Hancock Natural Resource Group®

A Manulife Investment Management Company

Natural Resource Flash Report

Timberland-Farmland: Resilience under Uncertainty

After nearly three months since the COVID-19 outbreak was declared a pandemic on March 11th, 2020, enough statistical economic information has accumulated to start gauging the tolls on global economic activities during the pandemic so far. In the first quarter of 2020, the annual rate of growth in U.S. GDP dropped -4.8 percent, while China's GDP contracted at an annual rate of -6.8 percent, marking the first negative reading since this measure was first tracked in 1992.[1,2] Financial markets also experienced historical selloffs. The U.S. S&P 500 fell 22 percent in the nine trading days after the pandemic declaration, while the broader developed market equities represented by the MSCI EAFE Investable Market Index saw 21 percent of its market value wiped out in the same period.[3] The current COVID-19 crisis has us reflect upon the relative performance of different sectors and asset classes from a historical perspective and highlights the necessity of real assets such as timberland and farmland to add greater resilience and lower return variance in an institutional investor's portfolio.

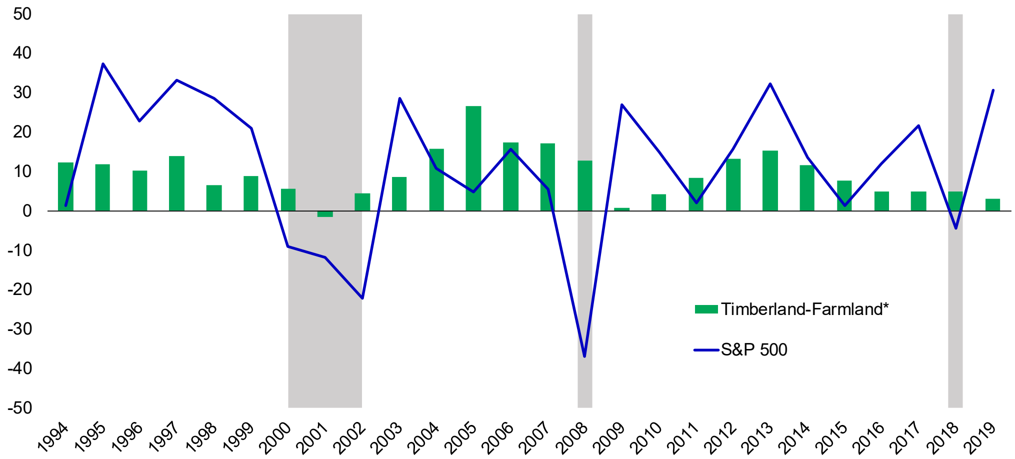
Timberland and farmland are long-term assets with strong historical performance and low-to-moderate variance in returns, providing institutional investors with favorable diversification benefits. This analysis provides a comparison between the returns on a combined timberland-farmland investment compared to public equities and long-term government bonds, with the focus on periods that experienced exogenous shocks resulting in significant financial volatility.

Chart 1 (see on page 2) provides an overview of historical returns for timberland-farmland investments compared to equities during the period 1994-2019. When mixed together in equal proportions, the 50/50 combination of timberland and farmland investments (green bars) showed positive total return performance in 25 out of the past 26 years, while U.S. stocks (represented by the blue S&P 500 line) displayed more pronounced volatility, with more instances of negative performance. In comparison to public equities, the 50/50 combined timberland-farmland investments demonstrated more consistent and resilient performance.

[1]The Wall Street Journal, April 29, 2020. https://www.wsj.com/articles/first-quarter-gdp-us-growth-coronavirus-11588123665
[2]The Wall Street Journal, April 17, 2020. https://www.wsj.com/articles/china-set-to-report-plunge-in-first-quarter-gdp-11587086697
[3]The Wall Street Journal, Feb 28, 2020. https://www.wsj.com/articles/more-markets-head-toward-correction-territory-as-coronavirus-spooks-investors-11582864550?mod=article_inline&mod=article_inline

Timberland and Farmland Delivered Consistent Positive Annual Returns Historically while Stock Markets Experienced Pronounced Downswings

Chart 1: Annual percentage returns for the S&P 500 and a 50/50 combined timberland-farmland investment (1994-2019)

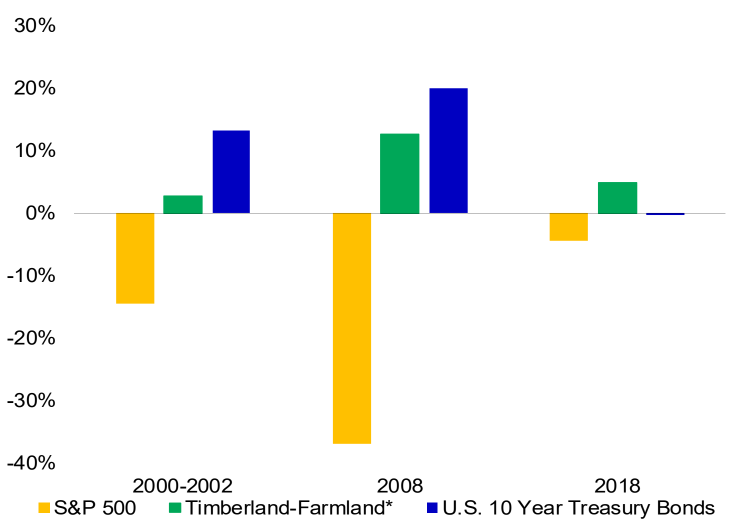


Source: Macrobond February 2020, NCREIF January 2020, HNRG Research February 2020.
Note: Timberland-Farmland is represented by a constructed index of 50 percent NCREIF Timberland Property total annual returns and 50 percent NCREIF Farmland Property total annual returns.

During 1994-2019, public equities experienced three periods of negative annual returns (shaded areas in Chart 1), i.e. 2000-2002, 2008 and 2018. In the first period, 2000–2002, the S&P 500 declined -38 percent over a three year period, responding to the collapse of the "dot-com" bubble in 2000 and the 9/11 terrorist attacks in the U.S. the following year. In 2008, the Global Financial Crisis triggered a -37 percent drop in the S&P 500. Lastly, in 2018, the U.S. stock markets experienced a modest downturn reacting to tightening monetary policy, following a series of interest rate hikes implemented by the Federal Reserve, and the uncertainty related to escalated trade disputes between the U.S., China and other major trading partners.

Timberland and Farmland Remained Resilient when Stock Markets Tumbled

Chart 2: Annual returns for the S&P 500, the 50/50 combined timberland-farmland investments and long-term U.S. government bonds in 2000-2002, 2008 and 2018



Source: Macrobond February 2020, NCREIF January 2020, HNRG Research February 2020.
Note: Timberland-Farmland is represented by a constructed index of 50 percent NCREIF Timberland Property total annual returns and 50 percent NCREIF Farmland Property total annual returns

Chart 2 compares the annual returns for public equities (represented by the S&P 500), the 50/50 combined timberland-farmland investments and long-term U.S. government bonds during these three periods of financial and economic dislocation. In all three periods, a 50/50 mix of timberland and farmland delivered positive returns.

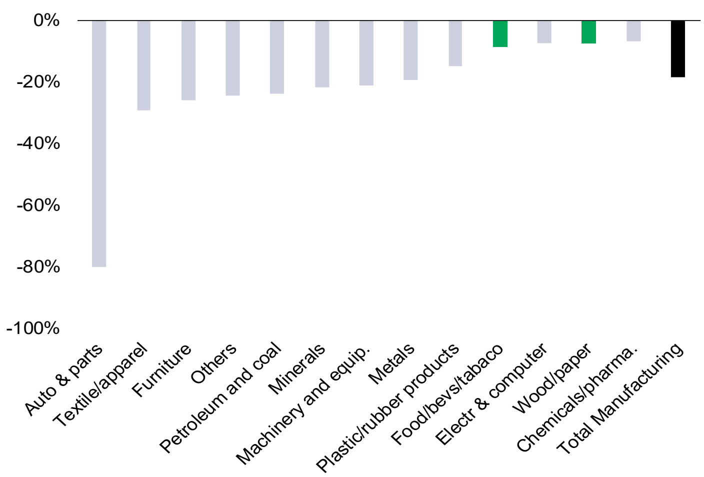
During the 2000-2002 recession, a combined timberland-farmland investment generated average annual returns of 2.2 percent, supported by appreciating farmland values, which compared favorably with annual returns of -14.5 percent for the S&P 500. In this period of financial and political upheaval, returns on bonds were also favorable, averaging 13.3 percent, with investors seeking safe-haven, low risk assets.

During 2008, the S&P 500 lost 37 percent, as capital fled public equities while bonds rallied, gaining 22.2 percent. Although not matching the returns on bonds, timberland-farmland generated healthy positive returns of 12.7 percent in a year of economic crisis. Key contributors to the strong performance of timberland-farmland in 2008 were surging agricultural commodity prices driven by increasing international trade of farm products.

[4]Board of Governors of the Federal Reserve System (US), retrieved on May 28, 2020. Industrial Production: Manufacturing (NAICS) [IPNMAN], https://fred.stlouisfed.org/series/IPNMAN

Timber and Agriculture Related Manufacturing Sectors Less Impacted in March and April

Chart 3: Cumulative percentage changes in output of manufacturing sectors as measured by changes in manufacturing industrial productivity indices in the U.S. during March and April 2020



Source: Board of Governors of the Federal Reserve System (US), Industrial Production: Manufacturing (NAICS) [IPNMAN], Retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/seriesIPNMAN, May 28, 2020.

In 2018, the slow-down in the U.S. and global economies led to a -4.4 percent drop in the S&P 500, while increasing interest rates and a flattened yield curve pushed the annual return on long-term government bonds below zero, dipping to -0.1 percent. Despite the shift in monetary policy, timberland-farmland investments continued to generate 5 percent returns for investors in 2018. Although markets for certain forest products and agricultural commodities were negatively impacted by the trade disputes between the U.S. and China beginning in 2018, a broad mix of timber and farm products allowed investors with diversified portfolios of timberland and farmland properties to weather a year of financial turbulence.

Recently reported manufacturing data suggest that the past patterns of resilience that have characterized timber and agriculture related investments could very well carry over into the current COVID economic downturn. Chart 3 shows the cumulative decline in U.S. manufacturing output by sector during March and April 2020. The U.S. total manufacturing output in March and April, as measured by the percentage changes in the Industrial Output Index, dropped a cumulative 18 percent over the two months.[4] Timber and agriculture related sectors fared well compared to other major sectors, with food/beverage/tobacco, at -9 percent, and wood/paper, at -7 percent, among the least impacted sectors.[5,6,7]

Unfortunate global events, such as the global outbreak of COVID-19, inject unanticipated added volatility to the investment landscape. Timberland and farmland investments can help to insulate a diversified portfolio from exogenous shocks to the economy and the financial environment, bringing greater consistency and resilience to a portfolio's return profile.

[5]Board of Governors of the Federal Reserve System (US), retrieved on May 28, 2020. Industrial Production: Nondurable manufacturing: Food, beverage, and tobacco [IPG311A2S], https://fred.stlouisfed.org/series/IPG311A2S

[6]Board of Governors of the Federal Reserve System (US), retrieved on May 28, 2020. Industrial Production: Durable manufacturing: Wood product [IPG321S], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/IPG321S

[7]Board of Governors of the Federal Reserve System (US), retrieved on May 28, 2020. Industrial Production: Nondurable manufacturing: Paper [IPG322S], https://fred.stlouisfed.org/series/IPG322S

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About Hancock Natural Resource Group

Hancock Natural Resource Group, Inc. is a registered investment adviser and part of Manulife Investment Management's Private Markets platform. We specialize in global farmland and timberland portfolio development and management on behalf of our investors worldwide. Our timber division manages approximately 6 million acres of timberland across the United States and in Canada, New Zealand, Australia, and Chile. Our agricultural investment group oversees approximately 300,000 acres of prime farmland in major agricultural regions of the United States and in Canada and Australia.

About Manulife Investment Management

Manulife Investment Management is the global wealth and asset management segment of Manulife Financial Corporation. We draw on more than 150 years of financial stewardship to partner with clients across our institutional, retail, and retirement businesses globally. Our specialist approach to money management includes the highly differentiated strategies of our fixed-income, specialized equity, multi-asset solutions, and private markets teams.

Important Information