



AQR Risk-Balanced Commodities Strategy Fund

Fourth Quarter 2013 Commentary

January 2014

Performance Summary

	Total Returns as of Quarter-End 12/31/13					
	4Q 2013	YTD	1 YR	Annualized		Since Inception (7/9/2012)
3YR				5YR		
ARCNX	-2.48%	-16.23%	-16.23%			-12.12%
ARCIX	-2.36%	-16.01%	-16.01%			-11.91%
DJ-UBS Commodity Index	-1.05%	-9.52%	-9.52%			-6.77%
ARCNX Gross/Net Expense Ratio: 4.20% / 1.50%				ARCIX Gross/Net Expense Ratio: 1.92% / 1.25%		

Performance data shown represents past performance and is not a guarantee of future results. Investment returns and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. Call 1-866-290-2688 or visit www.aqrfunds.com for current month-end performance.

Fund Overview

The Fund pursues an active approach to commodities investment, aiming to outperform standard commodity future indices through greater risk diversification, risk controls, and active commodity selection. The Fund invests in twenty-four commodity futures across six sectors: energies, base and precious metals, agricultural products, softs, and livestock.

We pursue a risk-balanced approach to build a diversified portfolio where all assets matter, but no one commodity sector dominates returns. Risk-balancing involves allocating investments by risk, which means that we attempt to avoid significantly overweighting any particular sector, such as energies. In addition, commodity sectors which have lower risk will generally be allocated more capital than sectors which are deemed riskier.

In addition to balancing risk across sectors, the portfolio is dynamically adjusted through time as market conditions change in an attempt to keep the overall portfolio volatility steady through time. The Fund also incorporates a systematic drawdown control process that will reduce the portfolio's target risk level and total exposures in adverse market environments. We believe that greater diversification and portfolio-wide risk



controls can lead to more consistent volatility reduce tail risk associated with this volatile asset class, and help the investor to remain invested through more difficult market environments.

We utilize AQR's proprietary macroeconomic, fundamental, and technical views in a systematic way to overlay the portfolio with over- and under-weights based on those views. The ultimate goal is to build a commodities portfolio that in the long run will deliver higher returns at a risk level similar to traditional indices by combining a better strategic allocation overlaid with tactical tilts.

The Fund is allowed to go both long and short in any given commodity, but will maintain a net long position across the portfolio. The investment process leads to an average beta to the Dow-Jones UBS Commodity Index around 1.0, although the portfolio will typically have lower beta in high volatility environments and a higher beta in low volatility environments. Our tactical over- and under-weights around the risk-balanced framework use the same forecasting models used in our global macro hedge funds and include signals based on price trends, the shape of each commodity's futures curve, inventory, macroeconomic variables, and many other indicators. The annualized target volatility for the portfolio averages 18%. This target varies modestly over time, increasing a bit when we are generally bullish on commodities and decreasing when we are less optimistic.

Performance Commentary

The Fund's class I shares returned -2.4% for the fourth quarter, as commodities sharply declined across several sectors. Precious metals, in particular, experienced a continuation of the historic sell-off earlier in the year, as gold and silver fell by -9.4% and -10.9%, respectively, driven by the Fed's decision to taper stimulative bond purchases. Agricultural commodities also depreciated on average throughout the fourth quarter (Q4), particularly corn and wheat. Global supply outlook was extremely bearish for both grains on expectations of a record setting harvest. Soybeans and soybean meal, on the other hand, appreciated on reports of increasing US demand. Base metals were mixed but appreciated on average, driven by stronger US economic data. While oil and oil products in general were buoyed by stronger global economic data, WTI crude was the exception, dropping on record US production and rising stockpiles. Natural gas was the strongest performing energy in Q4, appreciating 9.4% on extreme cold weather throughout the country, which boosted heating demand. In Q4, precious was the most significant sector, detracting -1.3% from the portfolio. Base metals detracted -0.2%, energies +0.8%, grains -0.9%, softs -0.8%, and livestock -0.1%.

While the Fund declined -2.4% for the fourth quarter, the Dow Jones-UBS Commodity Index declined -1.1%. Although we do expect the Fund to outperform traditional passive indices over a full market cycle, in any given quarter we expect the Fund to average a sizable tracking error of about 5% per quarter (or 10% annualized) to its benchmark. Given this, the underperformance of -1.3% during Q4, while disappointing, is within the expected range. This brings our since inception (7/9/2012) underperformance to -7.3%. This also is not abnormally high given an expected annual tracking error of 10% to the benchmark.

The underperformance relative to the passive DJ-UBS benchmark was due to a number of fund features. The fund maintained an average net exposure of greater than 100% during Q4 in order to target steady volatility, subject to our drawdown control process. Particularly early in the quarter, the Fund held much greater than 100% notional exposure as commodities fell sharply on global growth concerns and speculation of Fed tapering. Another source of underperformance was the fund's risk-balanced strategic allocation, which is more exposed to precious metals and less exposed to energies than the passive benchmark. Since precious metals underperformed while energies outperformed the complex, our sector allocation tilts resulted in underperformance. The tactical models helped mitigate the strategic losses and relative underperformance, with gains coming primarily from our bearish views on precious metals.

The Fund began the quarter at a low volatility target of 12.6%, reflecting both tactically bearish views and a lowered strategic risk target due to our drawdown control process. After the sharp sell-off during October, the drawdown control process reduced risk further. The strategic risk target is 11.4% at quarter-end, reflecting the drawdown control in addition to our bearish tactical positions.



Moving to return attribution, the strategic portion of the portfolio returned -3.4% while tactical tilts added +1.1%. The strategic return in this attribution is the return to a long-only portfolio with risk-balanced sector weights and a volatility target of 18% annualized (subject to drawdown control). The tactical returns are the active returns to commodity over- and underweights relative to this strategic portfolio.

The main contributor to tactical performance was an underweight to precious metals. Precious metals looked overvalued on a long term basis and had been trending downward on multiple horizons. As a result, precious metals looked unattractive both directionally and relative to other commodity sectors, which drove our large under-weight. This underweight helped mitigate losses as trends continued and precious metals fell throughout Q4.

At quarter end, the Fund's tactical positioning reflected bearish views on commodities as a whole due to technical weakness. Within energies, we prefer brent crude relative to WTI crude, mostly due to the difference in curve shape. As of quarter-end, the brent futures curve was more backwardated (futures with later expiry were cheaper), reflecting tightness in the global oil market and providing a positive roll yield, while the front of the WTI futures curve was in contango (futures with later expiry are more expensive), reflecting a glut of inventory in the U.S. and providing a negative roll yield. Within precious metals, we prefer silver to gold due to differing seasonal demand patterns. Within the grains commodities, we are bullish corn relative to the wheat, mostly on risk premia and long-term valuation signals. At the sector level, we are underweight precious metals and overweight energies, driven by a combination of valuation, momentum, and risk-premia signals.

The Fund finished Q4 with unfortunately poor relative and absolute returns. However, while short term results can be noisy, in the long term we believe the Fund's broader diversification, strong risk management, and active commodity selection will ultimately deliver more steady volatility and strong returns across market environments. We appreciate your investment.



Definitions

Beta: A measure of systematic risk of a security or portfolio. A beta of 1 indicates that if the index moves 10%, the fund is expected to move, on average, 10% over the same period. A beta of more than 1 indicates the fund is expected to move, on average, more than 10% in that case, and a beta of less than one indicates the fund is expected to move less than 10% in that case.

Dow Jones-UBS Commodity Index: a broad-based index used to represent the most frequently-traded global commodity futures.

Risk Premium: Expected excess returns earned for taking financial risk. In the case of commodities, a risk premium might be earned by speculators who allow commercial commodity market participants to hedge their price risk.

Roll Yield: The difference in price between futures that are closer to expiration vs futures that are farther from expiration. Roll Yield represents the difference between percentage changes in the underlying commodity price and the return from holding long futures in that commodity and rolling to the next contract before expiration.

Tail Risk: The risk of larger or more frequent losses than would be expected if returns to an asset or portfolio followed a normal distribution.

Volatility: A statistical measure of the variation in returns for a given security or index.

This Fund is not suitable for all investors. 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. Actual or realized volatility can and will differ from the forecasted or target volatility described above.

As of today, the most current holdings are as of 12/31/13. For the top ten holdings for the AQR Risk-Balanced Commodities Strategy Fund and a complete list of all AQR Funds holdings please visit:

http://www.aqrfunds.com/Reference_Materials/Prospectus_and_Fund_Information/Content/default.fs

Holdings are subject to change.

Past performance does not guarantee future results.

This material must be accompanied or preceded by the prospectus. [Click here for AQR prospectuses.](#)

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