



MADISON'S TIMBER PREVIEW

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This week lumber futures on the Chicago Mercantile Exchange are the hot topic among investors. A small rush of trading at the end of last week then a drop in activity in the middle of this week has analysts looking at lumber futures closely. The impact of futures on cash lumber prices is negligible, except in terms of perception. However when a contract is drawing to a close sometimes lumber dealers take the opportunity of discounted futures prices to request delivery. Such oddball occurrences have been popping up this week.

Pit-traded CME lumber futures prices Monday closed higher amid commodity fund-style repurchase of previously sold contracts in November, and outright buying of January positions. Futures closed up 3 per cent in limitless November and set an 11-week high on Monday as funds rolled their short November positions, and a firmer tone to cash lent support. Commercial traders, those who actually make or use the wood, were sellers. Mills were said to be willing to participate as sellers after three days of gains in the futures market. Cash markets were very quiet as cash traders remained unimpressed by the futures action.

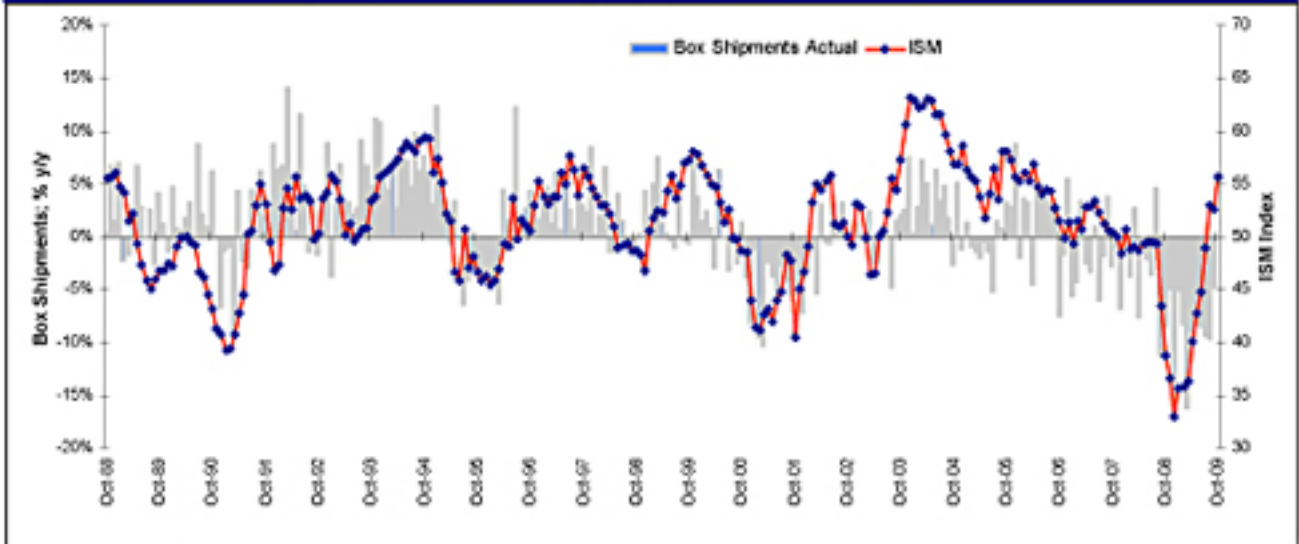
One analyst said the buying was started by pending home sales index from the National Association of Realtors that was construed by the complex as bullish. The forward-looking indicator, based on contracts signed in September, rose 6 per cent to a reading of 110.1 as Americans rushed to meet a deadline for a home-buyer tax credit. This indicator hit 21 per cent above the same analysis a year ago, when it was 90.9.

The benchmark makes this jump, from autumn 2008 to the present, the largest annual increase on record. In another indication of a recovering economy, the US Commerce Department said on Monday that US construction spending in September rose 0.8 per cent to \$940.3 billion, with home building rising 3.9 per cent, as residential builders rushed to finish projects in anticipation of a possible end to the first-time home-buyers tax credit. It is the largest gain since rising 4.2 per cent in July 2003. US mortgage applications rose for the first time in four weeks, reflecting a jump in demand for home refinancing loans as interest rates on 30-year loans dropped below 5 per cent, the Mortgage Bankers Association said on Wednesday. President Barack Obama on Friday will sign into law a congressional bill that will provide more aid to jobless workers and broaden tax breaks for homebuyers and businesses, the White House said on Thursday.

As the only thing left to do with these tax breaks for home buyers is dot the I's and cross the T's, this rush by home builders and buyers may not have been warranted. The combined momentum, however, could push real estate activity into higher gear early next year. Currently, distressed properties are making up a large proportion of sales, thus the recent uptick in activity may mask uncertainty about the long-term outlook. The Federal Reserve is focused on keeping mortgage rates low, but that motivation should wane in the months ahead. In fact, some analysts say if home prices fall again, with a new wave of foreclosures in the pipeline the negative difference is viewed as one of the largest obstacles to a recovery. The next round of foreclosures, however, will mostly be in the commercial property sector.

Given the upward activity in leading indicators for US home building and the US economy in general, the relationship between the Institute of Supply Management's monthly manufacturing supply index and corrugated box shipments deserves another look. Readers will remember Madison's examined this relationship in the August 14, 2009 issue of your Timber Preview. In a note on Wednesday, equity analysts at Deutsche Bank stated, "See graph of the 22-year look at the relationship between the ISM index and corrugated box shipments. Looking at the picture, we're struck by the dramatic rebound in the ISM index (note the extent & slope of the recovery). At the same time, it's hard to spot a point on the graph where an ISM reading near current levels hasn't translated to positive box volumes."

Figure 1: Box Shipments (% Change y/y) vs. ISM Index



Source: Deutsche Bank, ISM, Fibre Box Association

The Deutsche Bank note goes on to say that September year to date box volumes are off 9.8 per cent and September volumes were off 4.8 per cent. With year over year comparisons getting much easier and the strength in the ISM index, some healthy year over year comparison's over the next three to four months wouldn't be out of line with past performance. The analysts expect some healthy comparisons will raise discussions about a Q1 pricing recovery and should be good for containerboard equities. In the meantime, corrugated inventories remain low, capacity closures are mounting and a weak US dollar is helping to boost export volumes.

In terms of price, containerboard list prices remained flat in October with 42-lb linerboard at US\$530/ton. Spot prices were essentially stable, with 42-lb unbleached kraft linerboard in the US\$450/ton range. International Paper announced 1.4MM tons containerboard capacity closures (12 per cent of International Paper's domestic capacity and 4 per cent of total US capacity). Wood supply constraints and seasonal maintenance will control Q4 mill output.

Meanwhile in Europe containerboard producers are trying to get price increases in a still weak business environment, according to FOEX.fi. International trade needs to pick up more before clear improvement in the total consumption is shown, says FOEX.fi. Recent capacity increases maintain the over-supply situation. Some of the announced increases show in the FOEX indexes, but the levels reached are still well below the announced target levels.

Some North American forestry companies which have just released 3Q 2009 results, many of which were improved over 2Q 2009, are warning that 4Q 2009 will be worse. Given the usual seasonal slowdown of the lumber market following the US Thanksgiving Holiday, these predictions of caution seem accurate. However, the sheer scope of improvement of leading indicators in US home building and the economy in general do seem to point to a positive 1Q 2010.

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