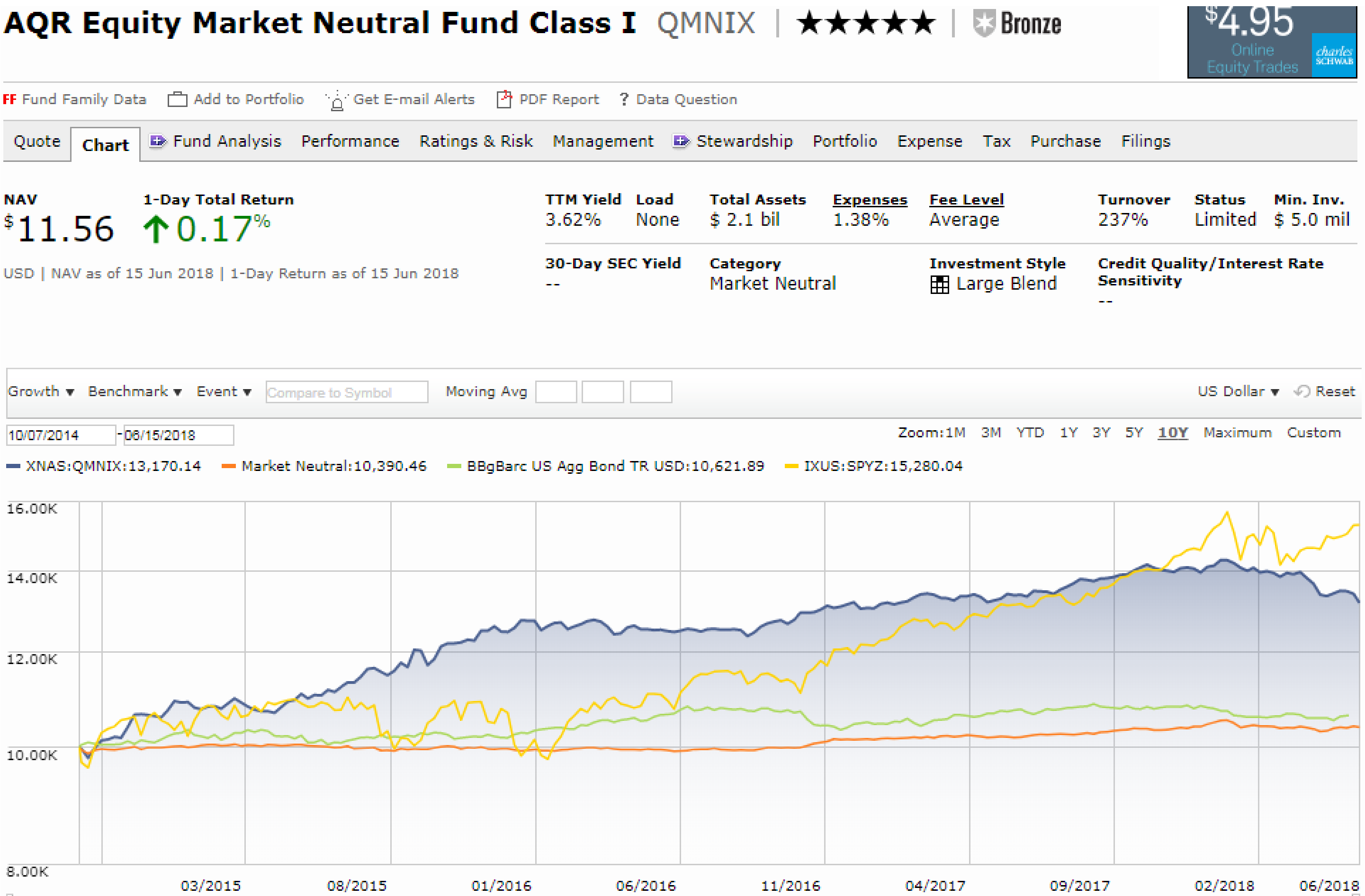
Has QMNIX Hit The Fan?

Yesterday we received a call from the first client that HCM lost. (Yes, there has been a 2nd, but in that case we got the better half in a divorce.) He decided to become a DIYer. At the time we wrote a Worth Sharing titled, "Another DIYer" in which we asked "**When the SHTF, and it will, who you gonna call?"** We knew the answer at the time, but what we didn't anticipate was that the call would concern QMNIX. We have added the S&P 500 (yellow line) to Morningstar's chart, which includes QMNIX's peers (orange line) and benchmark (green line):



There is a mountain of expertise in the Quant world, and AQR stands at the peak. As Morningstar's analyst notes, "The leadership team has close ties to academia. In fact, 11 of the firm's 26 principals have doctorate degrees, and five are current or former professors." On 9/1/17 she wrote:

"AQR conducts rigorous research into the sources of long-term investment performance. AQR Equity Market Neutral seeks to generate returns via a systematic stock-selection process that harnesses the output of this research. This well-designed process has manifested itself in a strong, albeit short, track record. The fund earns an initial Morningstar Rating of Bronze.

The stock-selection process employs a quantitative model to rank stocks from the MSCI World Index using well-established factors such as value and momentum and less quantifiable factors such as investor sentiment, which may use a metric (among others) such as change in percentage of shares shorted. High-ranking stocks are held in a long portfolio, low-ranking stocks are sold short, and the portfolio is structured to be market-neutral with no sector or country bets.

Since the fund's October 2014 inception through July 2017, its annualized gain of 10.8% trounced the market-neutral Morningstar Category average's 1.1% return. However, the fund's benchmark--three-month Treasuries--suggests that AQR's return expectations are much more modest relative to recent performance. Indeed, much of the fund's outperformance since its launch occurred in 2015, when it had a much smaller asset base and held more concentrated portfolios relative to current positioning. Outperformance has moderated, but the fund continues to outshine its category peers. As an indication of the fund's capacity constraints, AQR closed this fund to new investors in June 2017 when assets under management for this fund and AQR Long-Short Equity QLEIX, which employs the same stock-selection process, was $5.9 billion.

Investors here face a few risks: The stock-selection model may become less effective as computing power and big data become more pervasive. ...

But overall, this fund is a solid liquid alternative option for those who have access to it."

QMNIX			
1/26/18	12.57	11/3/15	10.68
6/14/18	11.54	2/11/16	11.09
	-8.2%		3.8%
	0.8		-0.3

So how has an OEF, with a Beta of 0, dropped 8.2% in the current correction relative to the S&P 500's Maximum Drawdown to date of 10.2%, as shown in our Maximum Drawdown calculations? Note that during the S&P 500's previous correction from 11/3/15 to 2/11/16, QMNIX actually gained 3.8%. We spoke to AQR's Jake Ashley, Vice President and Regional Director, yesterday. While he is sending us the monthly attribution reports, his "Executive Summary", U.S. Value Stocks, both long and short, have underperformed. As Patrick O'Shaugnessy has noted, **"Being a value investor in the F.A.N.G. era is no fun at all."** So is the Value Factor broken? We will address that question in our next Worth Sharing.