

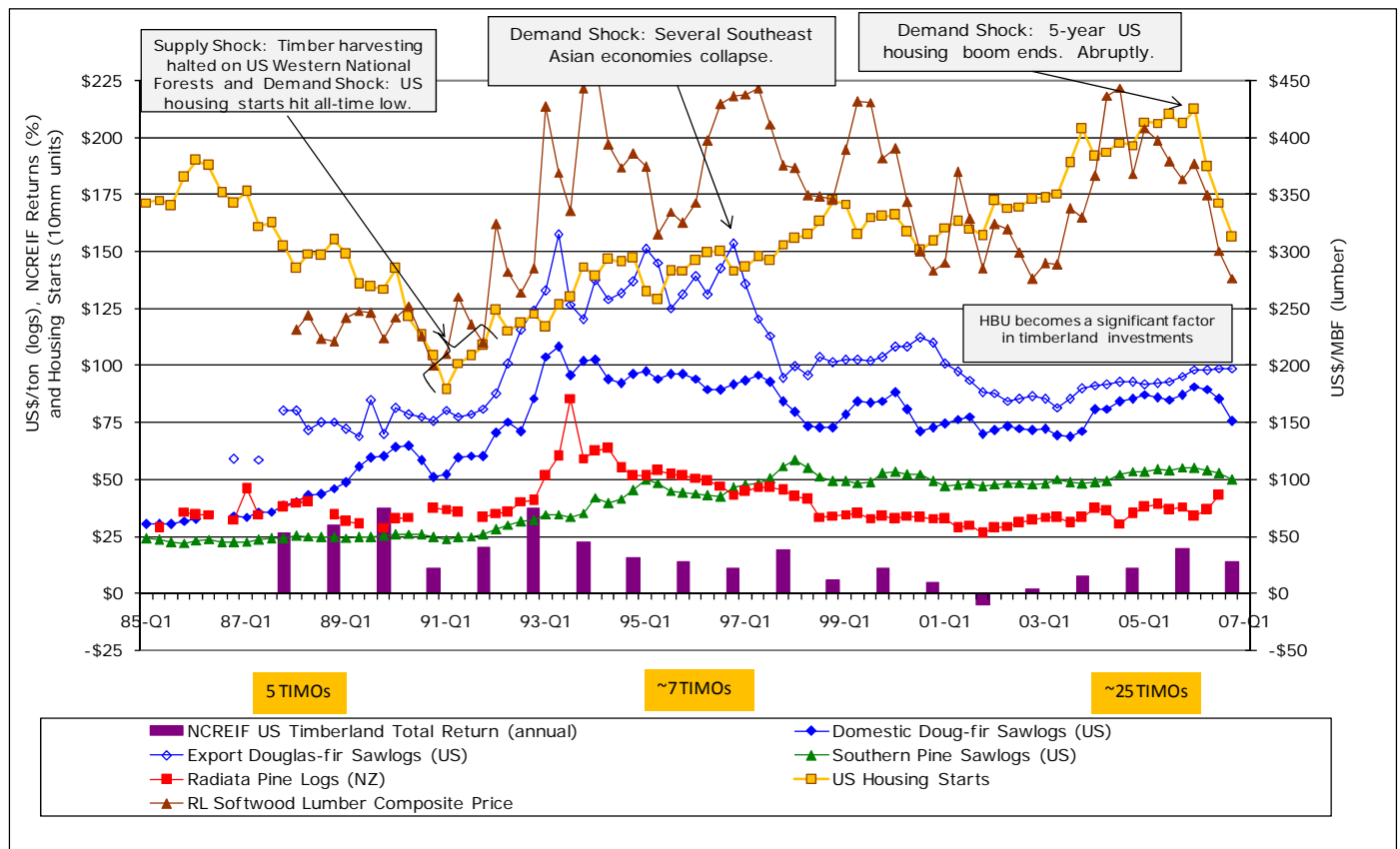


That was Then, This is Now

The (relatively) short history of institutional timberland investment has seen some major changes (Figure 1). Back in the early 1990s, the world experienced nearly simultaneous supply and demand shocks as the United States halted harvesting on National Forests in the West—the source of a significant portion of its softwood timber supply, and housing starts hit a historic low and began a 15-year climb. Softwood timber prices around the world rose sharply for a couple of years, then leveled off. Then several economies in

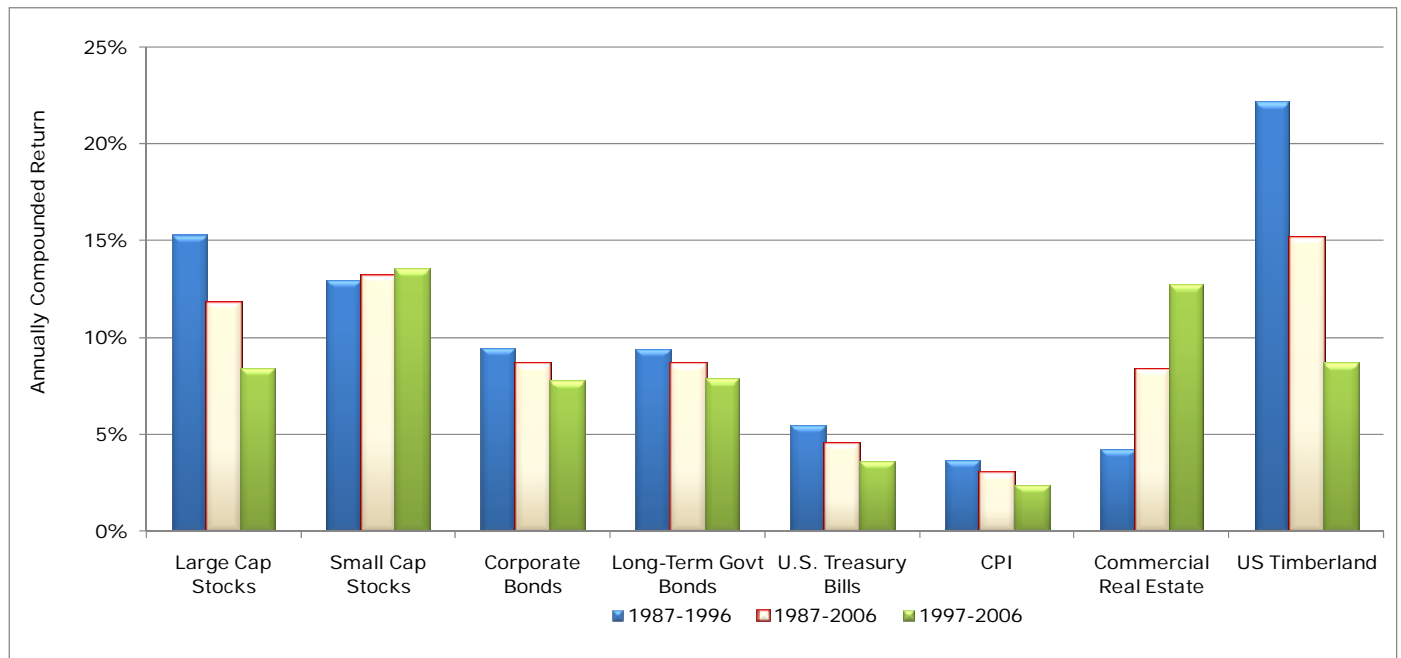
Southeast Asia collapsed in 1997. Timber prices in western North America fell through the year. Export log prices lost about as much as they had gained five years before. Most log prices had leveled off by 2002 or 2003 and most showed improvement through 2005. Then the wheels fell off the US housing market. (For an analysis of the US housing market and its impact on timber prices, please see Forest Research Notes Volume 2 Number 1, *Trends in Housing Starts*.)

Figure 1. A Short History of the Institutional Timberland Investment World



Sources: National Council of Real Estate Investment Fiduciaries, Log Lines. Pacific Rim Wood Market Report, Oregon Department of Forestry, Timber Mart-South, New Zealand Ministry of Agriculture and Forestry, Random Lengths, US Department of Commerce

Figure 2. Returns for Various Asset Classes, 1987-1996, 1987-2006 and 1997-2006



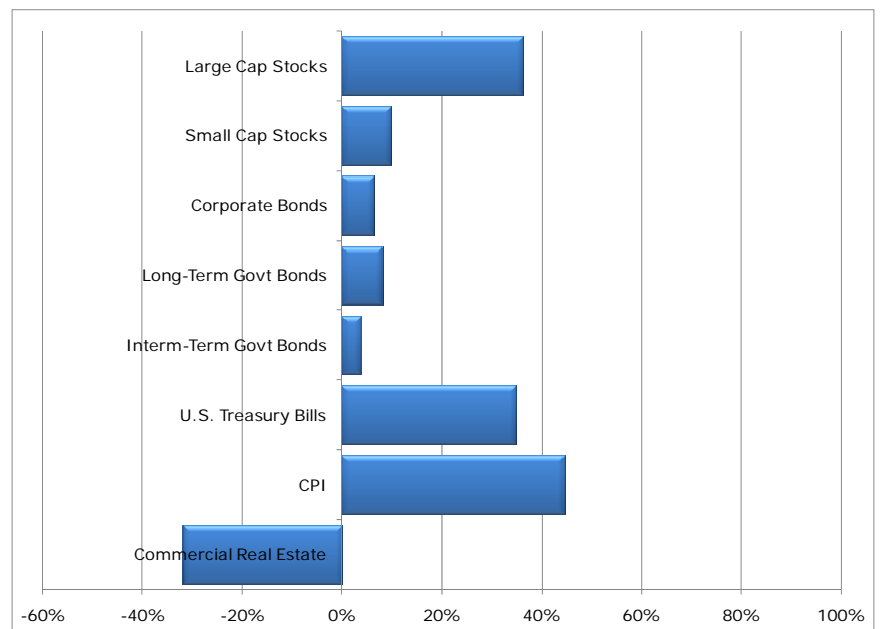
Sources: Ibbotson Associates, National Council of Real Estate Investment Fiduciaries

The NCREIF return bars in Figure 1 indicate that timberland returns are not what they used to be. We have had some clients question whether timberland is still a good investment. Well, the returns aren't what they used to be, but neither are returns from most asset classes.

Figure 2 compares returns from a number of asset classes over three time periods: the first NCREIF Timberland Index decade (1987-1996), the second NCREIF decade (1997-2006), and the NCREIF life (1987-2006). Commercial real estate has done much better in the most recent decade and small cap stocks have held fairly steady. Everything else has returned less over the last decade than it did over the previous decade.

We can also look at some other typical asset class analysis. Figure 3 shows correlation coefficients for the asset classes from Figure 2 since 1987.

Figure 3. Correlation with Timberland, 1987-2006



(See Forest Research Notes Volume 1 Number 4 *The Anti-Correlation Herys* for further discussion of correlations.)

Figure 4. Correlation with Timberland, 1987-1996

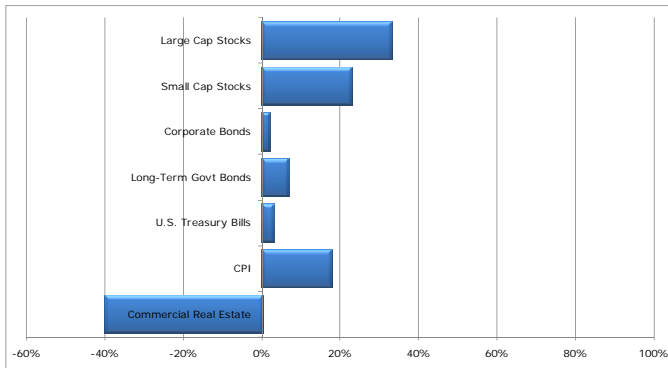


Figure 5. Correlation with Timberland, 1997-2006

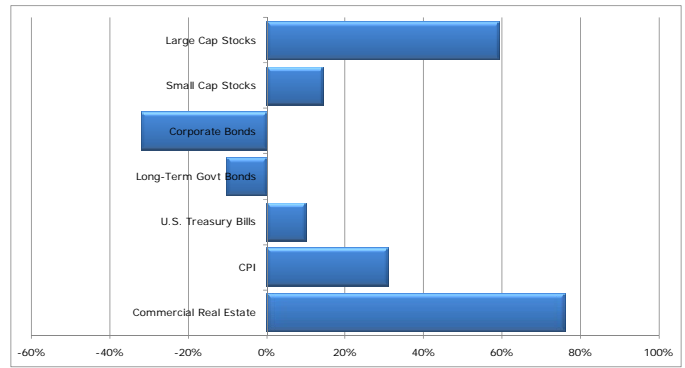


Figure 4 and Figure 5 show correlations for the two NCREIF decades. As we preached in Vol 1 No 4, the results of a correlation analysis can change dramatically, depending on the time period analyzed.

Timberland returns were much lower in the more recent decade, but volatility was also lower than in the previous decade. In fact, the past decade was less volatile for most assets, except large and small cap stocks.

Figure 6 compares data from the capital market line analysis for the two decades. The chart shows the risk/return points for each asset for each decade. The lines point from the 1987-1996 risk/return point to the 1997-2006 risk/return point. For example, small cap stocks moved from a return of 13% with a standard deviation of 20% in the first decade to a return of 13.5% with a standard deviation of 21.5% in the second decade.

If nothing else, the chart shows the importance of a diversified portfolio—returns for most assets were lower in the second decade, volatility for most assets was lower in the second decade, but commercial real estate saw increased returns and lower volatility as measured by NCREIF’s commercial real estate index.

Figure 6. Capital Market Line

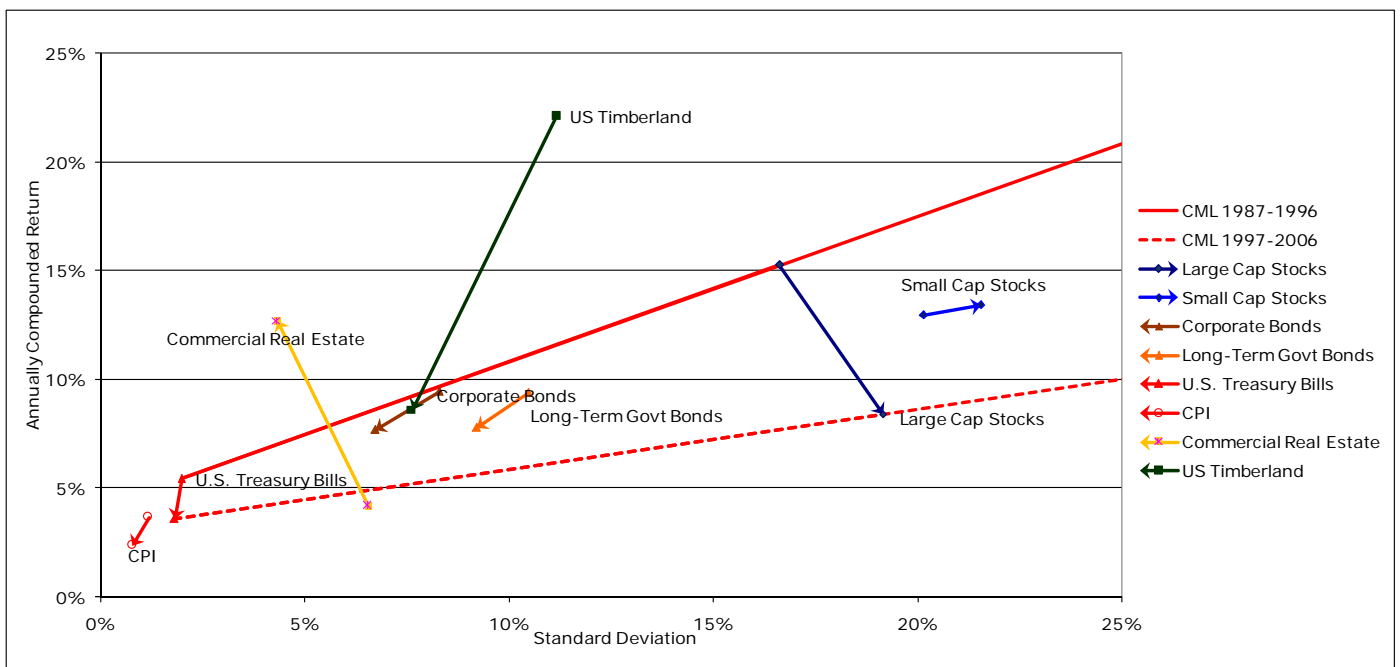


Figure 7. Security Market Line

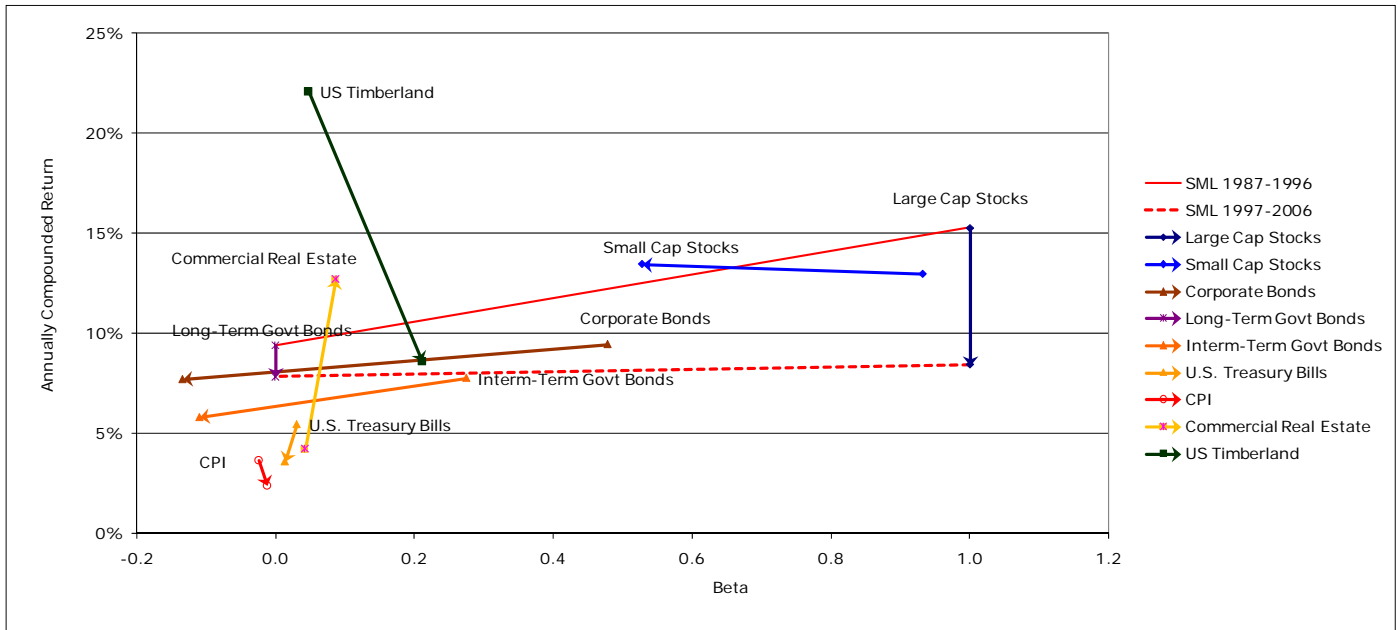


Figure 7 compares security market line analysis from the two decades. As in Figure 6, the lines show how each asset class moved from the first decade to the second decade. Betas increased for timberland and commercial real estate (and inflation), but not by much. Betas decreased a lot for small cap stocks, corporate bonds and intermediate-term US government bonds (and a little for US t-bills).

What Does It All Mean?

It means you should not rely exclusively on 20-year-old numbers to make your investment decisions. It means past returns are not guarantees of future returns. Figure 1 shows that the timberland world has been subjected to a shock of some kind every 5-10 years or so. Those shocks have helped create conditions that caused returns in the second NCREIF timberland decade to be different from those in the first decade. If we knew what the next shock would be, we could predict what might happen to timberland returns. (Of course, if we knew what the next shock would be, then it wouldn't be a shock, now would it?)

Watch This Space

This issue of the Forest Research Notes is the second quarter 2007 issue, yet it was published in October, well after the end of the third quarter. We blame the delay on the increasing demand for our services. (We have a habit of giving our clients' projects a higher priority than this newsletter.) To deal with this development, we are adding to our staff. We expect to provide full details in the third quarter Forest Research Notes (which we hope to publish before the end of the fourth quarter.)

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