most: during market downturns.

The chart to the right shows how Defensive Equity strategies performed during the Global Financial Crisis and other notable equity market drawdowns.<sup>2</sup> In each case, Defensive Equity experienced negative returns, but still fared better than the broader market.

### Defensive Equity has outperformed during the largest stock market drawdowns over the following time period.

June 1, 1988 - December 31, 2022



Source: Defensive Equity is the MSCI World Minimum Volatility Index. Data is not reflective of an actual portfolio that AQR manages. **Past performance is not a guarantee of future performance.** Foreign investing involves special risks such as currency fluctuations and political uncertainty.

<sup>2</sup> Notable equity market drawdowns defined as the three worst drawdowns for the MSCI World Index versus the MSCI World Minimum Volatility Index since June 1988.



## EXPOSURE TO HIGH QUALITY COMPANIES

A more conservative approach to investing in stocks, Defensive Equity portfolios often use a systematic, disciplined process to evaluate companies - relying on sound economic data to achieve consistent, repeatable returns.

**Defensive Equity strategies commonly target stocks of companies that have demonstrated strong fiscal health, exhibiting some or all of the following characteristics:**

- ✓ Stable Businesses
- ✓ High Profitability
- ✓ Low Operating and Financial Leverage
- ✓ Lower Variability in Earnings-Per-Share
- ✓ Other Measures of Quality

Many of these stocks have exhibited less volatility than their equity market counterparts and have the potential to produce higher risk-adjusted returns over a full market cycle than broader market indices.

Source: AQR. "Equity market counterparts" refers to corresponding capitalization-weighted equity indices in the same geographic region.

# How does Defensive Equity fit into a portfolio?

Investors with a long time horizon and low tolerance for capital losses may benefit from exposure to Defensive Equity.

## **Specifically, Defensive Equity could benefit investors looking to:**

- Reduce the overall risk of their equity portfolio while remaining fully invested
- Gain exposure to a diversifying equity strategy
- Potentially mitigate large losses of capital during periods of financial distress

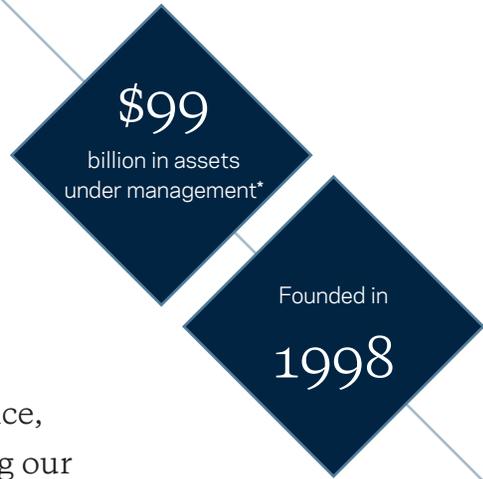
When constructing portfolios, Defensive Equity managers make many design choices that can lead to meaningfully different exposures and results. For example, performance can be impacted by how managers forecast risk, whether they incorporate quality metrics, and if they limit other market risk exposures. These details should play an integral role in any investment decision.

Source: AQR.

# 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, behavioral 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**

\*Data as of December 31, 2023.

## DISCLOSURES

Equity securities are subject to price fluctuations and possible loss of value. Foreign and Emerging Market investing involves special risks such as currency fluctuations and political uncertainty. Funds that emphasize investments in small and mid-cap companies generally will experience greater price volatility. The Adviser from time to time employs various hedging techniques, it is not possible to hedge fully or perfectly against any risk, and hedging entails its own costs.

This Fund seeks long-term capital appreciation. This Fund is not suitable for all investors. An investor considering the Fund should be able to tolerate potentially wide price fluctuations. The Fund 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. An investment in the Fund is subject to risks, including the possibility that the value of the Fund's portfolio holdings may fluctuate in response to events specific to the companies in which the Fund invests, as well as economic, political or social events in the United States or abroad.

There is no guarantee a strategy will achieve its stated objectives. You should not rely on this analysis as the primary basis for your investment, financial, or tax planning decisions. Equity securities are subject to price fluctuations and possible loss of value.

**Beta:** A measure of the amount the fund has tended to move given a move in the specified Index, using three-day overlapping returns. A beta of 1 indicates that if the index has moved 10% over a three-day period, the fund has tended to move, on average, 10% over the same period. A beta of more than 1 indicates the fund has tended to move, on average, more than 10% in that case, and a beta of less than one indicates the fund has tended to move less than 10% in that case.

**CRSP US Total Market Index:** an index comprised of nearly 4,000 constituents across mega, large, small and micro capitalizations, representing nearly 100% of the U.S. investable equity market.

**ICE Bank of America ML 3-Month T-Bill Index:** an index that tracks the performance of the U.S. dollar denominated U.S. Treasury Bills publicly issued in the U.S. domestic market with a remaining term to final maturity of less than 3 months.

**Russell 3000 Index:** a market-capitalization-weighted equity index that provides exposure to the entire U.S. stock market by tracking the performance of the 3,000 largest U.S.-traded stocks.

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

**MSCI World Minimum Volatility Index:** an index that aims to reflect the performance characteristics of a minimum variance strategy applied to the large and mid cap USA equity universe. The index is calculated by optimizing its parent index – the MSCI World Index – for the lowest absolute risk (within a given set of constraints).

**One cannot invest directly in an index.**

**Investors should carefully consider the investment objectives, risks, charges and expenses of the funds before investing. To obtain a prospectus or summary prospectus containing this and other important information, please call 1-866-290-2688 or visit [www.aqrfunds.com](http://www.aqrfunds.com) to view or download a prospectus or summary prospectus online. Read the prospectus or summary prospectus carefully before you invest. There are risks involved with investing including the possible loss of principal. Past performance does not guarantee future results.**

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