

Lumber Points To Slow Home Construction

One of the sad parts about the CME Group bowing to the inevitable and closing its trading floors is future futures traders will miss phone calls from pit denizens about markets such as lumber. I fondly recall one fellow from the 1980s who used to inform me, “They’re calling it steady.” Indeed, the electrocardiograms of the deceased could be called steady, too. And this market was the source of one of my favorite end-of-day post-mortems, “Narrowly mixed in quiet trading.”

But then we had the spotted owl ban on logging in old-growth forests in the Pacific Northwest, the never-ending drama of the Softwood Lumber Agreement between the U.S. and Canada, the housing boom and bust, and other disruptions in the market that led to the knee-slapper, “Lumber traders are never board.” Did I mention the commercial lumber-buyer who could slap me nine?

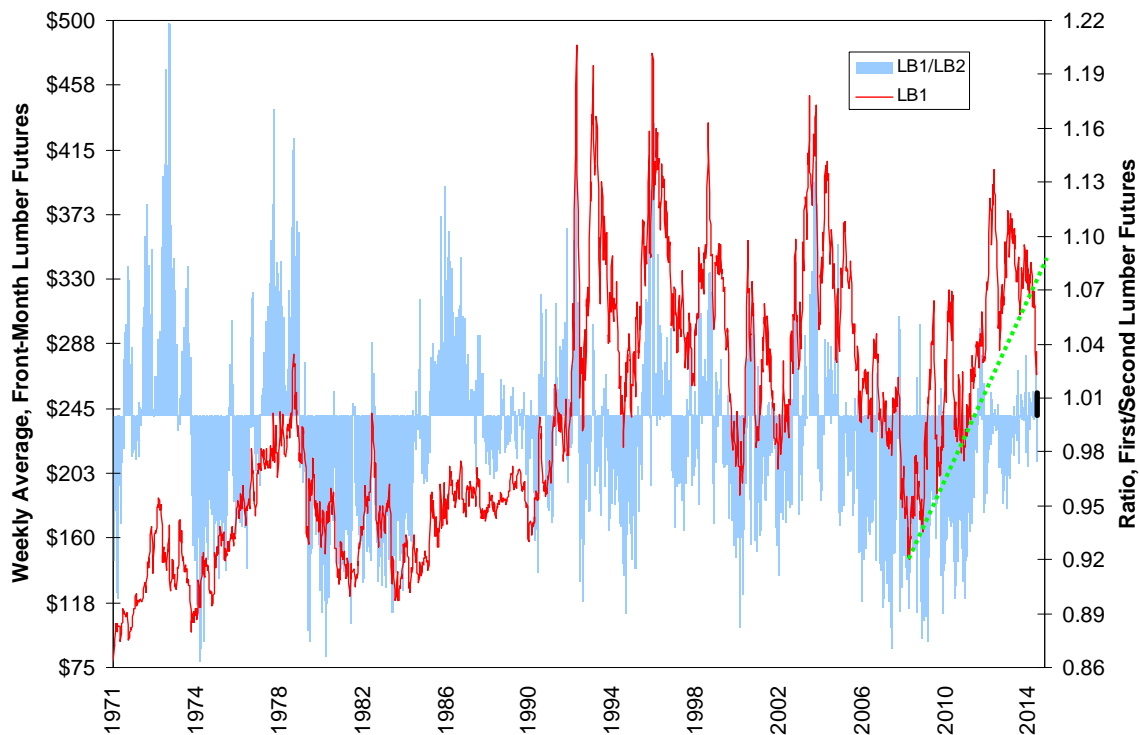
Lumber’s Forward Curve

Lumber futures, like those of other markets without an active cash-and-carry arbitrage between contract months, tend to oscillate between carry and inverted structures as a function of price. High prices should lead to a premium of the front month over the back, and vice-versa.

Front-month futures have declined 15.9% since the expiration of the September 2014 contract; the second- and third-month contracts have declined 18.8% and 17.6%, respectively.

The intermonth spread between May and July 2015 contracts is in a small inversion. This is somewhat unusual given lumber’s general uptrend extending back to the start of QE1 in March 2009 and its execution through the purchase of mortgage-backed securities (green trendline superimposed). Homebuilders, the principal buyers of lumber, are willing to remain floating on contracts for late-summer delivery; this signals soft expected demand.

Lumber's Forward Curve Near Flat



These weak expectations for homebuilding construction demand are consistent with two trends in the housing market. The first is a downturn in total housing starts and the second is a continued high percentage of multi-family housing starts within total housing starts. Multi-family units are less lumber-intensive than single-family detached houses. This trend toward high multi-family unit construction is consistent with the outsized 30.9% total return in the Bloomberg Apartment REIT index over the past year.

Constructing For Tenancy Remains High

