ABR Dynamic Funds – 1Q 2025 Newsletter

Financial Media Fear Mongering (And, Most Importantly, Why It Matters)

"Nothing in life is as important as you think it is, while you are thinking about it." – Daniel Kahneman

Introduction

Dodging the "risk" in risk premiums likely also means dodging the "premiums." Why are investors so interested in dodging the risk? Of course, human nature is a big part of the answer, but the fear mongering from the financial media contributes to it – typically in three parts:

1. Spot something in the market that looks a little unusual.
    a. It's not without precedent. Markets have survived it in the past.

2. Slather on a thick layer of ominous buzzwords.
    a. Include little, if any, analysis. Just overwhelm the reader.

3. Nod gravely at the fact that the future is risky.
    a. **The future is always risky! That's the source of risk premiums.** It's likely why investors stand to win in the long term.

But that's rarely what the reader takes away from the article. And that brings us to the "why it matters" focus of this note – in two parts.

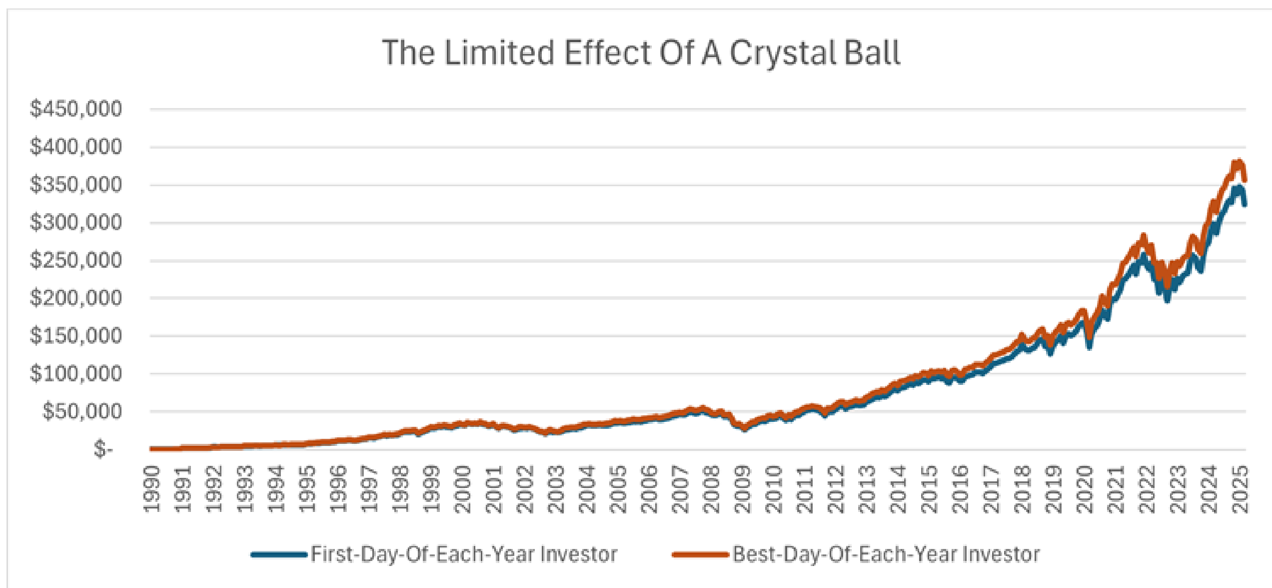
Why It Matters – Part 1

The fear mongering may paralyze investors. Who hasn't heard "let's wait and see how it plays out" or "maybe we'll get a better entry point soon"? But should investors try to time their entry into long-term investments?

We think the effort is likely to be counterproductive at worst and probably just a waste of time at best. To illustrate why, consider the following graph, which compares two fictional investors:

- "First-Day-Of-Each-Year Investor"
    - Invested $1,000 into the S&P 500 Index on the first day of every year since 1990.

- "Best-Day-Of-Each-Year Investor"
    - Also invested $1,000 into the S&P 500 once each year but on the *exact day* of the lowest S&P 500 price for each entire year.



Like everyone else, we would prefer the slightly higher value, but that modest difference is the maximum possible cumulative benefit, over 35+ years, of a flawless crystal ball.

An imperfect, emotional human may do worse than either investor shown above. Or, as many have said before us, **time in** an investment beats **timing** an investment.

Why It Matters – Part 2

After the fear mongering, the next article in most news feeds is often a "solution," equity-like returns with a buffer, hedge, or income. Many, including ABR, have written about these gimmicks. This time, we'll just show one chart from a recent post by AQR's Cliff Asness and Daniel Villalon, called "Rebuffed: A Closer Look at Options-Based Strategies."

They compared each fund to passive equity exposure that matched its beta (plus US Tbills for the remainder) and then sorted the funds into 4 outcomes. The outcomes are better or worse returns paired with bigger or smaller maximum drawdowns. The result?

- **Only 5% of the funds delivered higher returns with smaller maximum drawdowns.**
- **A dismal 72% of them muddled through lower returns and bigger maximum drawdowns.**

AQR concluded: **"To be blunt, these "buffered funds" are a marketing success, a success for the managers selling them, and a failure for investors lured in by the overpromise of magical equity returns without equity risk and then overcharged for the pleasure."**

Exhibit 3: Hypothetical Comparison to Passive Equity + Cash Mix

January 1, 2020 – January 31, 2025

Drawdown Compared to Simple Stocks+Cash	Cumulative Return Compared to Simple Stocks+Cash: Worse	Cumulative Return Compared to Simple Stocks+Cash: Better
Better	14%	5%
Worse	72%	9%

Source: AQR, Morningstar. The universe used is all funds in the Morningstar Equity Hedged (Global Category Options Trading), Defined Outcome, or Derivative Income categories with returns available from January 1, 2020, to January 31, 2025. There are 99 funds meeting these criteria as of January 31, 2025. For each fund, we construct a benchmark strategy that matches the fund's passive equity exposure by investing in the S&P 500 with the fund's realized equity beta (over the period) as the portfolio weight, and the remaining weight (1 – equity beta) into US 3M T-Bills. "Better" and "Worse" indicate each fund's performance in the either metric (total cumulative return or worst drawdown over the period) relative to its beta-matched benchmark strategy. Chart shows percent of funds in the universe fitting into each possible scenario. We use the manager-defined oldest share class for each fund. All returns are net of fees as reported to Morningstar and denominated in USD. No representation is being made that any investment will achieve performance similar to those shown. For illustrative purposes only and not representative of a portfolio AQR currently manages. Past performance does not guarantee future results.

Conclusion

Dodging the "risk" in risk premiums likely also means dodging the "premiums." Instead, diversification has generally worked better over the long term. Diversification tries to spread risk, instead of trying to escape it.

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Past performance doesn't guarantee future results, and all investing involves risk, including the loss of principal. It is not possible to invest directly in an index.

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