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Timber Investing: The Inflation Hedge That Pays Off in Every Type of Market

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If you start a conversation about the building inflationary pressures already sapping consumer pocketbooks, that talk will almost certainly turn to such classic hedges as gold, silver and even crude oil.

But one of the best inflationary hedges of the 20th century is often forgotten - even though it's likely to be just as effective this time around.

We're talking about timber - and timber stocks. And the facts speak for themselves. Investing in timber is a move virtually every investor should carefully consider.

Timber Trumps Inflation

In case you're sitting in Oregon, Kentucky, or some other state that's rich with forests - and therefore doubt the value of timber as an inflationary hedge - here is some research to consider. If you look at this with an open mind, you'll see that timber is not only a great hedge against inflation, but it's a market-beating investment in virtually every type of investment environment.

If you need to be persuaded timber investing is a strategy you need to employ, consider that:

- In the modern era, inflation has never been a match for timber, which has risen faster than overall prices for more than a century. During America's last major inflationary period - from 1973 to 1981, when inflation averaged 9.2% - timberland values increased by an average of 22% per year. On average, the price of harvested lumber itself has risen more than 5% annually over the past 100 years.

- Since 1910, the value of timberland as an investment has risen faster - and with less volatility - than stocks as measured by the Standard & Poor's 500 Index. Since 1987 alone - in spite of minor losses in 2010 due to the U.S. housing slump - the Timberland Index maintained by the National Council of Real Estate Investment Fiduciaries (NCREIF) has risen roughly 15% per year, compared to an annualized return of just 9.61% for the S&P 500.
- Timber investing has proven to be particularly alluring during bear markets. During the Great Depression, when stocks plunged more than 70%, timber gained 233%. And timber easily outperformed the S&P 500 during the 20th century's other major bear-market periods. Most recently, in 2008, when the S&P 500 lost 38%, the NCREIF Timberland Index gained 9.5%.
- Timber is a valuable tool for portfolio diversification since its price movements have a very low correlation with most other asset classes - less than +0.1.
- In spite of the glass-and-steel towers dominating the globe's urban landscapes, demand for timber is now higher than ever. The U.S. is the world's No. 1 consumer of wood products, using 27% of the timber harvested each year. The average American uses the equivalent of one 100-foot tree per year, and the rest of the world is quickly catching up. In fact, the United Nations now predicts demand for wood will double in the next 30 years, with China - already No. 2 in wood consumption - pacing the growth. As evidence of that demand, lumber exports from Canada to Asia have nearly quadrupled in the past five years alone.
- Although timber is considered a renewable resource and new trees are planted each year to replace a growing portion of the annual harvest, the world's wood supply is steadily shrinking (by an estimated 2.4% annually in the 1990s). In tropical regions, about 130,000 square kilometers (50,193 square miles) of forest is being destroyed each year. Roughly half of the forests that originally covered 46% of the earth's land surface are now gone, and 56% of North America's coastal rain forests have been destroyed. This is yet another persuasive argument that timber investing represents a significant long-term profit play.

Not Just an Inflation Hedge

If inflation isn't a worry for you, you still shouldn't ignore timber stocks. Historically, timber has proved itself to be a highly profitable investment - and thanks to rising global demand, timber shares should be top performers (as measured against other assets) in years to come.

Globally, the long-term supply-demand outlook for lumber - and for wood products in general - is highly bullish. And when you factor in shorter-term cyclical considerations - such as those related to the U.S. housing market - it gets even more attractive.

U.S. housing prices have experienced a major decline since 2006. And as prices have fallen, so has new construction. But while housing prices remain near their nadir, both buyer demand and building activity have started to increase.

The U.S. Department of Commerce, which tracks the U.S. housing market, reported that sales of new single-family homes rose to an annual rate of 329,000 in December, the highest level since the expiration of the federal-homebuyer tax credit in April (though the total for all of 2010 was just 321,000, down 14.4% from 2009). The available supply of new homes also dropped (from 8.4 months' worth of inventory to just 6.9 months' worth), and the median price leaped from $215,500 in November to $241,500.

Looking forward, the National Association of Realtors (NAR) also reported that pending home sales rose 2.0% in

If you'd like more of a "nameplate" stock - not to mention one that's got more room to rebound from the effects of the recent housing downturn - a third possible timber-investing candidate worth consideration is:

- **Weyerhaeuser Co. (NYSE: WY), recent price $23.66:** This Washington-based forest-products giant ($13.47 billion market cap) has customers worldwide, serving them with a wide range of construction materials, paper products, fibers and lumber. It manages 22 million acres of forests in 10 countries, and also has numerous mineral, oil and gas operations. Its Real Estate division also engages in property development, home construction and the real-estate brokerage business. The stock traded above $50 a share in April 2010, but eased off in May and June with the rest of the market. Don't, however, let the current low price confuse you - it reflects a special stock-or-cash dividend of $5.6 billion (about $26 per share) paid Sept. 1, 2010, to stockholders of record in July 2010. That payout is a key step in Weyerhaeuser's plan to become a REIT. The company reported $6.55 billion in total revenue for 2010, up from $5.52 billion in 2009. That translated into diluted earnings per share of $3.99 for the year, up from a loss of $2.58 in 2009. The stock pays a regular dividend of 60 cents a share, representing a yield of 2.55%.

For investors who don't want the risk of a single-company investment, there are several exchange-traded funds (ETFs) that hold a broad portfolio of timber stocks, including those just mentioned. Two of the leaders are:

- **Claymore Beacon Global Timber Index Fund (NYSE: CUT), recent price $21.93:** This fund attempts to mirror the performance of the stocks making up the Beacon Global Timber Index, which is composed of companies from around the world that own or lease forest land, harvest trees for lumber and other wood-based products, and that produce such finished products as lumber, paper and even packaging. All have a minimum market capitalization of $300 million, and trade in the United States - as common stocks, American depositary receipts (ADRs), or global depositary receipts. The fund's 52-week low of $8.00 a share occurred during last May's "flash crash." But its "effective (non-flash-crash) low" for the year was around $17.50 in late August, meaning it has gained about 28% over the past six months. The fund paid a 59-cent dividend in 2010, good for a current yield of about 3.00%.
- **The iShares S&P Global Timber & Forestry Index Fund (Nasdaq: WOOD), recent price $47.34:** This ETF seeks to mirror the price and yield performance of the S&P Global Timber & Forestry Index, which consists of roughly 25 publicly traded companies engaged in the ownership, management or upstream supply chain of forests and timberlands. These include forest products companies, timber real estate investment trusts (REITs), paper-products companies, paper-packaging companies and agricultural-products companies. The fund bottomed with the rest of the market in early July at $21.05, climbing steadily since. This iShares fund has no regular declared dividend, but paid two special dividends totaling $1.12 in 2010. The expense ratio is 0.48%.

If the housing market finally moves into a full-fledged recovery, and the consumer middle class continues to emerge in countries around the world (both virtual certainties), then timberland and wood products should continue to follow the bullish path that they've followed for the last 100 years.

And that means that timber investing shouldn't be viewed as just an inflation hedge - it should be looked at as a core investment strategy every investor should employ.

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December, the fifth increase in the past six months, although the NAR's pending sales index was still 4.2% below year-ago levels.

On the construction side, the Commerce Department said U.S. home construction fell 4.3% in December to an annualized rate of 529,000, though some of the decline in housing starts was blamed on bad weather. More importantly, permits for new construction - a better gauge of future housing-market activity - rose to an annualized rate of 635,000 in December, well above expectations and the highest level since March 2010.

The number of potential homebuyers also is likely to increase in the months ahead: The Conference Board just reported that its index of consumer confidence climbed to 60.6 in January, sharply higher than expected and the highest reading since May 2010. Consumer optimism was particularly strong in terms of the outlook for higher wages and more job creation.

That prospective surge in housing demand bodes well for a continued rise in raw lumber prices, which have actually increased (25% in 2009 alone) in spite of reduced building activity over the past four years, thanks to lower output by lumber producers.

Top Profit Plays

Unfortunately, it's not that easy for individual investors to make direct investments in lumber. And it's even more difficult to invest in the land on which lumber-producing trees grow. Although 71% of North American timberland is privately owned (the rest resides in national forests), the owners are almost exclusively companies in the forestry business or Timberland Investment Management Organizations (TIMOs).

TIMOs, created in the 1970s after Congress mandated broader diversification for institutional investment portfolios, are similar to real estate investment trusts (REITs). But TIMOs cater to large investors - pension funds, mutual funds and some wealthy individuals who can afford the typical minimum investment of $5 million. At the end of 2009, TIMOs had about $24 billion invested in U.S. timberland, up from just $1 billion in 1989.

Given that significant "barrier to entry," the best way for most individual investors to tap into these substantial opportunities in timber is by investing in the stock of corporations that own lots if it. Two timber-investing possibilities worth considering are:

- **Plum Creek Timber Co. Inc. (NYSE: PCL), recent price $41.09:** Plum Creek is based in Seattle, but has a long reach; it owns timberland in 19 states - from Washington to Maine and Wisconsin to Mississippi. Its forest holdings are also broadly diversified by species - from redwood and spruce, to ash and oak - as well as by age. The company also has a secondary division that focuses on mineral extraction and natural-gas production, giving it an extra edge in the inflation-hedge category. Plum Creek had revenue of $1.19 billion in 2010, producing earnings of $1.24 a share. The dividend of $1.68 gives the stock a very nice yield of 4.06%.
- **Rayonier Inc. (NYSE: RYN), recent price $59.83:** Structured as a REIT, Rayonier owns, leases or manages around 2.5 million acres of timberland in the United States and New Zealand. It also owns three sawmills in Georgia, and two specialty cellulose mills. The company produces both cellulose fibers and fluff pulp and engages in the international log-trading market. It also owns a separate portfolio of non-timber-related real estate. Based in Jacksonville, Fla., the company had 2010 revenue of $1.315 billion, which generated diluted earnings per share (EPS) of $2.54. Rayonier shares pay a dividend of $2.04 each, for a yield of 3.60%.