BARRON'S
THE DOW JONES BUSINESS AND FINANCIAL WEEKLY www.barrons.com NOVEMBER 6, 2018

Investing Insights: City National's Matthew Peron

By Abby Schultz

Matt Peron, CIO, City National Bank *COURTESY OF CITY NATIONAL BANK*

The October stock market rout understandably unnerved investors, but Matthew Peron, chief investment officer at City National Bank, a Los Angeles-based private wealth manager, is advising clients to think beyond this "healthy correction" to the long-term—at least the next decade.

"What we have to do is get ready for the next 10 years not looking like the past 10 years," Peron says.

As global markets recovered from the financial crisis throughout the past 10 years, the story line was one of "generally high returns with low volatility," Peron says. But those dynamics are likely to reverse in the coming years.

"We think that we're set up for lower returns with more volatility," he says. "It's going to require a different skill set and a different way to approach the market."

That volatility has been in full view. The S&P 500, just to take one measure, sank 6.9% in October, snapping a six-month winning streak. One month's activity can't be predictive. But it hints at the fact that investing in an exchange-traded fund tracking the S&P 500, or even the MSCI World Index, is unlikely to continue to pave a path of riches.

Instead, Peron's approach for his wealthy clients at City National, who include many in the entertainment business, is to build "strategic, durable portfolios" to withstand the market's ups-and-downs, and deliver healthy returns over the long haul.

"Portfolio construction will be very, very important," he says.

To create that durability, Peron focuses on building investment holdings for clients that can outperform in all market conditions. While creating a durable portfolio involves a different conversation with each of the bank's clients, there are some basic tenets to his strategy.

One is to focus on investments that benefit from the areas of the world fueling global growth. Today, that's the U.S. and emerging Asia, Peron says.

In the U.S., the economy and corporate earnings remain healthy, and an engine for growth, despite the market correction and a likely slowdown. The bank expects U.S. growth to be over 2% next year from about 3.5% today, while corporate earnings growth, which has soared above above 20% in 2018, will slow, but to a more normal rate of about 7% a year.

As for Asia, Peron points to youthful demographics, and the fact the region, including China and India, account for 60% of global growth, according to the International Monetary Fund. To ben-

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efit from this growth, City National is buying Asian hard currency bonds (issued in U.S. dollars, yen, or euros), with yields today of 8% or more for a bond with a duration of about four years compared with a yield of less than 4% for the S&P 500 3-5 Year Investment Grade Corporate Bond Index.

"We think it's a bit too early yet to buy emerging Asia equities," Peron says. "By our evaluation criteria, we'd like to get them a bit cheaper."

Unlike many wealth advisers, Peron eschews hedge funds and private equity as a means for boosting growth, saying they don't deliver the returns investors deserve given the risks and the fees.

So a second tenet of his strategy is to find less well-known, but arguably more straight-forward investments that aren't correlated to the public markets and provide an excess return. A typical hedge fund-of-funds, which invests in several hedge fund strategies, for instance, are often very correlated to the market, while "their risk premium can be constructed through other means that are cheaper and easier," he says.

A couple alternatives City National likes are railcar leases and reinsurance, businesses with healthy, uncorrelated returns.

In a tough year, clients employing these strategies could see their portfolios dip, "but over five, 10, 15 years, you should earn a nice premium," he says.

If anything, October's volatile market activity provided a test. Peron says a moderate risk portfolio, which the bank uses as a starting point, would be invested 70% in stocks, mostly in the U.S., with 3% in international developed markets and 6% in emerging Asia. Another 25% of the portfolio would be invested in "opportunistic" fixed-income investments, and 5% in real assets.

While returns on similar moderate risk portfolios fell last month, they didn't fall as much as the broad market.

"Our portfolios are built to draw down significantly less than a general balanced portfolio, or moderate growth portfolio, and in fact that's what happened in October," Peron says.