The policy goals and priorities of the Trump Administration are slowly coming into focus following Donald Trump’s upset win of the Presidency and the Republican’s holding onto majorities in both chambers of Congress. President elect Trump’s statements to date on the policy agenda for his first 100 days have opened a window onto where his more immediate efforts will be focused, and four areas clearly have the potential to directly impact on North American timber markets:

- Economic Growth
- Financial Sector Regulation
- Trade
- Immigration

The first two areas, economic growth and financial sector regulation have the potential to boost demand for wood products and timber by energizing housing markets. A more restrictive trade policy could have negative repercussions for the overall economy, but is likely in the near-term to favor the interests of the U.S. solid wood product sector and their suppliers of timber through tougher sanctions on the trade in softwood lumber with Canada. Finally, changes in immigration policy and the resulting constriction in labor availability could be a restraining factor in the current recovery in residential construction activity and could result in temporary and localized operational disruptions for timberland owners.

Following from his campaign slogan of “Make America Great Again”, President elect Trump has very sketchily outlined his intentions to apply a Keynesian program of infrastructure construction and tax cuts to stimulate the overall economy and to increase the rate of job creation. The degree that these goals can be met will be limited by Congress’s willingness to provide the funds for an ambitious public works program in the face of once again increasing federal budget deficits. However, an infrastructure program funded by investment tax credits rather than direct grants is a likely possibility. In addition, the Republicans control of Congress would be primed to seize this rare window of opportunity to enact both personal and business tax cuts. Consequently, a substantive Trump stimulus package has a reasonable probability of enactment in the first half of 2017, and would definitely enhance growth prospects over the next two years. Even New York Times economist Paul Krugman begrudgingly acknowledged on 11/14/16 that “…a Trump administration might actually end up doing the right thing for the wrong reasons… But an accidental, badly designed stimulus would still, in the short run, be better than no stimulus at all. In short, don’t expect an immediate Trump slump”.

The injection of meaningful economic stimulus in the next year would support further job creation at a point in the recovery when we are already at a 4.6 percent unemployment rate. Additional employment demand in a labor market with dwindling slack has a strong probability of being accompanied by real gains in wages and personal income. Financial markets have already recognized the potential for stronger U.S. economic growth in the next two years and have translated this view into the post-election bounce in the U.S. stock market, significant increases in bond yields, and a rebound in the U.S. dollar (Chart 1).

Residential construction, the key driver of U.S. timber values, will directly benefit from these Trump initiatives to boost economic activity. Strong job markets, higher labor participation rates and rising wages will all help enable potential first-time home-buyers, who have been side-lined by economic considerations, to move into the housing market. (Chart 2, page 2). Rising mortgage rates, which will accompany the bump-up in economic growth and wages, will act to moderate a resurgence in housing activity, but rising interest rates are not likely to cancel out the benefits to housing of stronger economic growth. Mortgage rates are currently near historical lows and the Federal Reserve is likely to remain

(Continued on page 2)
cautious in moving in the direction of tighter credit conditions given the still weak global economy, the strong recent rebound in the U.S. dollar, and the still extremely high level of global political and financial uncertainty. In addition, the positive impacts of improved economic growth on U.S. housing should be amplified by a second Trump policy area impacting timber, financial sector regulation.

Donald Trump has stated his intent to reduce the level of federal regulation impeding economic growth and business formation, and has specifically targeted the roll-back or down-sizing of the Dowd-Frank legislation passed under the Obama administration. An easing of banking regulations could encourage banks to broaden their mortgage lending beyond their currently narrow focus on just the most creditworthy borrowers and those seeking jumbo loans (>$417,000). In addition, credit availability for the housing market would positively respond to a shift away from the aggressive approach the current Justice Department has taken against past mortgage practices, which has resulted in big banks largely abandoning making mortgage loans insured by the Federal Housing Administration. Greater access to credit, particularly for new entrants to the housing market, could generate a strong tail-wind for home construction.

More restrictive international trade policy was another key campaign issue for Donald Trump, accompanied with promises to renegotiate existing trade agreements (such as NAFTA) and to be more confrontational with perpetrators of unfair trade practices (such as alleged currency manipulation by China). Implementing tariffs and quotas could have a chilling effect on U.S. international trade (particularly combined with an even stronger U.S. dollar), and result in a headwind to overall growth in the U.S. economy. The degree to which the Trump administration will pursue this avenue and the particular trade issues they plan to address have yet to be delineated.

For U.S. timberland owners, the most impactful trade issue is the current effort to renegotiate a softwood lumber agreement with Canada. The last trade agreement, which effectively limited Canadian exports of softwood lumber to the U.S., expired just over a year ago, and subsequently, Canadian shipments of softwood lumber have increased strongly. (Chart 3) The U.S. Foreign Agricultural Service report that Canadian softwood lumber exports to the U.S. in the first three quarters of 2016 were up 30 percent from the same period a year earlier. The imposition of quotas or duties on Canadian softwood lumber exports to the U.S. would result in higher softwood lumber prices and more demand diverted to U.S. sawmills, both of which would translate into stronger markets and prices for U.S. softwood sawlogs.

The U.S. Lumber Coalition recently filed a petition with the Department of Commerce (DOC) seeking the placement of duties on Canadian imports. The investigation of the countervailing duty (CVD) case will be conducted concurrently with on-going negotiations on a new softwood lumber trade agreement between the U.S. and Canada. The Department of Commerce will oversee the CVD case and determination of damages will be the responsibility of the U.S. International Trade Commission (ITC). The CVD case will be somewhat insulated from the results of the recent election, since the DOC staff who will be working on the case are largely career employees and the ITC consists of six members (always three Republicans and three Democrats) who serve nine-year terms. Negotiations on a new treaty were initiated by the Obama administration last year, but Trump will be appointing a new U.S. Trade Representative, who will take on direct responsibility for the negotiations next year. Canadian officials have already expressed concern that Trump’s administration
U.S. housing starts eased slightly in third quarter of 2016, slipping 2 percent from the previous quarter. For the first three quarter of 2016 housing activity improved compared to the same period in 2015, with total housing starts up 5 percent and the proportion of single family starts rising to 67 percent from 64 percent over the first three quarters of 2015. The stronger residential construction activity provided support for the Crow’s Framing Lumber Composite Index to move 2 percent above the second quarter. On a year over year basis, softwood lumber prices in the third quarter were 12 percent higher than in the third quarter a year earlier. Currently, the U.S. softwood lumber industry recently filed an unfair trade practices suit against Canada, which could result in Canadian imports of softwood lumber being subject to countervailing duties sometime in the first half of 2017. This action would bolster North American softwood lumber prices.

In the third quarter of 2016, Australian dwelling approvals (a key indicator of residential construction activity) were 58.6 million units, slightly above the previous quarter, but still 3 percent below the cyclical peak of 60.6 million units set in the first quarter of 2015. The flattening out of Australia’s housing activity in recent quarters reflects an easing in the overall Australian economy, tied to weakness in global commodity markets and slower growth in China. Structural lumber prices held at last quarters level, which remains 3 percent below third quarter prices last year. When published in early January, Australian sawlog stumpage prices are expected to be flat to down from the prior six months.

Log exports from New Zealand to China reached a new peak in the third quarter. At 3.3 million cubic meters, sawlog exports to China from New Zealand were up 8 percent from the previous quarter, and were nearly 1 percent above the all-time high set in the second quarter of 2014. Demand for New Zealand radiata pine logs in China has benefited from a revived construction sector due to an easing in credit availability. The price of New Zealand sawlogs delivered to China, denominated in USD, held steady in the third quarter despite improved demand, as competition with other supply regions (particularly Russia) remained strong. In the third quarter, the price of New Zealand sawlogs delivered to China (on a USD basis) were 26% higher than in the same period a year earlier.
Figure 4. Exchange Rates
The U.S. dollar was relatively stable in the third quarter of 2016 against the currencies of Brazil, Canada and Chile, and lost a little ground against the Australian dollar and the New Zealand kiwi. Compared to the second quarter, the U.S. dollar appreciated against the currencies of Canada and Brazil by roughly 1 percent, and weakened by less than 1 percent against the Chilean peso. The currencies of both Australia and New Zealand made modest gains over the previous quarter, of 3 percent and 2 percent, respectively. The relative calm in currency markets will not extend into the final quarter of 2016, as the U.S. dollar is poised to make significant gains based on the Trump victory in the U.S. presidential election and the strong probability that the Federal Reserve will raise interest rates at their December meeting.

Figure 5. Regional Softwood Sawtimber Stumpage Prices
In the third quarter, New Zealand softwood sawlog stumpage prices denominated in U.S. dollars stabilized (up 1 percent from the previous quarter) after staging a dramatic recovery over the previous three quarters, and are now close to the levels sustained in mid-2014. New Zealand sawlog prices have rebounded on a recovery in China’s demand for sawlog imports. U.S. Pacific Northwest sawlog prices benefited from a combination of healthy export demand and strong domestic sawlog markets, gaining 3 percent over the previous quarter. In the U.S. South, timber prices continue to be held down by ample timber inventories throughout the region despite increases at domestic sawmills and plywood plants and rising exports of both logs and lumber. In the third quarter, U.S. southern pine sawlog prices drifted lower, slipping 2 percent compared to the second quarter.

Figure 6. Pulp and Pulpwood Prices, U.S. South and Brazil
In the third quarter, the price of Bleached Eucalyptus Kraft Pulp (BEKP) continued to drift lower (1 percent) as global hardwood market pulp capacity expands. Concurrently, Southern Bleached Softwood Kraft (SBSK) pulp moved in the opposite directions from BEKP, gaining 2 percent over the previous quarter, and widening its premium over the BEKP price to 14 percent. Pine pulpwood delivered prices in the U.S. South lost 1 percent compared to the second quarter, but were still up 1 percent from 3rd quarter last year. Eucalyptus delivered pulpwood prices in Brazil increased 8 percent over the previous quarter, and 7 percent above prices third quarter last year.
Figure 7. U.S. Timberland Operating Cash Yields
U.S. cash yields from timberland operations at 2.30 percent in the third quarter, were up 60 basis points from second quarter yields, which is just shy of last year’s third quarter yield of 2.31 percent, and at the average of third quarter cash yields reported over the past five years.

Figure 8. Hancock Securitized Timberland Index
The Hancock Securitized Timberland Index, a market-capitalized weighted performance Index of timberland held in public market ownership rose 18 percent from June through September. The Index’s increase is largely due to the rally of Weyerhaeuser stock over the quarter, which increased nearly 21 percent over the three month period. Weyerhaeuser’s rapid rise was largely brought on after a coverage initiation by Goldman Sachs which assigned the security a ‘Buy’ ranking with substantial upside. On the day Goldman released their report, Weyerhaeuser stock increased by nearly 6 percent. Potlatch also contributed to the Index’s gain, rallying 14 percent over the quarter, while Rayonier and Deltic Timber continued positive gains. Only Catchmark detracted from performance, falling just over 4 percent, due in part to the release of poor

Figure 9. Timberland Enterprise Value
In the third quarter, timberland held in private financial ownership in the U.S. South averaged $1,779 per acre, representing a small decrease over the second quarter but marginally up year-over-year. Public timberland values, measured by the Timberland Enterprise Value per Southern Equivalent Acre (TEV/SEA), increased by 11 percent over the quarter, and by 19 percent year over year, largely due to a sizeable rally in Weyerhaeuser stock. In the third quarter, Weyerhaeuser comprised 80 percent of the Index’s value.
will be less accommodative in their approach to trade negotiations than Obama.

Tighter immigration controls were also a high-profile component of the Trump campaign message and have been highlighted as a priority issue for the new administration. A more restricted labor pool could have some negative implications for timber markets. A more limited migrant labor force could result in operational difficulties and constraints for U.S. timber owners, increasing competition for and the price of labor for harvesting, planting and transporting timber. A more restricted pool of labor in the construction trades could also slow the future expansion in residential construction activity and add to the price of home construction. However, these negative labor effects are more likely to be regionally concentrated and temporary in their ability to broadly disrupt timber markets.

In summary, President-elect Trump’s intentions to bolster the pace of economic growth and employment through a combination of infrastructure spending, tax cuts, and deregulation of the financial sector should bolster the forward momentum in U.S. housing markets, at least over the next year or two. Trump policies are also likely to put upward pressure on interest rates, but the moderating impacts of rising mortgage rates should be off-set by corresponding gains in real income and expanded access to credit for home buyers. A more restrictive trade policy coupled with a stronger U.S. dollar will be a problem for some export oriented segments of the forest product sector, such as market pulp and the export of West Coast sawlogs, but the key value component of U.S. cross-border trade in forest products is imports of Canadian softwood lumber, and U.S. timberland values would benefit at least in the short-term from the re-imposition of trade restrictions. Even with the possibility of higher labor costs in both timber operations and in down-stream construction markets, the Trump administration’s initial policy agenda is on balance a positive influence on the outlook for timber markets in 2017.

Footnote:  
1 http://www.nytimes.com/2016/11/14/opinion/trump-slump-coming.html?_r=0

NOTES:

Figure 1. The source for the U.S. Housing Starts is U.S. Bureau of Census. The Housing Starts data includes Single-family and Multi-family starts. RISI’s Crown Framing Lumber Composite Index data is used for lumber prices.

Figure 2. Quarterly Australian Dwelling Unit Approvals is published by the Australian Bureau of Statistics. The Lumber Index is published by Induror Timber Market Survey using Softwood Structural lumber prices (Blended Price - 60 percent MGP 10 90x35x4800, 40 percent MGP 10 70x35x4800). Log Price Index is calculated using the (APLPI) Radiata Pine Domestic Stumpage prices. The log price is an average of Intermediate and Medium sawlog prices.

Figure 3. Quarterly New Zealand softwood log export volume to China and China Import prices are published by the RISI International Timber Service.

Figure 4. Monthly average Exchange Rates are from Macrowind.

Figure 5. Quarterly Softwood Sawtimber Stumpage Prices for the U.S. Pacific Northwest is reported in Loglines published by RISI. The weighted index is made up of 50 percent Domestic Douglas-fir (47 percent #2 and 53 percent #3 Sawmill sorts) and 50 percent Whitespruce (47 percent #2 and 53 percent #3 Sawmill sorts). U.S. South prices are published by Timber Mart-South (60 percent Southern Pine Sawtimber and 40 percent Chip-n-Saw). Australian domestic prices are calculated using the KPMG Australian Log Price Index (APLPI) Radiata Pine Domestic Stumpage prices. The log price is an average of Intermediate and Medium sawlog prices.

Figure 6. Quarterly Market Pulp prices are published by Hawkins Wright. U.S. Southern Pine Pulpwood prices are published by Timber Mart-South. Brazil Eucalyptus Pulpwood prices are published by STOP Engenharia de Projetos Ltda.

Figure 7. Annualized Operating Cash Yields are published by National Council of Real Estate Investment Fiduciaries (NCREIF). Yields are calculated using 60 percent U.S. South and 40 percent U.S. West.

Figure 8. The Hancock Securitized Timberland Index (HSTI) uses a base-weighted aggregate methodology (similar to that used to construct the S&P 500) to calculate a market capitalization-weighted value for five publicly traded timber-intensive forest products companies. Base weights were adjusted for the emergence of new companies or at the beginning of each year. Dividends are not reinvested. The companies included in the HSTI have no investment relationship with Hancock Timber Resource Group.

Figure 9. Public equity values are derived from our Timberland Enterprise Value per Southern Equivalent Acre (TEV/SEA) calculation for five timber-intensive publicly traded companies as compared to southern timberland values per acre calculated from the NCREIF database. TEV is a quarterly estimate based on total enterprise value (total market equity + book value debt) less estimated value of processing facilities, other non-timber assets and non-enterprise working capital. SEA uses regional NCREIF Sacre values to translate a company’s timberland holdings in various regions to the area of southern timberland that would have an equivalent market value.

References to expected investment performance in this newsletter are based on historical information and are based on management projections. Potential for profit as well as for loss exists.