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MUTUAL FUNDS

Forests Are a Treasure. But Are They Good Investments?

By TIM GRAY JAN. 13, 2017

Trees don't watch the stock market. Forests keep growing — and potentially increasing their value — even when inflation surges or the market swoons.

Big investors, like university endowments and insurance companies, have long allocated money to timberland in places like Oregon's fir-and-spruce forests, Georgia's pine plantations and Appalachia's hardwood groves.

Until a few years ago, retail investors were mostly shut out of this market. The deals were too big, involving thousands of acres and tens of millions of dollars.

That changed over the last 15 years with the introduction of two timber-focused E.T.F.s — the iShares Global Timber & Forestry E.T.F. and the Guggenheim MSCI Global Timber E.T.F. — and the evolution of big forest-products companies like Weyerhaeuser and Rayonier. Today, the big timber companies are organized as real estate investment trusts (R.E.I.T.s) focused on managing forestlands, having sold off many other operations.

Ordinary investors can now put money into timber without venturing into the woods. Buying shares of an E.T.F. or a R.E.I.T. won't replicate the benefits of directly owning vast timberlands, but it does enable one to bet on timber.

And there's an old-fashioned option: buying a little woodlot of one's own.

That’s more akin to a part-time job than a passive investment, but it can yield financial gains.

“If you look at the statistics from the U.S. South, close to two-thirds of the timber harvest is coming from small landowners,” said Robert G. Flynn, director, international timber, for RISI, a forest-products research firm.

The E.T.F.s are more diversified than their names suggest. They do own timber companies: Both of them count Weyerhaeuser, Rayonier and Potlatch, the leading R.E.I.T.s, among their holdings. But they also invest in International Paper, packaging-maker WestRock and (in Guggenheim’s case) Sealed Air, which is perhaps best known for plastic Bubble Wrap.

“Investors should always buy an E.T.F. with their eyes open and understand that some things that come with the package may not be what they had in mind,” said Todd L. Rosenbluth, director of E.T.F. and mutual fund research at CFRA, an investment research company.

In terms of returns, the E.T.F.s have looked more like spindly saplings than strong sequoias. The Guggenheim fund failed to match the S.&P. 500’s return in the last three calendar years, and the iShares fund failed to do so in 2014 and 2015. Last year, the Guggenheim fund returned 5.7 percent while the iShares fund returned 10.8 percent, compared with 12 percent for the S.&P., including dividends.

William H. Belden III, head of E.T.F. business development for Guggenheim Investments, said his company’s timber E.T.F. targeted a subsector. “Timber is a proxy for the economy and how it’s doing, especially construction and home building,” he said. Some investors want to emphasize timber in their portfolios, and a focused E.T.F. lets them do that, Mr. Belden said.

Owning shares of timber R.E.I.T.s is a more direct, if riskier, way to wager on the woods. These companies own forests across the United States. Weyerhaeuser’s roughly 13 million acres approximate the combined area of New Hampshire and Vermont. Weyerhaeuser and Rayonier also have land abroad, the former operating in Uruguay and the latter in New Zealand. Potlatch owns only domestic timberlands.

Daniel P. Rohr, an analyst Morningstar, called the R.E.I.T.s a “pretty good substitute" for timberland ownership "because the assets are the same." In both cases, cash flows from the forest, either through the harvest of logs or the sale of land. He cautioned that whenever people buy shares in a single R.E.I.T. or any individual stock, they're taking on company-specific investment risks, like potential bankruptcy. "If I'm owning a timberland R.E.I.T., it's because I'm bullish on U.S. housing, not because I want to add diversification to my portfolio," Mr. Rohr said.

Campbell R. Harvey, an economist at Duke University, likewise warned that timber doesn't improve a portfolio's likely return or dampen its risk. Commodities, like timber, can help protect investments against "an unexpected burst of inflation," he said. But timber should be part of a broader commodities fund or E.T.F. that may also invest in oil, natural gas, metals and other agricultural products. "It's unwise to think timber alone fills the bucket for commodities," he said. "That's analogous to holding 100 shares of I.B.M. and calling that your equity portfolio."

If investing in a timber E.T.F. or R.E.I.T. can be risky, buying a woodlot is more so. A fire, windstorm or insect infestation can fell your trees (and your investment) in short order. And while timber has produced gains for institutional investors — the National Council of Real Estate Investment Fiduciary's Timberland Index has returned an annualized average of about 12 percent since 1986 — small buyers shouldn't expect that.

"I'd say it's not until you get into a $1 million-plus range that you'd start getting into properties that are mostly driven by their investment return," said Jim W. Hourdequin, managing director of Lyme Timber, in Hanover, N.H.

Yet owning a 100- or 200-acre woodlot can make sense for someone who enjoys the land for reasons beyond its financial return, said Tom D. Martin, president of the American Forest Foundation.

Mr. Martin and his sister have 200 acres in northern Wisconsin, and they harvest some of their hardwoods, mainly sugar maples and red oaks, every dozen years or so. The income covers taxes, insurance and road-maintenance costs. In the meantime, their families bunk in the cabin on the property. "The memories and the wildlife are the richest return," he said.

When a novice decides to buy timberland, the first step is hiring a forester, who can help select a plot, said Keith A. Argow, president of the National Woodland Owners Association in Vienna, Va. The forester will evaluate the trees and their quality, the soils and other growing conditions, and even the proximity to potential customers like sawmills, he said. Assuming you find the right property for a good price, you then must manage it. A forester will also help devise a plan for that, including when to harvest and how much.

A management plan can help owners tap into other sources of cash, like leasing hunting rights or participating in state programs that provide tax abatements for, say, improving wildlife habitat or water quality, said Raymond A. Lamberton, president of New England Forestry Consultants. In the Northeast, someone with sugar maples might sell maple syrup. But all of those income streams probably won't add up to big return. "Where you'll make the money on is reselling the land," Mr. Lamberton said.

Daniel E. Crocker, an educational administrator in Bangor, Me., didn't acquire his woodland, in nearby Exeter, Me., to harvest timber. He and his wife, Chris, bought their first 40 acres, in 2002, because they wanted a place to cross-country ski, cut Christmas trees and watch wildlife with their two children.

A few years later, they bought two adjacent parcels, bringing their total holdings to 96 acres and total cost to about $75,000. The land hadn't been logged in 25 or 30 years, and they realized that selling timber could bring in cash, Mr. Crocker said. They've since harvested twice, netting about $15,000, he said. The proceeds have been reinvested in the property, in the form of a trout pond, a road and improvements to the wildlife habitat.

"You're not going to fund your kid's education or retire at 55 this way," he said. "But you can supplement your income."

Though the Crockers are generating cash, the biggest return has been physical and emotional, Mr. Crocker said. Right now, the softwood market, mostly firs and spruce in Maine, he said, "has gone belly up, but I'll still be cross-country skiing on our property on Saturday morning, and we can still make maple syrup there."

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