



# AQR International Equity Fund - Class N/I

## Fourth Quarter 2013 Commentary

January 2014

### Performance Summary

Total Returns as of Quarter-End 12/31/13

	4Q 2013	YTD	1 YR	Annualized		
				3YR	5YR	Since Inception (7/31/2004)
AQINX	6.76%	23.44%	23.44%	8.59%	14.03%	7.16%
AQIIX	6.86%	23.97%	23.97%	8.99%	14.38%	7.51%
MSCI EAFE Index	5.71%	22.78%	22.78%	8.17%	12.44%	7.22%
AQINX Gross/Net Expense Ratio: 1.30%/1.30%				AQIIX Gross/Net Expense Ratio: 0.93%/0.93%		

*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](http://www.aqrfunds.com) for current month-end performance.*

### Overview

It was another strong quarter for international equity markets, with the MSCI EAFE Index returning 5.71% in the fourth quarter. The AQR International Equity Fund Class I/N shares returned 6.86%/6.76% for the quarter, outperforming their benchmark index by 1.10%/1.05%.

Developed equity markets rallied in the fourth quarter, with almost every country in the MSCI EAFE index showing positive returns in local currency terms. Economic conditions in Europe continued to improve at a moderate pace. Spain announced its first positive quarter of growth in 2 years, while Germany also showed improved economic growth. Outside of the eurozone, growth in the UK continued to be strong. The European Central Bank reacted to low inflation in Europe by easing monetary policy, which was also supportive of equity prices.

In contrast to improving growth in Europe, economic growth lagged expectations in Australia. The Reserve Bank of Australia placed partial blame for the slowdown on the recent strength of the Australian dollar, and was able to successfully talk the currency lower over the quarter.



Japan continued its year-long trend of a stronger equity market and a weaker currency driven primarily by easy monetary policy. During the fourth quarter, Bank of Japan governor Kuroda re-emphasized the bank's commitment to easy monetary policy, including a pledge to keep monetary stimulus in place until inflation stabilized around its 2% target.

## Performance Commentary

The **stock selection strategies** outperformed the benchmark in the fourth quarter of 2013, led mainly by strong returns in Europe. Returns in Japan and other regions also contributed positively to performance, though to a lesser extent.

In Europe, positive returns from momentum, both across and within industries, were only partly offset by slightly negative returns from our stability signals. Outperformance in Japan was mainly driven by our industry-relative valuation and investor sentiment signals, while industry-relative momentum signals in the region detracted from returns throughout the quarter.

Industry selection for the overall fund was flat this quarter. Gains from a net underweight position in materials were offset by losses from a net overweight position to industrials. On the other hand, our industry-relative bets for the overall strategy performed well this quarter, driven by positive returns in the industrials and consumer discretionary sectors.

Tactically, we are underweight value in Europe due to tighter than normal value spreads. Conversely, in Japan we have a modest overweight to value.

The **country selection strategy** contributed positively to fund performance in the fourth quarter. Value signals performed well, while and momentum signals were flat.

Our overweight position in Japan was the largest contributor to excess returns in the fourth quarter, as Japanese equities continued their year-long strong performance. Bank of Japan governor Kuroda re-emphasized the bank's commitment to easy monetary policy, including a pledge to keep monetary stimulus in place until inflation stabilized around its 2% target. Our underweight position in Australian equities and overweight position in German equities also contributed positively. Australian equities had positive returns over the quarter, but trailed the average developed equity market return due to sluggish economic growth. German equities rallied due to modestly improving economic growth and easier monetary policy from the European Central Bank.

Our overweight position in Hong Kong was the largest detractor over the quarter. Hong Kong equities finished the quarter with a positive return, but lagged the average developed equity market, which caused our overweight position to detract from performance.

Our largest overweight position continues to be Japan, due to supportive price momentum and improving economic fundamentals. We are also overweight equity markets in Germany, because of attractive valuations and strong price momentum, and Hong Kong, which is attractively valued. We are underweight equity markets in Australia, Switzerland and Sweden, as all three markets appear expensive.

The **currency selection strategy** detracted modestly from performance in the fourth quarter. Momentum signals contributed positively, value signals had muted performance, and carry signals detracted. The largest contributor in the fourth quarter was our overweight position in the euro. The euro rallied despite a cut in interest rates by the European Central Bank, as strong growth allowed the currency to overcome the headwind of easier monetary policy.

The largest detractor from performance in the fourth quarter was our overweight position in the Japanese yen. As described above, the Bank of Japan reiterated its commitment to accommodative monetary policy, which caused the yen to continue its year-long decline. Our underweight position in the British pound also detracted, as the pound rallied on better economic growth.



As of the end of the quarter, we are overweight the euro due to attractive valuations, supportive price momentum and improving fundamentals. We are also overweight the Japanese yen due to interest-rate-related signals, positive sentiment and attractive valuation. Our largest underweights are in the British pound and Australian dollar. We are underweight the pound due to interest-rate-related signals and expensive valuation, and underweight the Australian dollar on poor price and fundamental momentum.



## Definitions

**Carry:** The difference between the yield earned from holding a financial instrument and the cost of financing. Positive carry means that the yield (in the form of interest, dividends, etc.) is greater than the financing cost; negative carry means that the financing cost exceeds the yield.

**Momentum:** An asset is deemed to have positive momentum if it has performed well in the past relative to other assets in the same universe.

**Valuation:** A measure of whether an asset or company is cheap or expensive compared to similar companies.

**MSCI EAFE Index** (Europe, Australasia, Far East): a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada. One cannot invest directly in an index.

The Fund uses derivatives to manage its country and currency exposures. The use of derivatives 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. Foreign investing involves special risks such as currency fluctuations and political uncertainty. The Fund is not suitable for all investors.

An investment in any of the AQR Funds involves risk, including loss of principal. The value of the Funds' 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. Please refer to the prospectus for complete information regarding all risks associated with the Funds.

An investor considering the Funds should be able to tolerate potentially wide price fluctuations. The funds are subject to high portfolio turnover risk as a result of frequent trading, and thus, will incur a higher level of brokerage fees and commissions, and cause a higher level of tax liability to shareholders in the funds. 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.

A privately offered fund managed by the Adviser was reorganized into the Fund on August 28, 2009, the date the Fund commenced operations. This privately offered fund was organized in June 2004 and commenced operations in August 2004 and had an investment objective, investment policies and restrictions that were, in all material respects, the same as those of the Fund. However, the privately offered fund was not registered as an investment company under the 1940 Act. In addition, this privately offered fund was not subject to certain investment limitations; diversification requirements, liquidity requirements, and other restrictions imposed by the 1940 Act and the Code which, if applicable, might have adversely affected its performance. The Fund's performance for periods prior to the commencement of operations on or about August 28, 2009 is that of the privately offered fund.

**An investor should consider the investment objectives, risks, charges and expenses of the Fund carefully before investing. To obtain a prospectus containing this and other information, please call 1-866-290-2688 or download the file from [www.aqrfunds.com](http://www.aqrfunds.com). Read the prospectus carefully before you invest. There is no assurance the stated objective(s) will be met.**