

# Commodities Investing – Shiver Me Timbers!

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**“Success is often nothing more than moving from one failure to the next with undiminished enthusiasm” - Winston Churchill**

In our review and analysis of the various asset options that compose the 7Twelve allocation philosophy, the importance of low correlation continues to be the primary factor that contributes to overall successful returns. In this week’s article, we will discuss the role the commodities sector plays in fulfilling this requirement.

A commodity is an item for which there is demand, but is supplied without qualitative differentiation across a market. Commodities are generally basic resources and agricultural products, such as iron ore, crude oil, coal, salt, sugar, coffee beans, soybeans, aluminum, copper, rice, wheat, gold, silver, palladium, and platinum. Soft commodities are goods that are grown, while hard commodities are extracted through mining. Energy commodities, which include electricity, gas, coal and oil, will be the topic of next week's article.

Traditionally, commodities have proven to be quite volatile. However, commodity prices have been rising over the past three years. There has been significant press espousing the recent high prices of gold and silver, but investors need to keep in mind that commodities do not earn. They simply grow, or shrink, in market price. Gold is a good example. The price of gold soared from \$77 an ounce in 1977 to more than \$800 an ounce by 1981. Yet, cash held in gold was dead money for the next 26 years. The price didn’t exceed \$800 again until the fourth quarter of 2007.

There are a myriad of ways to invest in commodities, such as futures and options. These types of investments can be risky and require sophisticated knowledge. In contrast, mutual funds and ETFs can cover a range of commodities, either in broad or focused sectors. Dr. Craig Israelsen, creator of the "**7Twelve Asset Allocation Strategy**", demonstrated that commodities reduce portfolio risk and offered an option termed “quasi-commodity”. Quasi-Commodities are mutual funds that serve as proxies for commodities.

TPI firmly believes that commodities are an integral component of a diversified portfolio. One particular sector that we are excited about is **TIMBER!** Since the days of Robin Hood and King John, the wealthy and powerful have owned woodland. Twenty years ago, insurance companies and big pension funds started purchasing forests as a hedge against inflation. For the first time, economists began evaluating timber in terms of total returns and risk/reward ratios. The track record of early investors, and the results of recent academic research, indicates that timber is a near-perfect asset.

Studies show that a diversified timber portfolio would have returned 13.3 percent annually over the past 40 years, compared with 11.6 percent 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 percent, timber gained 233 percent. Most recently, when the S&P 500 lost 38

percent in 2008, the Timberline Index ***gained*** 9.5 percent. Timber is a valuable tool for portfolio diversification, as its price movements have a very low correlation to most other asset classes – less than +0.1. The United Nations predicts that the demand for wood will double in the next 30 years, with China (already number 2 in wood consumption) pacing the growth.

The best reason to invest in timberland is the simple fact that trees grow. Silently unattended, the average North American forest produces about 8 percent more timber every year. As trees grow larger, their value increases. Consider southern pine. Wood from 12-year-old trees is used for pulp, and a cord sells for about \$20. When those same trees are 24 years old, they are used for saw timber and worth about \$60 a cord. In periods where pulp prices are more favorable than lumber prices, lumber managers can take advantage by harvesting early and replanting. The differing uses of wood also allow investment managers to insulate investments from downturns in adversely affected markets. As in our current situation, when housing starts are low due to problems in the real estate markets, managers can sell more timber to paper companies or other forest product companies.

Gold, silver, and platinum can be alluring and act as important investment tools. They are considered an option to hedge against inflation. Timber might not be as 'sexy' an investment modality, but in various forms can be an excellent asset in a diversified portfolio. TPI feels very strongly that commodities, especially timber, should be an integral part of client's investment strategy.