Chapter 8
Is Construction of Timber Focused Exchange Traded Fund Plausible in SAARC Countries With Reference to India?

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ABSTRACT

Given the fact that timber is neither traded as commodity nor is any timber-focused exchange-traded fund (ETF) available in the SAARC countries, the objectives of this chapter are to examine the plausibility of making use of the wood resources of SAARC countries in the form of ETFs, e.g. timber-focused ETF, the nature of the legal and policy frames in these countries as implemented in timber business with reference to their suitability for opening ways to construction of timber-focused ETF and the theoretical plausibility of constructing a timber-focused ETF with reference to India. It is found that in comparison with other SAARC countries, India has developed timber-based industries whose stocks are traded in the bourses and amenable to analysis for ETF construction purposes. While Bangladesh, Pakistan, Sri Lanka, and Nepal have certain legal and institutional artifacts for preservation and maintenance of forests toward gradual but by-and-large unplanned industrialization of the timber industry, Maldives and Bhutan have hardly any.

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INTRODUCTION

Increasing trade in timber (timber, wood, lumber, log etc. are used synonymously each being conceived to be a member of generic class 'wood') and forest products support economic growth. The rate of growth of investment in timber can be one of the highest rates of growth owing to the continuous compounding. There are meager correlations between timber investments and assets. The price-expectation for timber may depend on the derivative contracts in lieu of econometric forecasting and hence may be used as a component in the investment portfolio in order to cut the portfolio risk. Further, timber investments may facilitate managing the risk of inflation. Overall timber investments are expected to moderate depreciation and volatility of the portfolio. The cash flow from timber investment is akin to a long-term discount bond. Within the timber component of the investment portfolio there may be further diversification in terms of alternative products like lumber and pulp wood. This however needs a vibrant, if not deep, timber-focused asset market.

TIMBER BASED FINANCIAL PRODUCTS

An exchange-traded fund is a hedging instrument against the risk of one specific stock, rather the return from it generates out of the concerned sector as a whole. As a result, not only institutional investors but also retail investors are benefited by it. Since investment in timber is immune to inflation, pays higher returns than do stocks, investment in land yields positive return even during recession and finally it is possible to invest in timber without physical possession of timber via investing in timber-focused exchange-traded funds (ETFs), the timber investment is increasingly receiving importance from the global investing communities. It can be proved that investments in the above products can enable an investor in portfolio diversification such as to achieve an equilibrium level of utility but the success of the investment depends on the financial and legal artifacts of the specific country. It is popular in the developed western countries. For example, in USA two popular timber funds are S&P Global Forestry & Timber Indexed Fund (symbol WOOD) and Timber ETF (symbol CUT). The proof is given below.

Suppose x is the weighted portfolio return in R. The investor's utility is $f(x)$. D is the set of constraints, for the time being, without any timber-focused ETF. If we now assume that timber-focused ETF is launched in the economy and the investor chooses to include it in her portfolio for diversification purpose, i.e. the ETF return moves in the opposite direction to all other returns, or it props up $f(x)$ during slump and pulls down during boom thereby pushing the investor towards a steady state equilibrium $f(x) = f(z)$

Proposition

Irrespective of the boom or slump in the economy the timber-focused ETF enables an investor to achieve the steady state equilibrium position.

Axiom

The portfolio returns are real numbers.