

# Executive Summary

The dynamics of institutional timberland investing have changed over the past 30 years. Timberland investments have been widely acknowledged for their low correlations to other assets, counter-cyclical hedging properties and extending the efficient frontier of portfolios. With the maturation of U.S.-based timberland investments and the growth of consumption in emerging economies, it is Forest Investment Associates' (FIA) opinion that timberland investors should consider adapting their strategies to the current dynamic of timberland investing by strategically distributing capital across the global timberland investment spectrum.

The U.S. will remain a major component of global timberland portfolios; however, the importance of global wood flows and their resulting effect on the opportunity set for timberland investors has never been more important. The rise of the middle class in countries such as Brazil, China, India and Indonesia propagates a corresponding consumption of wood products. Non-U.S. investments in a globally diversified timberland portfolio offer investors two primary benefits: enhanced returns and diversification. We suggest that enhanced returns are achievable in emerging markets while diversification benefits, earning modest premiums to U.S. timberland investments, are available to investors in the more mature non-U.S. timberland markets.

Mature non-U.S. markets such as Australia, Chile, New Zealand and Uruguay are important countries to timberland investors. The investment objective is not to achieve outsized returns but to diversify cash flows while receiving slight premiums to U.S. timberland returns. These markets have significant capital deployed in the timberland sector, thereby compressing discount rates for new acquisitions given the depth of



*Sixteen-year-old teak plantation in Costa Rica*

capital availability. The track record in these countries is strong as indicated by the relatively long-tenured investment history.

Both the Organisation for Economic Cooperation and Development (OECD) and the McKinsey Global Institute predict that a majority of the world's future economic growth will be in today's emerging economies. Most of this growth will occur in demand-rich but timber-poor emerging countries, especially China and India. Direct investment in these countries can be quite difficult and investors may not be fully compensated for risk exposure. FIA contends that identifying geographically strategic countries with the combination of favorable growing conditions, business environment and logistics is the right move. Malaysia, Cambodia, Indonesia, Vietnam and Laos make up our strategic shortlist of Southeast Asian countries well positioned to meet wood demand in China and India.

Unlike emerging economies in Asia, Brazil has a plantation-based forest products sector which is globally cost competitive and well established. The diversity of end-use markets,

variety in species, and industrial land ownership coupled with the country's highly developed forest plantation capabilities facilitate a stand-alone strategy for timberland investors in Brazil. Of any country in the world, Brazil has the capacity to rival the U.S. timberland market in depth, transactions and eventual assets under management. However, investing in Brazil does not come without pitfalls. The country consistently ranks as one of the toughest countries in which to conduct business, and the 2010 attorney general opinion severely restricts foreign capital from taking title to real estate. Despite its challenges, Brazil should rank as a priority for timberland investors.

FIA proposes three main approaches for timberland investors to augment an allocated or existing U.S. timberland portfolio: 1) gaining timber market diversification through exposure to mature non-U.S. markets, 2) supplying the rapid growth in emerging economies, and 3) participating in the evolution of Brazil's domestic forest industry. Based on risk tolerance and expected return, an investor can customize a mix of strategies to optimize portfolio returns and achieve the objectives of the timberland investment program.