#83 FOR IMMEDIATE RELEASE: May 7, 2010

Land hedges both inflation and systemic risk
By Curtis Seltzer

On Thursday, May 6th, the Dow Jones Industrial Average fell almost 1,000 points, a little more than nine percent, in 16 minutes, and no one knows why. At day's end, the DJIA was down only 342 points, and everyone didn't think that was too bad…considering the place it had visited.

Fingers of possible blame pointed in many directions—Greeks bearing debt, Jihadist glitches, automatic computer-trading programs, a trader's "fat-finger" mistake, jitters about financial-reform legislation, too much sugar in Wall Street's afternoon power drinks, a Madoff mole wreaking revenge.

A thousand point drop got me to thinking.

I'd been talking to my daughter, Molly, a few minutes before the DJIA's dipsy-doodle. She works on the speed desk at Bloomberg News in Manhattan, feeding headlines and financial news into the company's terminals. She's up to the minute on this stuff; I'm a lagging indicator, often intentionally so. We were talking about the future and how to prepare for it.

I said I thought people in their 20s and 30s were going to have a much tougher time earning livings and preparing for retirement than Baby Boomers, because the global financial system -- and the American end of it, in particular -- seemed increasingly volatile, increasingly fragile and increasingly vulnerable to system-breakups, from both internal and external sources. System risks, in short.

This got me thinking about hedges.

Gold is often touted as a hedge against inflation. But when I looked at gold price and the Consumer Price Index, I saw that inflation had risen with reasonable consistency year to year while gold was volatile—spiking in 1980 and during the last several years, but lagging the CPI for most of the years in between. One study I reviewed showed the average annual rate of return on gold between 1979 through 2008 was 5.37 percent, most of the gain coming during the last decade, compared with stocks at 11.9 percent, 3-month T-bills at 5.9 percent and rare coins above 10 percent.

Gold is a fear purchase, not an inflation hedge. If you think it's likely that the world will fall apart, you put gold in your bedroom safe so you can buy guns and toilet paper. If that time comes, inflation will have solved itself through collapse.

Gold doesn't behave like a commodity, because people buy it for reasons other than consumption and utility. It's a non-renewable resource like oil, but it doesn't get used up like oil, coal and natural gas. It seems to me that people use it as a financial worry bead, fingering it more in times of high stress.

When Molly set up her retirement account last year, I gave her the conventional advice about index funds and broad baskets of stocks and bonds. But what I wanted her to do was to set up a real-estate IRA to buy land, which she couldn't do.

An inflation hedge should track inflation…and do a little better.

Between 1999 and 2009, the average annual inflation rate has been 2.6 percent. For the 10 years preceding, it was 3 percent.

It's difficult to measure national returns on timberland investments, because tracts vary so much in size, management, types, length of ownership and other factors. The data base at the National Council of Real Estate Investment Fiduciaries (‼ HYPERLINK "http://www.ncreif.com/" ¶ www.ncreif.com⊥) is widely used for comparing investments, but it's skewed toward large tracts and tax-exempt investors, primarily pension funds. The same bias is found in NCREIF's farmland index, all of whom are tax-exempt investors.

Nonetheless, the NCREIF average annual timberland return in the 20 years between 1990 and 2009 was 2.76 percent. The average annual return for farmland between 1992 and 2009 was 2.74 percent.

Using the NCREIF indexes, farmland and timberland returns did a bit better than inflation during the last two decades. These types of land investments as measured by NCREIF are reasonably good inflation hedges.

A 2009 study from Jeff Mortimer at J.P. Morgan Investment Analytics & Consulting found that timberland "…has provided an annualized return of 14.60%..." over the past 22 years while correlating "highly with inflation…."

Looking ahead, I see nothing that would suggest that stocks and gold are getting less volatile, and the financial system in which they function seems to be looking more vulnerable, more risky. Whether systemic risk is reduced in the future is anybody's guess; mine is that it will not.

Gold may be the coin of last resort, but short of total collapse, farmland and timberland appear to be better hedges against both less-than-catastrophic events and inflation. If nothing else, land prices will appreciate due to population growth over the long term. And if the toilet-paper choice is between gold bars and leaves, well….

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