Timberland — Resilience, opportunity amid economic uncertainty

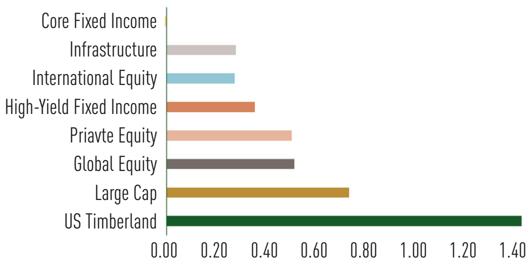
Authors

Daniel Rigby, CFA, CAIA – Director, Portfolio Analytics

MaryKate Bullen – Managing Director, Head of Business Development & Sustainability

The investment landscape as we enter 2025 remains colored by economic uncertainty, geopolitical risk, inflationary pressures, high interest rates, volatile capital markets, and the unknown future of global trade policy. Forest Investment Associates (FIA) believes these challenges necessitate a strategic approach to portfolio management, focusing on stability, diversification, and investment optionality. These same challenges also present opportunities for investors to consider long-term cash flows from assets that are historically uncorrelated with broader market movements. In this context, investors appear to be turning to real assets, such as timberland, which offers tangible value and has historically provided resilience against negative market disruptions. While uncertainty and volatility can create opportunities for savvy investors, FIA believes timberland stands out with its often-underrated qualities — resilience and its real return profile — that help to mitigate broader investment risks. Amid persistently high interest rates and increasing inflation, allocations to timberland have become even more timely for institutional portfolios. This is due to the ability of the asset class to generate long-term returns above inflation, with potential for stable yields from timber sales and other complementary revenue streams.

Sharpe ratios across asset classes, 2014-2024



In this article, FIA reviews timberland's performance across financial shocks and long-dated time periods to explore facets of low volatility, stability, total return, and growing natural capital values that may present a compelling case for investors to actively manage asset allocation and capital deployment in today's uncertain environment.

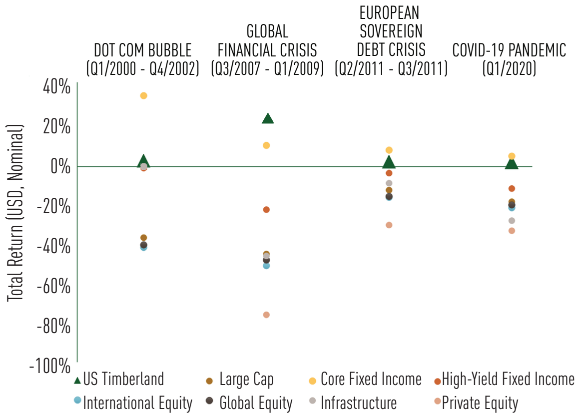
Low Volatility and Stable Returns Over Market Disruptions

Through both academic and industry research publications, timberland has long been recognized for its low volatility and stable returns, offering a hedge against market fluctuations and serving as a resilient asset in periods of economic uncertainty. As an asset class, timberland can offer a high risk-adjusted return, as demonstrated by the Sharpe ratio. This metric, which measures excess return above a risk-free rate relative to investment volatility, highlights timberland's potential advantage in today's investment environment. Over the past decade, US timberland, represented through the NCREIF-Total Timberland Property-Level Index, has outperformed major asset classes on a risk-adjusted basis, with a Sharpe ratio of 1.43, nearly double that of the S&P 500.

The lower volatility of forest investments has been traditionally derived from the role of biological growth as a value driver and the optionality of timing of harvests and forest management in relation to market cycles. Investors receive income from timber sales over time while market values are typically assessed through independent valuations. The interplay between yield and appreciation, as total return, have historically provided a benefit to investor portfolios, giving timberland owners flexibility to defer value from near-term cash flow to medium and long-term appreciation. When market conditions become challenged, forest owners can retain value on the stump — in the forest itself — by postponing harvest and therefore yield, allowing the forest to continue to grow and compound value. Additionally, these two core return components of timber are also influenced by other factors that drive income and appreciation, such as ancillary revenues and underlying land values.

Beyond looking at long-term performance relative to volatility, another perspective regarding downside risk mitigation is to study how timberland has performed against market turbulence and other unforeseen negative economic events. The next chart shown below examines timberland's performance looking across key market disruptions, such as the Dot Com Bubble, the Global Financial Crisis, the European Sovereign Debt Crisis, and the COVID-19 Pandemic. The data indicate that timberland's performance remained stable during these tail events, preserving value with non-negative returns during significant market stress. Timberland and core fixed income delivered the highest returns during these economic shocks, while other asset classes experienced greater value loss and volatility. It is important to note that the comparison reflects short, intense periods of economic disruption and, as a safe-haven asset class, core fixed income performed as expected. During these shocks, US timberland also preserved value through biological growth and the long-term view inherent to the valuation of forest asssets.

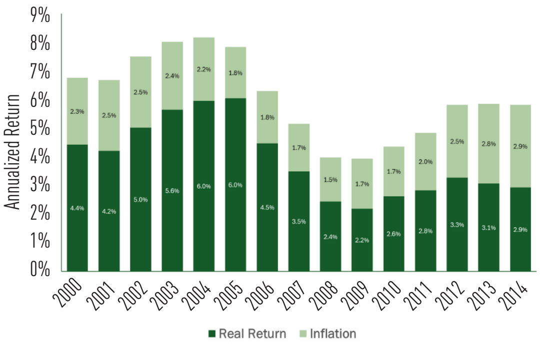
Asset class returns in economic disruptions



Timberland's downside protection supports another interesting financial characteristic: a low correlation with other asset classes. Timberland's correlation to major asset classes is generally below 0.5 and even extends into negative territory. In addition, the capital preservation characteristics of forestry contribute here as well. Because value can be retained on the stump and returns include appraised values that integrate long-term expected cash flows, FIA believes there is comparatively low value-at-risk in timberland assets. As other asset classes may be sharply impacted by market disruptions, corrections, and global events, trees continue to grow, creating value and allowing the appraisal-based component of total return to buffer short-term impacts.

Having established the low volatility and downside protection features inherent in timberland, it is also important to consider return generation over time. FIA analyzed total returns over the past 25 years to determine if data supports the asserted resilience of timberland through market shocks and cycles. The chart below represents 10-year holding periods of timberland across investment vintages starting in the year 2000. Over the past 25 years, FIA finds that regardless of which year an investor

10-Year timberland returns by vintage



entered the timberland investment space, holding an investment for ten years would have resulted in a positive real return. While income and appreciation portions of return shift in response to timing and market conditions, the total return presents overall resilience throughout market influences.

Bringing together the aspects considered above, timberland demonstrates potential for value preservation and stability through uncertain markets, a high relative return per unit of risk, low correlation, consistent real returns, and natural inflation hedging characteristics.

Preserving Value, Finding Optionality Through Forests and Natural Capital

Investors today may also rightly seek to understand where timberland can provide additional return and portfolio benefits beyond weathering difficult investment environments.

FIA sees other attributes of forest investments as being particularly well suited for investors seeking to position portfolios through diversification and added real assets exposure. Beyond biological growth and harvest timing, timberland investors benefit from additional revenues sources, option value in land, and exposure to the natural capital of forest ecosystems. Historically, lease revenues, easements, recreation and "highest and best use" real estate values have been the core ancillary or alternative revenue sources for timberland investments. Today, a diversifying set of complementary value drivers may enhance the traditional return components. For example, growing demand for alternative energy brings revenue from solar and wind leases or sales, and underground carbon capture and storage can lead to significant upside value for timberland owners who also hold subsurface pore storage space.

In addition, markets around the valuation and pricing of natural capital are growing, and forests offer natural carbon storage and sequestration, potential for restoration and reforestation, wildlife habitat, biodiversity conservation, water quality and quantity benefits, and more. As environmental markets continue to develop in response to climate change, nature loss, and environmental degradation, FIA believes this will benefit forest investors who demonstrate long-term sustainability practices consistent with sound forest management. In some cases, environmental market revenues are part of current forest investment theses, providing additional income realizable today, and FIA anticipates that the current upward trend toward alternative and complementary environmental values will continue.

Where novel environmental values cannot be monetized today, timberland investors may acquire and manage natural capital assets with potential to realize additional revenue sources as markets or regulations develop in the future. FIA believes that with increasing pressure on the world's natural resources and land base, productive forest assets that sustain natural capital are positioned for increased financial and non-financial values. While the size of global carbon markets stayed relatively flat in 2024 at around $1.4 billion and with 180 MtCO2e of retirements, MSCI Carbon Markets forecasts credit markets could reach from $7-35 billion by 2030.[1] Even as headlines tout the separation of major investors and banks from net-zero alliances, carbon markets have seen increasing interest in nature-based carbon removals such as those from reforestation, and in the first three quarters of 2024, investment into nature-based carbon alone was nearly $9 billion.[2] Beyond carbon and into biodiversity, the World Economic Forum found potential for biodiversity credit markets to reach $2 billion by 2030 and $6 billion by 2050,[3] and forests are home to more than 80% of the planet's terrestrial biodiversity, according to the United Nations. Aligning commercial timberland strategies with solutions to environmental challenges presents not just an ESG benefit, but potential for added return on investment, combining natural capital strategies with commercial forestry and sustainable timber production. For investors facing long-term climate and nature-related risks and regulation, accessing natural capital through timberland offers a reputational and financial risk mitigation strategy.

As the forestry asset class continues to expand and evolve, the movement to embrace a broader emphasis on natural capital — where real assets like forestry and agriculture intersect with the management of ecosystem services and nature-based solutions — is set to grow. FIA believes management strategies should continue to emphasize risk mitigation to protect return over time. Looking to these new values alone, or even merely over-reliance on novel sources of upside, could risk the demonstrated timberland benefits discussed above. However, when integrated into long-term commercial forest management strategies, FIA believes investors can gain both traditional portfolio benefits and exposure to higher risk-adjusted returns from emerging and evolving value drivers.

Conclusion

In summary, FIA views forest investments as durable real assets that provide relatively attractive risk-adjusted returns, demonstrate stable performance during market disruptions, and have historically delivered positive real returns across a broad range of economic conditions. As we navigate the opportunities and challenges of 2025, FIA encourages investors to consider the role of timberland and natural capital alongside their proven benefits for investment portfolios. Wood products support the essential infrastructure of modern life—from the homes we build to the packaging that connects global trade and the hygiene products vital to a growing population. As the world continues to depend on forests, timberland investments stand as an enduring solution for real asset investors seeking stability, growth, and sustainability.

In a world of increasing complexity, the timeless simplicity of forests—growing, renewing, and sustaining—offers both tangible value and enduring opportunity.

FOREST INVESTMENT ASSOCIATES®

Since 1986, Forest Investment Associates (FIA) has managed forest investments with a commitment to sustainability and performance. Serving institutional investors, we offer access to diverse timberland and natural capital assets with approximately 2.1 million acres (855,000 hectares) of certified forests in the United States and Latin America and approximately $5.1 billion in AUM as of 9/30/24. FIA's approach blends its deep experience in natural resource management with a focus on long-term returns, environmental stewardship, and helping clients grow value through sustainable forestry. FIA is proudly independent and majority employee owned with offices across the Americas.

Data Sources and Information for All Charts: All returns are as of 9/30/2024, gross of investment management fees, and reported in USD. The indices include NCREIF Total Timberland Property-Level Index (Timberland), S&P 500 (Large Cap), MSCI ACWI (Global Equity), MSCI EAFE (International Equity), ICE BofA HY Index (High Yield Fixed Income), Bloomberg Barclays U.S. Aggregate Bond Index (Core Fixed Income), S&P Global Infrastructure Index (Infrastructure), and S&P Listed Private Equity Index (Private Equity). All benchmark indices, except for Timberland, are sourced from Bloomberg; the Timberland return data is provided by NCREIF. In the market disruptions chart, returns are calculated from the peak-to-trough for each benchmark during each specific market disruption. Sharpe ratios are based on a ten-year holding period ending 09/30/2024, with the 10-year Treasury yield used as a proxy for the risk-free rate. Inflation calculated via Federal Reserve Economic Data (FRED) Consumer Price Index for All Urban Consumers: All Items in U.S. City Average, Seasonally Adjusted

Disclaimer: Information based on stated datasets and third-party references as well as subjective views of the authors. This does not constitute an offering of any investment or an inducement to participate in any investment or investment advice. Past performance does not guarantee future performance. FIA is a Registered Investment Adviser with the Securities and Exchange Commission in the United States.

[1]MSCI Carbon Markets.
[2]MSCI Carbon Markets.
[3]WEF (December 2023). Biodiversity credits: Demand Analysis and Market Outlook.