Brave New World

In conversation with Cliff Asness

Monthly Perspectives
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15 minutes

Brave New World: We Are Ready

Calling bubbles is hard. Machine learning is weird. Legendary quant manager Cliff Asness,Ph.D., Founder, Managing Principal & Chief Investment Officer, AQR Capital Management expounds on value, volatility and the limits of certainty.

At our annual Investment Strategy Conference, I had the pleasure of sitting down with a real legend in the quant investing world: Cliff Asness. For some 30 years, Cliff has been a leading figure in his field, with *bona fides* next to none. He studied under Nobel laureate Eugene Fama — widely regarded as the father of modern finance — and then led the quant research group at Goldman Sachs before venturing out on his own. In 1998, he co-founded AQR Capital Management, a quant hedge fund manager that has grown rapidly, reshaping the industry in its wake.

The theme of our conference was "A Brand New Renaissance," one where capital is now reshaping intelligence, infrastructure and energy systems. As AI moves from concept to implementation, its impact should broaden across sectors and earnings, extending market leadership beyond a narrow group of early winners.

We believe that the AI-driven transformation will unfold far faster than the Renaissance because intelligence itself is scaling, compressing centuries of human progress into years. History shows that these transitional periods, when optimism confronts constraint, are often among the most important for long-term investors. They are the moments when excess is exposed, when durable business models separate from fragile ones and when capital must be allocated with discipline rather than assumption. In this environment, portfolio construction matters; investments need to be aligned with the real-world buildout that underpins the next phase of this new Renaissance.

In this brave new world, we invited Cliff Asness of AQR Capital Management to challenge our thinking on the discipline and diversification required to build world-class portfolios that can prosper and protect capital through the next phase of this Renaissance. Cliff did that and more. Despite a life steeped in numbers, Cliff is blessed with a frank, larger-than-life personality. He tells it like it is, never afraid to admit to errors even when they're his own. Below is an edited excerpt of our conversation. I hope you enjoy reading it as much as I enjoyed experiencing it.

Brad Simpson
Chief Wealth Strategist, TD Wealth

Simpson: Thank you so much for coming today. We have a lot to cover, and I know many of you are super-excited. For the quant folks in the room, this is like Beatlemania.

Asness: It *is* like Beatlemania, because the Beatles are 80 now.

Simpson: Come on now, I don't think we're quite there. Okay, let me start with the obvious question. You can't talk about the past few years without talking about AI and tech and momentum stocks and growth. Is this, from your point of view, another bubble? How do you address that?

Asness: Sure. First let me start out with the bad news. You're going to get a wishy-washy answer from me, which I actually think is appropriate. And it says something about what quants do. I think there are people who can say smart, helpful things about whether these eight U.S. stocks that dominate the markets represent a market bubble — but it's generally not a quant. A lot more of our business is spent analyzing these thousand stocks around the world against these other thousand stocks, and mostly comparing them within similar sectors.

> "We tend to really hate the last year of a bubble. We really love the period before, and we really love the period after, but we do not tend to enjoy the crescendo."

Though I'm not averse to calling bubbles, I did study under Eugene Fama — he was my dissertation advisor in Chicago — and he's seen as kind of the godfather of the efficient-market hypothesis, so bubble is not a very "efficient-market" word. I have used it loudly, probably too loudly, twice in my career, both times somewhere around a year or two early.

The first time I screamed bubble was '99/2000, the famous tech bubble. That was a painful time for us. We tend to really hate the last year of a bubble. We really love the period before, and we really love the period after, but we do not tend to enjoy the crescendo — because even with things like momentum in a quantitative model, timing it to the second is hard. The other time I screamed bubble was in 2019 and 2020, some people call it the "Covid bubble." But note that I said 2019, which was before Covid. That's when I said, "We're going to up the value bet, because this is crazy," so I can't really take credit for it, even though it did work out for us.

One of the things we built back in '99/2000, when we were suffering, was — and I think we were the first to do this publicly — we built a measure. You know, in academia, value investing is real simple. The way the academics do it is just by using price multiples. Many of you have heard of the so-called "value factor" — that is, low multiples beat high multiples over time.

But up to that point, we hadn't seen anyone say, "All right, how wide are these disparities today? And does that help forecast the future?"

We found that in the tech bubble, as you might imagine, the disparities were very, very wide — easily wider than in the 50 years of data we had. And that disparity, historically, had been a good indicator. When it was tight, it was not the best time to be a value investor, and when there were big differences it was a better time. If you asked me at that point, am I ever going to see a bubble quite that extreme again in my career, I think I would have said highly unlikely. It is the most extreme thing we've seen in 70 years of data — and then it happened again.

In 2019, we were approaching disparities as big as the dotcom bubble, and then Covid sent us way past that. You guys probably remember the six months after Covid when all you were supposed to own was Tesla and Peloton? One of those actually still kind of works. The other one did not work out so well.

Asness: All of this is my way of saying, I'm willing to call something a bubble. Rarely and occasionally. But my definition is a very stringent one. Mathematically, there's always a growth rate in the future that could justify the multiple. I'm open-minded, but if even I am willing to say, "That's not going to happen," then there's a good chance it's a bubble.

To finally get to the question, though, I don't think I'm comfortable using the word "bubble" about what is essentially seven or eight stocks. I would not bet a lot of money against this. There is a growth rate, and these stocks don't look like the dotcoms. They make money, for instance. In the dotcom era, the valuation differences were significant, and the super-expensive ones lost money — they didn't make money. You didn't have to have a quality-versus-value trade-off. So, if you forced me to bet, I'd be a very mild short, but very mild.

Simpson: In 1999, they were using the "eyeballs" ratio.

Asness: How many people looking at the website versus the valuation of the website.

Simpson: Right. I suppose that leads us to our next question. The S&P 500, as you know, is super-concentrated today, with 35% to 40% of the market cap held by just 10 companies or so. If you're benchmarking up against the S&P and you're trying to produce an excessive rate of return, how do you do that?

Asness: That's a great question. How does concentration matter? The difficulty that concentration brings is almost exclusively on the long-only side. Take a quant like us: you have a thousand stocks around the world long, a thousand stocks short, so these five to 15 names that are dominating the world right now hold no special standing for us. They can go up 50% tomorrow. They can fall 50% tomorrow. It's not what you're betting on.

I don't mean to make it sound like a panacea. Our way doesn't work all the time, either. I think it works more than it doesn't, or I wouldn't do it, but it's really quite independent of these weights. If you are running a more traditional, long-only, "beat the benchmark" portfolio, it's hard to make any money with a negative opinion because all you're allowed to do is not own something.

So, if you have analyzed the stock and believe it's going to perform poorly, not owning it doesn't move the dial very much. And concentration exacerbates that problem — when you have a few stocks that are dominant, it squeezes all those other weights that were always small, so it takes away some of your opportunity set. When it comes to the stuff we do, though, I would argue it doesn't really matter much.

By the way, when you lose in a strategy, it's not always more attractive going forward. Most of the time when something loses, we tend to think it's a little cheaper, but not always. Concentration can matter if it tells you something. It can help explain what's going on, even if it can't predict what's going on. But for a lot of the stuff we do, and for other managers who can actually express negative views, it doesn't matter very much at all.

Simpson: Thanks for that. Let's talk about the other part of the equation: bonds. A lot of folks in this room, for the first time in their

career, had to take calls from clients asking, why is this bond in my portfolio going down at the same time as my equities? That's supposed to be the diversifier. And so the debate is around whether the so-called "balanced" 60/40 portfolio as a strategy is structurally impaired, or do you think this was an aberration?

Asness: I'm much more in the aberration camp. Again, we live in a volatile, fat-tail business. Aberration does not mean we won't see it again. I mean, 2022 was a shock to everyone. Inflation in the U.S. getting to 9%, 10% — not the highest ever but clearly the worst we've seen since the 1970s. I think if most of us were told at the beginning of 2022, we're going to see inflation go from 2% to 9%, most of us would have guessed it would be a pretty bad year for both stocks and bonds. But even that wasn't a real Black Swan. It just looked like the end of the distribution curve. And you'll see the other end of the distribution too. So, I'm definitely in the camp that that was an extreme year, but stocks and bonds have diversified each other over the long term. It's always the case.

And I'll point out too that, even in 2022, the 60/40 story was still mainly a stock story. It would be nice if the 40% went up, but bonds move around about a quarter to a third as much as stocks. So, 60/40 is still largely about stocks. It was disappointing and certainly added salt to the wound in 2022, but it was still the case that 2022 was mainly about what happened to the stock market. To seriously diversify away from stocks, you have to make a more radical move. In a 60/40, the 40% is largely delevering stocks more than diversifying against stocks.

"In a 60/40, the 40% is largely delevering stocks more than diversifying against stocks."

Simpson: That's an interesting way of looking at it. All right, moving on. So the U.S. dollar is ratcheting down all of a sudden, and the market is starting to realize, we have some macro stuff going on. We now live in this world of heightened macro risk. Is this something that, in your view, we're going to be experiencing for a lot longer, or are we just one kick at the can away from the pre-Covid era when all was well and nobody cared about any of that stuff.

Asness: Well, I'll even question the premise of the very last part of your question. The pre-Covid era had plenty of macro shocks. It had Brexit, it had the taper tantrum. And of course it ended with Covid. I think what's happening now is that the market seems to be actually reacting to some of the macro and even macro/political uncertainty, when it had blissfully ignored it for so long. So, I don't think the weird part now is uncertainty.

Do I think it'll stay elevated? The way quants judge uncertainty is, we come up with data to try to get objective measures of uncertainty. That may sound like a weird concept, but you can look at dispersion or analyst forecasts. It could be for macroeconomic numbers, or it could be for individual stocks even. When dispersion is higher than normal, that's almost the definition of uncertainty, right? When everyone agrees, uncertainty is low. And we've been in a time of objectively measured higher-than-normal uncertainty for a while, and that tends to be sticky.

I wouldn't make huge bets on this because, like I said, it could go back to complacency in a heartbeat. But I do think uncertainty is higher than normal — it has been for a while. What's different now is, it turns out, if you wake up and the president of a superpower is going to invade an ally, the market actually cares.

"When we had 'Liberation Day,' there was a huge market reaction. But then subsequent tariffs had smaller and smaller reactions. So it's very possible that, by the time America is invading Great Britain, we're going to see no reaction at all, right?"

When things have been good for a while, you get lulled. I could argue that, given some of the oddness going on now, the market reactions are still kind of muted, but they are not ignoring things. You know, we saw with tariffs, when we had "Liberation Day," there was a huge market reaction. But then subsequent tariffs had smaller and smaller reactions. So it's very possible that, by the time America is invading Great Britain, we're going to see no reaction at all, right?

Simpson: You reminded me. I was on a stage like this when Bear Stearns was going down, and there was a guy in the crowd. He kept calling out, down another percent! Down another percent! So, I would ask members of the audience, if that's happening, please be kind enough to let us know.

Asness: In 1987, literally one year before I arrived at the University of Chicago, it was Black Monday. And Monday was one of the two days Gene Fama taught his first-year PhD seminar. Supposedly, he started the class at 3 p.m., so the crash had happened already and he didn't know. Gene's just not a guy who cares about what the market is doing in a given day, right? He flew in from California and came straight to class.

So, students immediately start asking him, "Professor, what's going on here?" The story is that he's like, the market's down? What's it down? And the reply, it's down 23%! He supposedly just said, "Well, there's going to be something called a 'Monday effect' forever." Which is quant-geek, asinine stuff. You see a phenomenon once — like average returns are lower on Monday — and you assume it forever after. That is bad quantitative modeling, and I think he was kidding.

Simpson: Speaking of good quant versus bad quant, you've made the case that good quant and good discretionary management aren't so different, right?

Asness: Yeah, I think good quant and good discretionary have gotten more similar over time. At the end of the day, they're still constructing portfolios that are very different. A quant is going to have something like a thousand stocks long, a thousand stocks short. Discretionary managers, even if they're fully long/short, are going to be much more concentrated in a few equities and learning everything they can about those stocks. But I think what we believe in and bet on as concepts have gotten much more similar over my career. And the changes, by the way, have come from the quant side. We were behind a good discretionary manager.

Quant investing nowadays has a lot of things we don't even talk about because it's proprietary — some of the stuff on the machine learning and the alternative data side — but the core set of academic and quant factors has expanded from the price-multiple factor, price momentum and maybe size. Those were the big three 3 five years ago. But slowly, over time, quants added things like the profitability factor.

It turns out more profitable stocks on average outperform less profitable stocks. The risk factor. Turns out measurably lower-risk stocks tend to outperform. Things like volatility beta tends to outperform. Stocks where management is buying back shares more than they're issuing shares, those tend to outperform. All of these tendencies work more often than not, but they don't always work. And if you do it for one stock, you're crazy. You don't use quantitative methods to take a big bet on one stock.

Anyway, if you add up all the published factors out there in the quant and academic world, it looks far closer to a holistic process, perhaps with the exception of price momentum, which probably can't fit into a real Graham & Dodd framework. So, your favourite stock would be one that's selling for low multiples, that's very profitable, that's very low-risk, where management is signalling that they think it's cheap by buying back shares. And there are a number of other factors that I don't think a Graham & Dodd manager would disagree with at all.

Three of my colleagues, for instance, wrote a paper called "Buffett's Alpha." We were trying to look at famous investors and asking the question, we know they're not quants, but if they were, what kind of quants would they be? What quant factors would explain their returns the best? And it turned out you could explain a lot of Warren Buffett's returns with three of the major quant factors: the price-multiple or "value" factor; the profitability factor; and the low-risk factor.

Simpson: But you weren't part of the authorship.

Asness: No, I was not. You know that famous lunch that he auctions off? I haven't done this, but I've toyed with bidding on it just so I could convince him that the paper's actually a compliment. It's very clear in there, they laud him. They go, "We're after-the-fact." Quants didn't even have this in their model for the first 20 years while he was using it.

But I think there are good quants and I think there are good discretionary managers. How they implement can look radically different, but I think the environments they'll be happy or sad in are a little more correlated today. And I think it's the quants who have come to the mountain, not the mountain that's gone to the quants. I love the changes to quant, but I'm also humbled by them because I think we're admitting that, yeah, the stuff we were doing 35 years ago really was very light.

Simpson: Which leads to my next question. The systematic landscape has changed an awful lot. A lot of the change comes from people who either read your journals all the time, or they work for you and then go out and compete with you. So how does AQR maintain its edge? How do you stay ahead of the firms you compete with?

Asness: Sure. These have been some of the most fruitful years for improving our process, increasing our edge. A lot of it was the fact that two things came into the world that didn't exist before, and you won't be shocked by either one: machine-learning models and alternative-data models. We still bet on the old behavioural factors that people know about, but a lot of our efforts have been on the newer side. Some of those really bear little resemblance to old-school factor investing. Some are correlated but, we think, improved measures.

I will give you one example: fundamental momentum. I told you, we like to see good things happening. One of the ways quants have tried to measure this for years is getting textual data. The most famous and widespread example is corporate earnings calls, but you could do it with newspaper stories, you could do it with other things.

You get earnings calls and you analyze, is this good or bad news? And over time, people started to develop quite large and complex tables that were basically word and phrase counts — way simplified. If you see the word "increasing," it's plus two points. Hopefully everyone in the room sees the problem with that. If the actual sentence was, "Massive embezzlement is increasing," well, our bad on the plus two. For something to work in the quant world, you can survive a lot of that because it only has to be right most of the time.

Over the past five years or so, however, we've been applying machine learning to our decision-making process — because ML applied to things like text data is much better than our word-count tables.

What ML does is sum up the content of an earnings call. And what it produces is a set of numbers, a "vector" of numbers for each earnings call that describes the call. What you then do is, you do research on that vector of numbers, and you ask, what combinations of these numbers predict good returns or bad returns? In the end it turns out that you produce a strategy that's considerably better than the old word-count strategy.

Machine learning can be much more opaque, though. You have to spend some time to figure out if you're doing what you think you're doing. The truth is, I probably slowed us down on some of this newer stuff by a year or two. I think some of that is very justifiable. When you have stuff that's worked for you for 25 years, changing is a big deal.

ML often doesn't feel quite as intuitive as simpler factors. Sorting stocks on profitability and diversification — I think we all get what's going on there. But that vector of numbers? It can be a challenge to truly understand it. You can get to a point, at least we have, where you're comfortable trading on it, at least for some of what you do. You never bet the ranch or anything, because there is almost always in ML some leap where you have to accept, "Yeah, I don't really know exactly what's going on there, but I understand enough."

Prior to ML, we had always prided ourselves on needing two things to make a call: number one is, the strategy has to have worked over the long term. No matter how good the theory is, if it has lost money for 40 years, we're not doing it. But going the other way, if something has worked long term, but we had absolutely no idea why, we would have shied away from that as well.

And it was one of our younger researchers who said it to me, "Cliff, if you always understood every single step in what a machine-learning process was doing, where's the value-add? If it was simple and obvious, and you could just grasp it, why would you need it in the first place?" So it did involve a little bit of an attitude adjustment. There's no bright line, but if roughly, conceptually, we used to be 50/50 intuition versus data and results, we might be two-thirds/one-third today, having to give up a little of our need for intuition in this brave new world. It took me a bit to get comfortable with it, but I'm glad I did.

Simpson:I think being comfortable in this brave world is going to take a bit for all of us! We're ready, though. We've got a fantastic Wealth Strategy Process and a Four Pillars strategy to guide us, so we're definitely ready. Cliff, thanks so much for joining us today, and thanks everybody for listening.

Asness: That was great, thanks.

Market Performance

Canadian Indices ($CA) Return	Index	1 Month (%)	3 Months (%)	YTD (%)	1 Year (%)	3 Years (%)	5 Years (%)	10 Years (%)	20 Years (%)
S&P/TSX Composite (TR)	135745	0.84	6.12	0.84	28.32	18.89	16.36	12.88	8.17
S&P/TSX Composite (PR)	31924	0.67	5.49	0.67	25.03	15.41	12.99	9.55	5.04
S&P/TSX 60 (TR)	6452	-0.19	4.68	-0.19	23.64	17.61	16.09	12.87	8.32
S&P/TSX SmallCap (TR)	2457	8.71	17.11	8.71	62.19	23.13	17.17	13.41	5.93
S&P/TSX Preferred Share(TR)	2456	0.39	1.86	0.39	13.93	12.77	7.96	7.51	3.61
U.S. Indices ($US) Return									
S&P 500 (TR)	15441	1.45	1.76	1.45	16.35	21.11	14.99	15.57	10.93
S&P 500 (PR)	6939	1.37	1.44	1.37	14.87	19.40	13.31	13.59	8.82
Dow Jones Industrial (PR)	48892	1.73	2.80	1.73	9.76	12.78	10.27	11.50	7.81
NASDAQ Composite (PR)	23462	0.95	-1.11	0.95	19.54	26.52	12.41	17.66	12.30
Russell 2000 (TR)	14333	5.35	5.75	5.35	15.81	12.20	6.16	11.21	8.02
U.S. Indices ($CA) Return									
S&P 500 (TR)	20974	0.43	-1.41	0.43	9.74	21.90	16.36	15.20	11.90
S&P 500 (PR)	9425	0.35	-1.72	0.35	8.35	20.17	14.66	13.22	9.76
Dow Jones Industrial (PR)	66411	0.70	-0.41	0.70	3.53	13.51	11.59	11.13	8.74
NASDAQ Composite (PR)	31868	-0.07	-4.19	-0.07	12.75	27.34	13.75	17.28	13.27
Russell 2000 (TR)	19468	4.29	2.45	4.29	9.23	12.92	7.42	10.85	8.95
MSCI Indices ($US) Total Return									
World	21577	2.26	3.44	2.26	20.08	19.85	13.39	13.69	8.97
EAFE (Europe, Australasia, Far East)	15484	5.22	9.09	5.22	31.84	16.77	10.83	10.09	6.03
EM (Emerging Markets)	4173	8.86	9.48	8.86	43.67	17.32	5.81	10.53	6.26
MSCI Indices ($CA) Total Return									
World	29308	1.23	0.21	1.23	13.26	20.63	14.74	13.32	9.92
EAFE (Europe, Australasia, Far East)	21032	4.17	5.69	4.17	24.35	17.52	12.14	9.74	6.95
EM (Emerging Markets)	5669	7.77	6.07	7.77	35.50	18.08	7.07	10.17	7.18
Currency									
Canadian Dollar ($US/$CA)	1.36	-0.81	-2.83	-0.81	-6.38	0.76	1.28	-0.26	0.90
Regional Indices (Native Currency, PR)									
London FTSE 100 (UK)	10224	2.94	5.21	2.94	17.86	9.57	9.80	5.33	2.91
Hang Seng (Hong Kong)	27387	6.85	5.71	6.85	35.41	7.83	-0.64	3.36	2.80
Nikkei 225 (Japan)	53323	5.93	1.74	5.93	34.75	24.96	14.03	11.77	5.99

Benchmark Bond Yields	3 Months	5 Yrs	10 Yrs	30 Yrs
Government of Canada Yields	2.20	2.92	3.42	3.87
US Treasury Yields	3.67	3.79	4.24	4.87

Bond Indices ($CA Hedged) Total Return	Index	1 Mo (%)	3 Mo (%)	YTD (%)	1 Yr (%)	3 Yrs (%)	5 Yrs (%)	10 Yrs (%)
FTSE TMX Canada 91-day Treasury Bill Index	486	0.18	0.55	0.18	2.68	4.09	2.91	1.94
FTSE TMX Canada Universe Bond Index	1207	0.58	-0.43	0.58	2.02	3.65	-0.02	1.91
FTSE TMX Canada All Government Bond Index	1122	0.51	-0.71	0.51	1.32	2.93	-0.62	1.42
FTSE TMX Canada All Corporate Bond Index	1516	0.80	0.44	0.80	4.21	5.84	1.77	3.29
U.S. Corporate High Yield Bond Index	324	0.37	1.21	0.37	5.84	7.59	3.64	5.86
Global Aggregate Bond Index	267	0.10	-0.20	0.10	2.88	3.18	-0.29	1.63
JPM EMBI Global Core Bond Index	593	0.13	0.82	0.13	10.77	7.79	0.76	3.35
S&P/TSX Preferred Total Return Index	2456	0.39	1.86	0.39	13.93	12.77	7.96	7.51

Source: TD Securities Inc., Morningstar®, TR: total return, PR: price return, as of January 31, 2026.

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