



# Timberland Investment Group Market Report

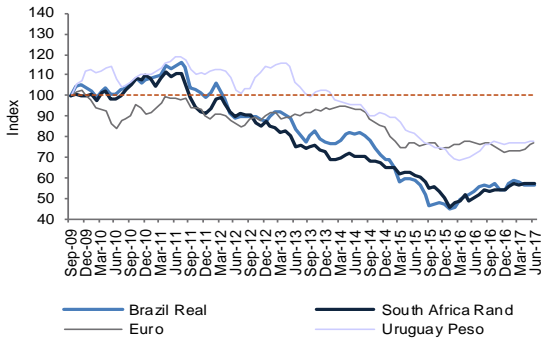
## 2<sup>nd</sup> Quarter 2017

## Table of Contents

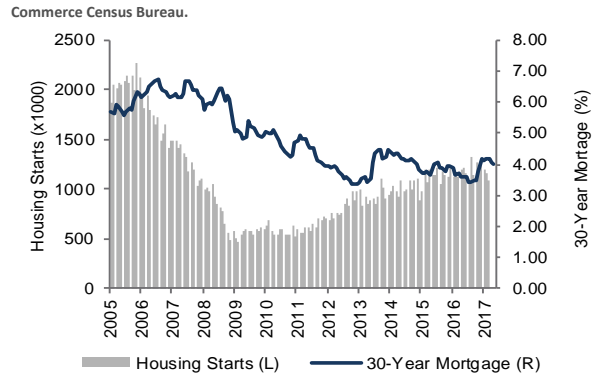
<b>Timberland Investment Dashboard</b> .....	<b>3</b>
<b>Executive Summary</b> .....	<b>4</b>
<b>United States</b> .....	<b>7</b>
<b>Latin America</b> .....	<b>15</b>
<b>Europe</b> .....	<b>21</b>
<b>South Africa</b> .....	<b>23</b>
<b>New Zealand</b> .....	<b>25</b>
<b>Australia</b> .....	<b>27</b>
<b>Baltic Dry Index</b> .....	<b>29</b>
<b>Global Pulp and Paper Markets</b> .....	<b>30</b>
<b>Disclaimer</b> .....	<b>32</b>

# Timberland Investment Dashboard

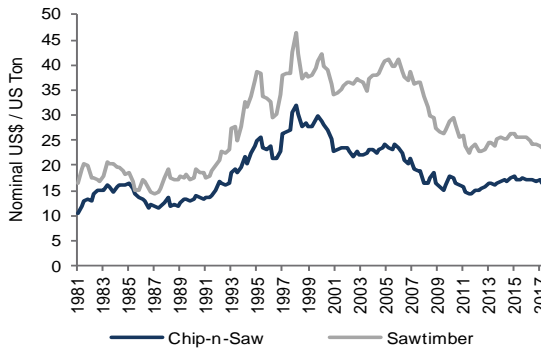
**Indexed Exchange Rates of Selected Countries vs. the US Dollar (2009=100).** Sources: Federal Reserve Bank; Bloomberg.



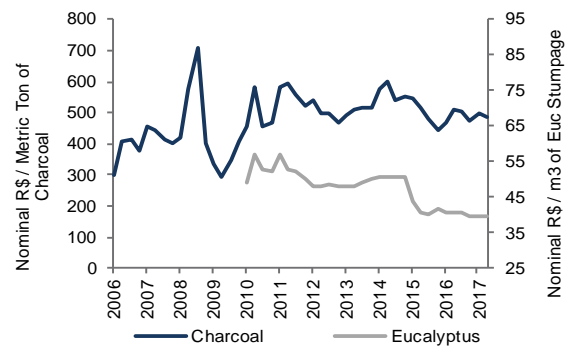
**Annual US Housing Starts, Seasonally Adjusted Annual Rate, and 30-year Mortgage Rates.** Sources: Federal Reserve Bank; US Dept. of Commerce Census Bureau.



**US Southwide Quarterly Pine Chip-n-Saw and Sawtimber Prices.** Source: TimberMart-South.

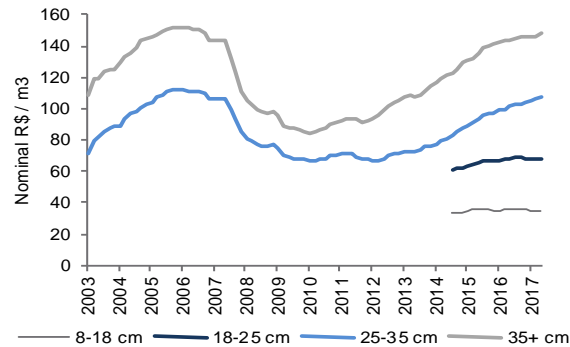


**Quarterly Charcoal and Eucalyptus Stumpage Prices in Minas Gerais, Brazil.** Sources: Associação Mineira de Silvicultura, Silviconsult.



**Pine Sawtimber Stumpage Prices in Paraná State, Brazil.** Source:

STCP. (STCP changed small log diameters in Q416 so there is limited revised historical data)



**Baltic Dry Index.** Source: Bloomberg.



## Executive Summary

### United States

- The US economy expanded at an annual rate of 1.4% (real GDP) in Q1 reflecting growth in nonresidential fixed investment, exports, residential fixed investment, and personal consumption. Imports, federal government spending, state and local government spending, and private inventory investment were drags on growth.
- Unemployment declined slightly from 4.4% in April to 4.3% in May as labor force participation edged lower.
- Manufacturing declined to 54.9% in May versus 57.2% in March.
- The US housing market continues to strengthen moderately, although the recovery is following an uneven pace. May housing starts declined -5.5% over the prior month and -2.4% over May 2016; multifamily starts accounted for 27.3% of May starts versus a historic average of 23.0% since 1990.
- Southern pine sawtimber prices declined -1.4% for the quarter and -6.1% year-over-year.
- Chip-n-saw prices declined -2.3% sequentially in Q2 and -3.4% year-over-year.
- Southern mixed hardwood sawtimber prices declined -5.3% for the quarter and -8.5% year-over-year.
- In the US South, both softwood and hardwood pulpwood prices declined quarter-over-quarter and year-over-year in Q2.

### Latin America

- In Q1, Brazil's economy expanded for the first time in nine quarters with real GDP increasing 1.0% quarter-over-quarter versus a decline of -0.5% quarter-over-quarter in Q4.
- Despite ongoing political issues, the Brazilian government continues to pursue economic reforms, including pension reform, although expectations of any significant changes in the near-term have somewhat declined.
- Brazilian softwood sawtimber prices were mixed again depending on the assortment, although larger-diameter sawtimber grades experienced year-over-year gains.
- Brazilian charcoal prices declined -2.4% quarter-over-quarter. The price of eucalyptus used in charcoal production was flat in Q2 versus Q1.
- Eucalyptus pulpwood prices in Brazil declined -0.6% for the three months ended June and -4.0% year-over-year.
- In Q1, Chile's GDP increased 0.1% year-over-year following 0.5% year-over-year growth in Q4.
- Argentina's economy showed continued improvement with real GDP growth of 0.3% year-over-year versus a decline of -1.9% year-over-year in Q4.
- Guatemala's real GDP grew at an annualized rate of 3.0% in Q4 (latest available) versus Q3's 2.6% annualized rate.
- Uruguay's economy increased at an annualized rate of 4.3% real in Q1, versus 3.4% growth in Q4.
- Eucalyptus pulpwood prices in Uruguay increased 1.7% quarter-over-quarter in Q2 and 3.4% year-over-year.

### Europe

- In Q1, euro zone real GDP increased 0.6% quarter-over-quarter as compared to 0.5% quarter-over-quarter growth in Q4.
- Gross fixed capital formation grew 1.3% quarter-over-quarter in Q1 versus an increase of 3.4% quarter-over-quarter in Q4 while industrial production increased 1.3% month-over-month in May after increasing 0.3% month-over-month in April.
- In May, exports increased 12.9% year-over-year while imports increased 16.4% year-over-year.
- In Estonia, pine sawlog prices declined -2.5% from three months earlier, but were slightly up 0.3% year-over-year. Birch sawlog prices declined -2.6% from three months earlier, but increased 0.9% year-over-year.
- Estonian pulpwood prices were mixed. Pine pulpwood prices declined -0.9% from three months earlier and -2.5% year-over-year. However, birch pulpwood prices increased 0.9% from three months earlier and 10.4% year-over-year.

### South Africa

- In Q1, South Africa's economy entered into a recession with real GDP declining -0.7% quarter-over-quarter following a decline of -0.3% quarter-over-quarter in Q4.
- Political conditions continue to trouble South Africa. Separately, Moody's downgraded South Africa's credit rating from Baa2 to Baa3, keeping it at investment grade with a negative outlook.
- In May, lumber prices increased 2.5% versus the prior three months and 5.4% from May 2016.
- Softwood log prices were generally positive. In nominal terms in Q1: A grade logs declined -2.9% for the quarter and -0.7% year-over-year, B grade logs increased 1.6% for the quarter and 5.5% year-over-year, C grade logs rose 1.5% for the quarter and 6.5% year-over-year, and D grade logs increased 1.2% for the quarter and 6.2% year-over-year.
- While some of the aforementioned price gains seem steep, it is worth noting that the annual inflation rate in South Africa is 5.1%, so in real terms most of the gains are less notable.

### New Zealand

- In Q1, New Zealand's real GDP grew a modest 0.5% quarter-over-quarter versus growth of 0.4% quarter-over-quarter in Q4. Agriculture was better while construction was weaker.
- New Zealand A-grade export log prices continued to firm in March driven by strong demand for logs from China, New Zealand's largest export market. Domestic log prices also increased given continued housing strength driven by low interest rates and strong demand from the horticulture industry (e.g. poles used in foundations and retaining walls).

### Australia

- In Q1, Australia's real GDP increased 0.3% quarter-over-quarter versus growth of 1.1% quarter-over-quarter in Q4. Agriculture, forestry & fishing and manufacturing were weaker.
- Australian softwood roundwood prices increased on better Chinese demand while prices on hardwood logs also improved. Both softwood and hardwood chips moved higher.

### Global Pulp & Paper Markets

- In Q2, bleached softwood kraft pulp (“BSK”) prices increased 5.4% versus the prior quarter and 8.0% year-over-year.
- During the quarter, softwood pricing continued to improve given better demand and as the effects of downtime earlier in the year continue to ripple through the market.
- That said, there is less demand for BSK during the slower consuming summer months in the Northern Hemisphere and capacity is increasing given SBSK/fluff pulp capacity starts beginning in Q3.
- Hardwood kraft pulp prices increased 15.0% in Q2 versus the prior quarter and 12.9% year-over-year.
- That said, Chinese hardwood demand is moderating, global inventories are rising, and supply is increasing (e.g., APP’s second line at its Oki mill in South Sumatra (1.4mn MT); Fibria’s second line at its Três Lagoas mill (1.95mn MT) in Brazil; Metsä Group’s new 1.3mn MT pulp and bioproduct mill (500k MT of hardwood pulp and 800k MT of softwood pulp) in Äänekoski, Finland).

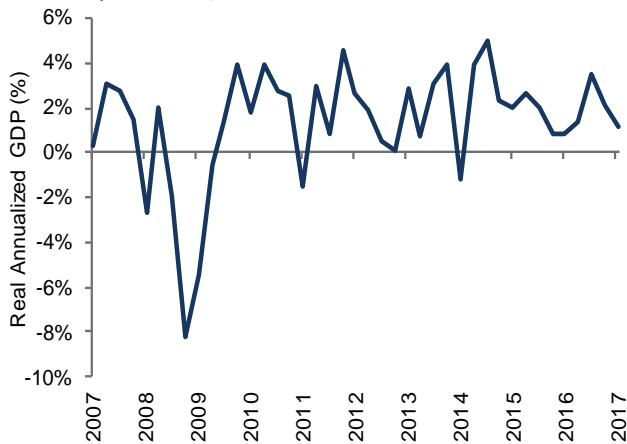
## United States

In Q1 (the latest GDP data available; 2Q2017 GDP expected to be released July 28) the US economy expanded at an annual rate of 1.4% (real GDP). This was below the 2.1% real GDP gain from the prior period (Figure 1). The Q1 increase in real GDP reflected growth in nonresidential fixed investment, exports, residential fixed investment, and personal consumption that were partly offset by negative contributions from federal government spending, state and local government spending, and private inventory investment. Imports also increased, which reduced GDP. The unemployment rate declined slightly from 4.4% in April to 4.3% in May while the change in total nonfarm payroll employment (seasonally adjusted) was 174,000 in April versus 138,000 in May. Meanwhile, the labor force participation rate edged lower from 62.9% in April to 62.7% in May and continues to trend along the lowest levels in almost four decades (Figure 2).

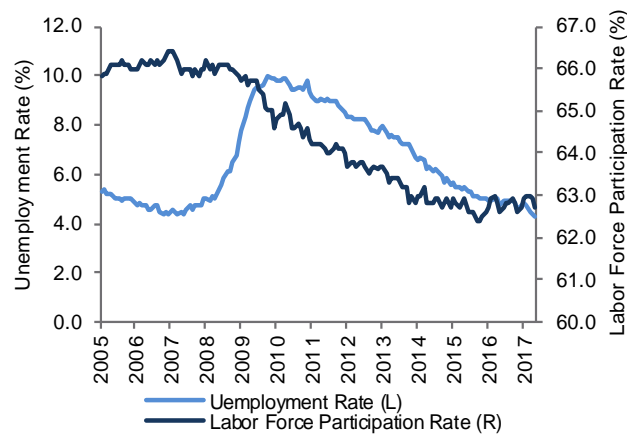
Manufacturing softened in recent months. The Institute for Supply Management (“ISM”) Purchasing Managers Index, a bellwether of manufacturing activity, declined to 54.9% in May from 57.2% in March (Figure 3).

**Figure 1. Annualized Quarterly US Real GDP Growth (%).**

Sources: US Dept. of Commerce, BEA.

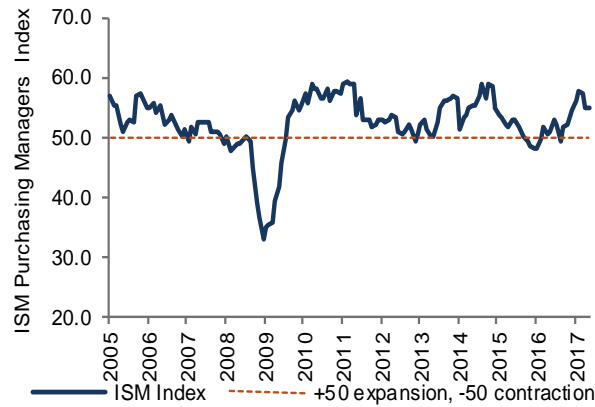


**Figure 2. US Unemployment, and Labor Force Participation Rate.** Sources: Sources: US Dept. of Labor, BLS.



**Figure 3. US ISM Purchasing Managers Index.**

Source: Institute for Supply Management.



### US housing

The US housing market continues to grow, although the recovery is following an uneven pace.

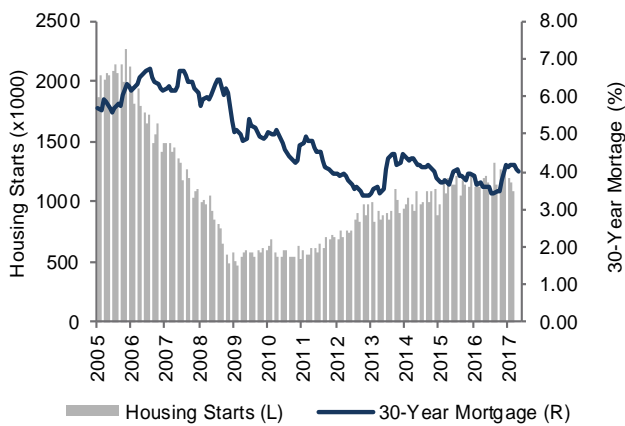
In May, housing starts totaled 1.092 million units. This figure is down -5.5% versus April’s 1.156 million units and -2.4% versus May 2016’s 1.119 million starts (Figure 4). The share of multifamily starts as a percentage of total starts declined to 27.3% versus 28.5% in April and 30.7% in March.

New single-family home sales increased 2.9% month-over-month in May (Figure 5). The largest increase was in the West (+13.3%) followed by South (+6.2%). New home sales declined in the Midwest (-25.7%) and Northeast (-10.8%). Inventories of new homes remained flat at 5.3 months of supply in May versus April.

With respect to current housing stock, existing home sales increased 1.1% month-over-month in May (2.7% year-over-year) to 5.62 million units and versus May 2016’s 5.47 million units. Inventories of existing homes increased modestly to 4.2 months in May from 4.1 months in April, still low by historical standards.



**Figure 4. Annual US Housing Starts, Seasonally Adjusted Annual Rate and 30-year Mortgage Rates.** Sources: Federal Reserve Bank of St. Louis, US Dept. of Commerce Census Bureau.



**Figure 5. Monthly New Home Sales, New Building Permits, and Existing Home Sales, Seasonally Adjusted Annual Rates.** Sources: US Dept. of Commerce Census Bureau, National Association of Realtors.



In May, building permits declined -4.9% month-over-month. This decline was driven more by multi-family permits, which declined -10.4% month-over-month versus single-family permits, which declined -1.9% month-over-month.

**US forest products and timber markets**

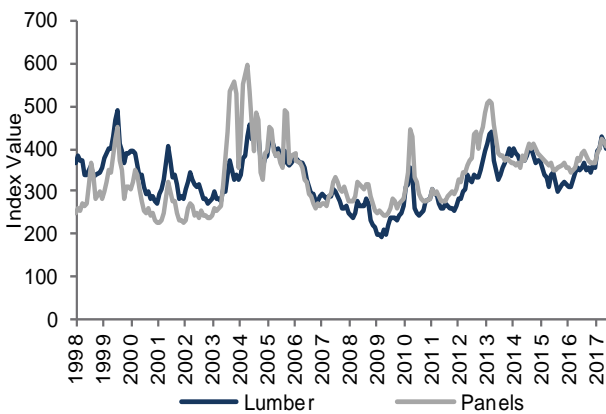
Softwood lumber prices increased 7.5% quarter-over-quarter in Q2. This compares to a historical average sequential increase of 1.7% over the last decade. Prices jumped in April due to concerns over Canadian exports to the US given impending duties on Canadian lumber. Once the actual duties were promulgated on April 24<sup>th</sup>, lumber prices slowly drifted lower as buyers held back on purchases and worked off inventories they built ahead of the duty determination. Prices eventually stabilized at \$397/mbf in mid-June. The preliminary anti-dumping duty announced on June 26<sup>th</sup> (please refer to the **US Softwood Lumber Duties** section on page 14) had little impact on the lumber market. Meanwhile, US lumber exports increased 1.1% year-over-year in Q1 (export data are released on a one-quarter lag).

During Q2, structural panel pricing increased 6.6% versus Q1. This compares to a historical average sequential increase of 4.7% over the last decade (Figure 6). Similar to lumber, Oriented Strand Board (“OSB”) prices jumped in early April due to expanding order files. Prices leveled off in late April / early May and then started to decline given slower sales. However, prices began to increase again in June given better order files and scuttlebutt concerning upcoming mill maintenance downtime. In Q1, US OSB production increased 6.0% year-over-year, imports increased 4.6% year-over-year, and exports increased 25.8% year-over-year (OSB and plywood production, import and export data are released on a one-quarter lag). Meantime, plywood prices moved higher earlier in the quarter given better demand, partly due to improved weather which resulted in increased construction activity. As the quarter progressed, plywood sales slowed and order files thinned leading to lower prices. Moreover, buyers were hesitant to purchase additional volume beyond covering immediate needs in the hope that plywood prices would further decline. That said, prices increased in late June,

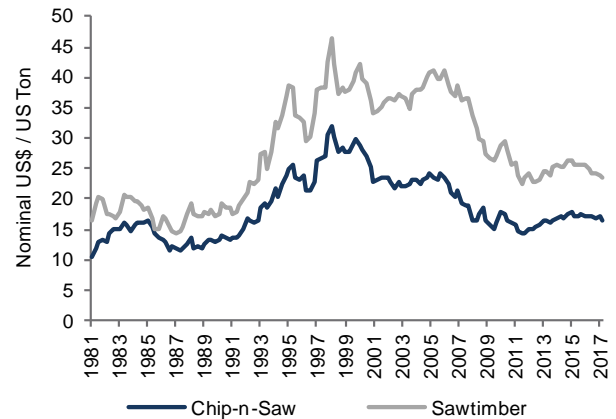
particularly in Western Fir, as a veneer dryer at Freres Lumber Company in Lyons, OR was taken out of commission due to a fire. In Q1, US plywood production increased 2.4% year-over-year, imports increased 2.5% year-over-year, and plywood exports jumped 60.8% year-over-year.

**Figure 6. US Framing Lumber Index and Panel Composite Index.**

Source: Random Lengths.



**Figure 7. US Southwide Quarterly Pine Chip-n-Saw and Sawtimber Prices.** Source: TimberMart-South.



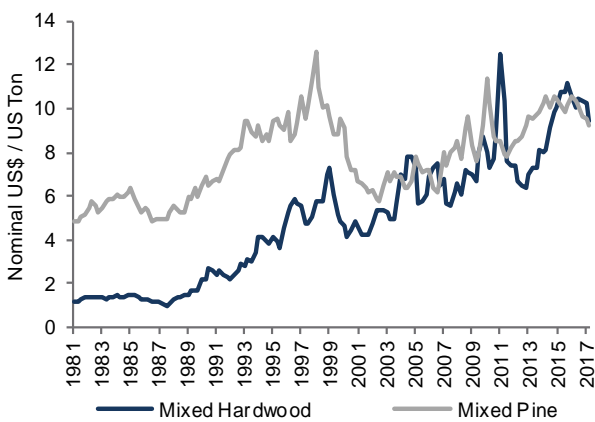
Throughout the US South, pine sawtimber prices declined -1.4% in Q2 and -6.1% year-over-year according to TimberMart-South (Figure 7). Chip-n-saw prices declined -2.3% sequentially in Q2 and -3.4% year-over-year. Timber availability continued to pressure prices.

Southern hardwood sawtimber prices were weaker during Q2. Region-wide, mixed hardwood prices declined -5.3% for the quarter and -8.5% year-over-year. Oak sawtimber prices declined -0.9% quarter-over-quarter and -1.1% year-over-year (Figure 8).

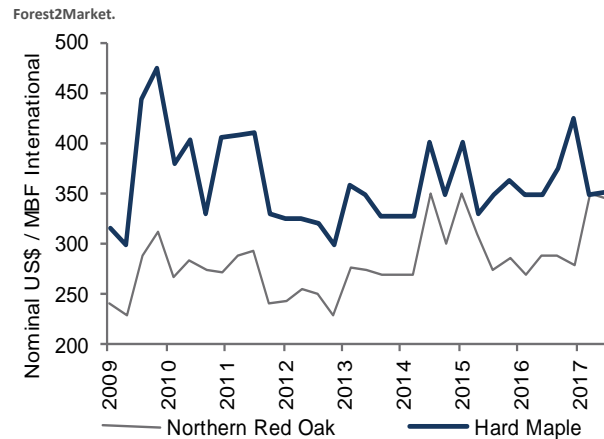
During Q2, Canadian sawmiller Conifex noted that it will begin taking wood deliveries in August at its El Dorado, AR mill as part of the mill’s lumber capacity expansion (180 million board feet (“mmbf”)). The mill will begin producing lumber in September. During Phase I of the expansion, the mill will receive 115 loads per day (~3,400 tons per day assuming 29 tons/load). The mill will increase deliveries to 215 loads per day (~6,200 tons per day assuming 29 tons/load) in Phase II of the expansion. Further, it appears that the Klausner Lumber Two mill in Enfield, NC (250 million board feet) will begin production by year-end. At full capacity (which may take a few quarters following the start of production), the mill will receive more than 200 loads per day. Meantime, Roy O. Martin remains on track to start its greenfield OSB mill (800 million square feet) in 3Q17 while Norbord has the potential to restart its Huguley, AL OSB mill (500 million square feet) later this year or early next year. Further, a former Georgia-Pacific pine sawmill (52mmbf) near Cross City, FL, is being sold and reopened by the new owner. Georgia-Pacific also recently completed a US\$ 388 million energy improvement project at its Brewton, AL mill and is now focused on investing US\$ 50 million to upgrade the mill’s paperboard machine and increase its competitiveness. Separately, Resolute Forest Products announced the closure of coated mechanical paper machine 2 (190,000 tons) at its Catawba, SC mill effective July while White Birch announced the closure of its Bear

Island, VA newsprint mill (240,000 MT), date to be determined. That said, there is the potential for some of the wood loss from Bear Island to be absorbed by a new pellet mill from Enviva as the company recently signed an option agreement for a 168-acre industrial site near Danville, VA. The Danville-Pittsylvania Regional Industrial Facility Authority approved the agreement during its June 12<sup>th</sup> meeting.

**Figure 8. US Southwide Quarterly Mixed Hardwood and Mixed Oak Sawtimber Prices.** Source: TimberMart-South.



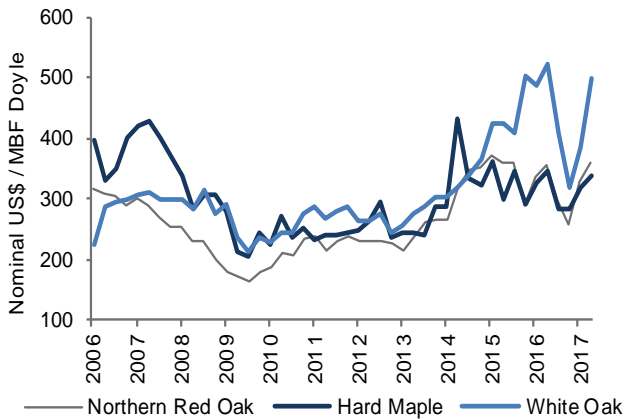
**Figure 9. Quarterly Northern Red Oak and Hard Maple Sawtimber Prices in New York.** Source: Forest2Market.



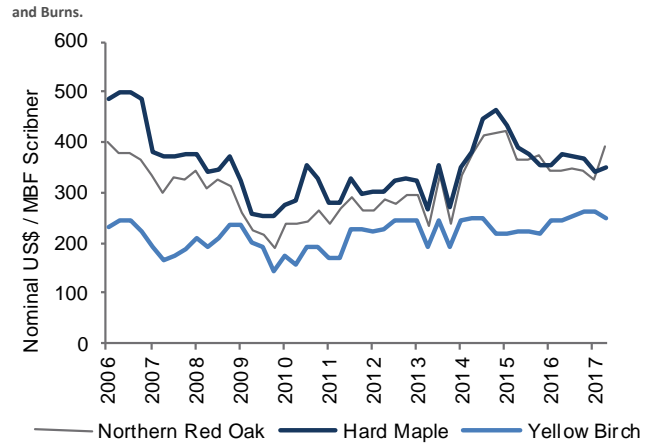
In other timber markets, prices were mixed during the quarter. In New York’s Adirondack region, northern red oak declined -1.4% quarter-over-quarter, but increased 19.8% year-over-year (Figure 9). Hard maple increased 0.6% in Q2 and year-over-year. In Ohio, red oak increased 10.1% compared to Q1 and 1.3% year-over-year. Hard maple increased 6.3% during the quarter, but declined -2.6% year-over-year. White oak increased 29.1% in Q2, but declined -4.7% year-over-year (Figure 10).

In Wisconsin, northern red oak increased 19.1% quarter-over-quarter in Q2 and 13.7% year-over-year (Figure 11). Hard maple increased 2.0% for the quarter, but declined -6.7% year-over-year. Yellow birch sawtimber declined -4.2% quarter-over-quarter in Q2, but increased 3.1% year-over-year.

**Figure 10. Ohio Northern Red Oak, Hard Maple, and White Oak Sawtimber Prices in Ohio.** Source: Forest2Market.



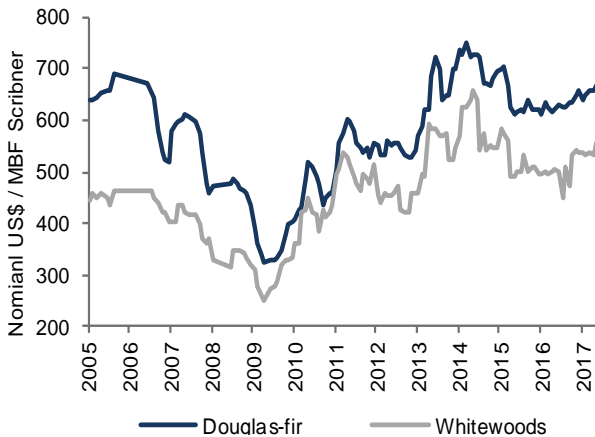
**Figure 11. Northern Red Oak, Hard Maple, and Yellow Birch Sawtimber Prices in Wisconsin.** Source: Steigerwaldt and Burns.



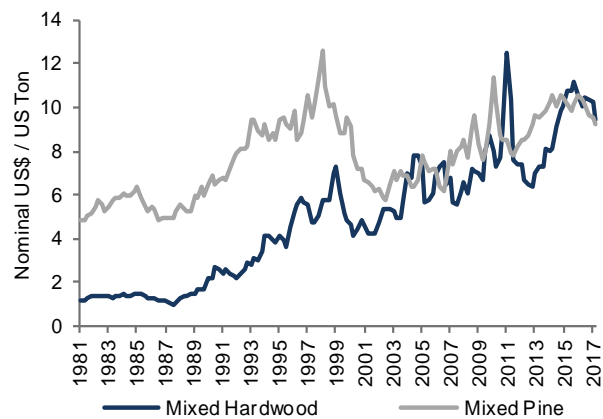
In Oregon, softwood sawlog prices increased. The price of Douglas-fir #2 increased 3.2% sequentially and 8.2% year-over-year (Figure 12). As of May 2017 (latest data available), Douglas-fir remains -9.0% below its 2014 peak. The price of Whitewood #2 logs increased 1.7% for the quarter and 8.6% year-over-year. As of May 2017, Whitewoods are still down -15.5% from their 2014 peak. In March 2017 (the latest available data), total softwood log exports to China increased 40.4% year-over-year to 83.36mmbf from 59.36mmbf in March 2016, softwood log exports to Japan declined -20.7% year-over-year to 33.14mmbf from 41.79mmbf in March 2016, and softwood log exports to South Korea declined -14.7% year-over-year to 5.0mmbf from 5.86mmbf in March 2016.

In the US South, hardwood pulpwood prices declined -2.5% in Q2 and -18.5% year-over-year while pine pulpwood prices declined -3.7% quarter-over-quarter and -10.6% year-over-year (Figure 13).

**Figure 12. Monthly Columbia River #2 Douglas-fir and Mixed Whitewood Log Prices.** Source: Log Lines.



**Figure 13. US Southwide Quarterly Mixed Hardwood and Mixed Pine Pulpwood Prices.** Source: TimberMart-South.



**View from the Ground**

BTG Pactual Timberland Investment Group (“TIG”) regional asset managers regularly report on conditions that impact wood pricing in their operating areas. In east Texas, Louisiana, and southern Arkansas, Q2 was uneventful with market conditions remaining largely the same as the prior quarter. In east Texas, while an oversupply of pine pulpwood has depressed prices, there is concern that pulpwood prices could move lower over the next several months as contractors begin to harvest in areas they normally are unable to access because of wet weather. In Arkansas, timber prices have yet to respond to the upcoming expansion of Conifex’s El Dorado mill causing some timber owners to defer harvests.

In South Carolina, North Carolina, Georgia, and Florida, extreme dry weather conditions moderated during the quarter given the onset of summer rains in May and June. That said, there has been no positive impact on timber pricing as of yet given that the rains have not significantly limited timber supply. Meantime, prices in Georgia have been negatively impacted (pulpwood down \$2-3/ton) by the Ips pine beetle, which has resulted in greater timber availability as owners have increased harvesting. In South Georgia, the West Mims fire in the Okefenokee Swamp area, which has affected around 160,000 acres, has increased the availability of salvage wood thereby pressuring timber prices. On a positive note, the Klausner One mill in Live Oak, FL has corrected its earlier operational issues and began to operate more efficiently, resulting in increased wood intake.

In Central & Southern Alabama, prices were stable in Q2 as excess timber supply was offset by improving timber demand. At recent timber sales, there have been an increasing number of buyers, some of whom were looking to aggressively move wood. There is the potential for timber demand to further increase given Georgia-Pacific’s upgrade at its Brewton, AL paperboard mill and the likely restart of Norbord’s Huguley, AL OSB mill later this year (both mentioned previously).

In Virginia, the closure of White Birch's newsprint mill (240,000 MT) has resulted in further timber pricing pressure. There continues to be an oversupply of wood in the region and demand is primarily dictated by two large pulp/board companies.

In Ohio, demand for hardwood sawtimber remains strong given growing end markets including whiskey barrels, railroad ties, flooring, and furniture.

In Appalachia, demand for quality hardwood sawtimber remains strong while pulpwood remains challenged.

In Wisconsin, an early spring break-up prevented loggers from accessing forests thereby resulting in lower than normal inventory builds for many grades. Now that break-up has passed, a number of species including aspen are beginning to experience some pricing tension.

In the Pacific Northwest, markets are strong with timberland owners pulling some harvests forward to take advantage of improving pricing. This strength is due to better end market demand (lumber, plywood), limited timber supply relative to demand, export market growth, and less wood flow from Canada.

#### **US Softwood Lumber Duties**

On June 26<sup>th</sup>, the US Department of Commerce unveiled preliminary anti-dumping duties on Canadian lumber imports with an average rate of 6.87%. These preliminary duties rates went into effect on June 30<sup>th</sup>, when the notice was published in the US Federal Register, with most Canadian lumber producers having the duties retroactively applied for 90-days (to late March). The anti-dumping duties are intended to penalize Canadian lumber producers that price their products in the US below prices in their home market and/or below the cost of production. This follows the ruling from the US Department of Commerce on April 24<sup>th</sup> imposing a preliminary countervailing duty of around 20% against Canadian softwood lumber exports to the US. With both preliminary determinations now issued, the combined anti-dumping duty / countervailing duty rate for most Canadian lumber producers is 26.75%. The final duties will be decided by the US Department of Commerce on September 6<sup>th</sup> at which point the US International Trade Commission will have 45 days to determine whether Canadian imports injured the US lumber industry. If the US International Trade Commission determines that there has been injury, final duty orders would be issued upon publication in the Federal Register.

## Latin America

### Brazilian economy

Brazil's economy expanded for the first time in nine quarters in Q1 with real GDP increasing 1.0% quarter-over-quarter versus a decline of -0.5% quarter-over-quarter in Q4. Agriculture increased 13.4% quarter-over-quarter in Q1 (due to strong corn and soy harvests), industry increased 0.9% quarter-over-quarter, and services was flat quarter-over-quarter. Investment declined -1.6% quarter-over-quarter after falling -1.6% quarter-over-quarter in Q4. BTG Pactual's Brazilian Economics team currently expects 2017 real GDP of 0.5% year-over-year as the economy continues to undergo adjustments arising from the recession.

As part of this economic improvement, household consumption was better, declining a slight -0.1% quarter-over-quarter versus -0.5% quarter-over-quarter in Q4. This improvement, however, was not aided by unemployment which remained elevated at 13.3% in May. Moreover, industrial production increased 4.0% year-over-year in May after declining -4.3% year-over-year in April.

Meantime, inflation (Índice de Preços ao Consumidor Amplo or "IPCA") continues to decline, falling to 3.60% in May from 4.57% in March and 6.29% in December, the lowest reading since 2007 (Figure 14). Real rates have also trended lower as evidenced by declining Treasury inflation-protected bond yields, despite slick tick-ups in May and June (Figure 15). Meantime, in May, Brazil's central bank cut the Selic rate by another 100bps to 10.25% following a 100bps cut in April as inflation has slowed and the government looks to spur economic growth. In June, Brazil's central bank reduced its inflation target to 4.25% in 2019 and 4.0% in 2020, down from the 4.5% target that had been in effect since 2005. The margin of tolerance was maintained at +/- 1.5%.

As a result, exports increased 4.8% sequentially in Q1 following a -1.0% quarter-over-quarter decline in Q4. Imports increased 1.8% sequentially in Q1 after increasing 3.5% quarter-over-quarter in Q4. Separately, in Q2, the real depreciated around -2.3% sequentially, but was still 8.1% higher year-over-year (Figure 16).

On the political front, the Lava Jato ("Car Wash") scandal continues to unfold with far-reaching consequences. In late June, President Michel Temer was indicted for corruption by the Brazilian General Prosecutor. In mid-July, a majority of lawmakers on the Constitution and Justice Committees voted to recommend shelving the corruption charge. That said, the indictment will go to a full vote on the Lower House floor on August 2. Following that, the case only goes to trial at the Supreme Court if a 2/3 majority of the Lower House approves. This indictment follows news in May that President Temer approved payments that Joesley Batista, chairman of the world's biggest meat exporter JBS, made to silence jailed former House speaker Eduardo Cunha and an associate (JBS is majority owned by J&F Investimentos which is owned by Joesley and his brother Wesley). In June, Brazil's Superior Electoral Court acquitted President Temer of illegally financing his 2014 election campaign. Separately, in July, Brazil's former president Luiz Inacio Lula da Silva was convicted of graft and money laundering as part of Lava Jato and sentenced to nine and a half years in prison.

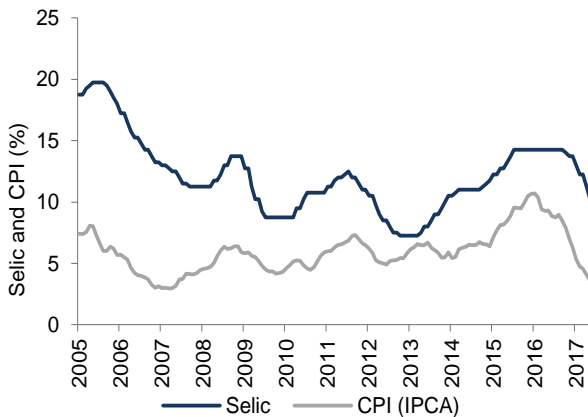
Joesley Batista indicated that he bribed directors of the BNDES public bank, members of the Workers' Party and former economy minister Guido Mantega to obtain a US\$ 2.7 billion loan from BNDES for the construction of the 1.5 million MT/yr bleached eucalyptus kraft (BEK) Eldorado greenfield pulp mill (81% owned by J&F Investimentos) in Três Lagoas in

2011. Given J&F's US\$ 3.2 billion corruption settlement with the Brazilian government, there is now market scuttlebutt that Eldorado could be sold to Arauco or Fibria in order to raise capital.

Meanwhile, the government continues to attempt economic reforms, including pension reform, although expectations of any significant changes in the near-term have somewhat declined. A watered-down version of the original pension legislation could solely focus on increasing the minimum retirement age with more prominent reforms taking place under a new administration. The government is also enacting labor reform by changing outmoded labor laws that have been in place since the 1940s. On July 12, the Senate approved and President Temer signed into law the labor law bill, which increases flexibility on overtime and holidays and prioritizes direct negotiations between workers and employers over existing labor regulations. Given that a number of states in Brazil are cash strapped, President Temer and Finance Minister Henrique Meirelles are contemplating a securitization plan that would allow the federal government to issue securities backed by late taxes owed by Brazilian citizens and companies.

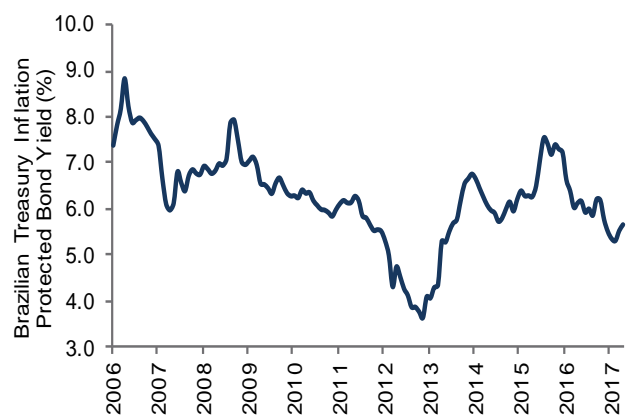
**Figure 14. Brazilian SELIC Rate and Annualized IPCA Index.**

Source: Banco Central do Brasil, Brazilian Institute of Geography and Economics.



**Figure 15 Brazilian Treasury Inflation Protected Bond Yield.**

Source: Brazil National Treasury.





**Figure 16. US Dollar: Brazilian Real Daily Exchange Rates.**

Source: Board of Governors of the US Federal Reserve System.



### Brazilian forest products and timber markets

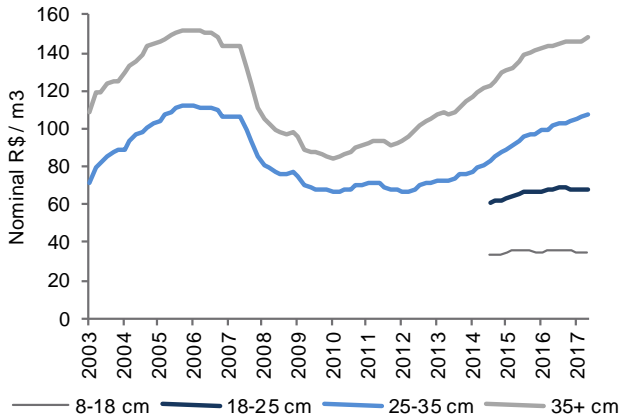
The price of pine timber in Brazil was mixed during the quarter depending on the assortment. Through the end of June, pulpwood (8-18 cm) in Parana State declined -0.9% quarter-over-quarter and -4.5% year-over-year in local currency terms. Small sawtimber (18-25 cm) declined -0.4% quarter-over-quarter and -1.1% year-over-year and large-diameter sawtimber (25-35 cm) gained 0.7% quarter-over-quarter and 5.0% year-over-year. Veneer logs (>35 cm), used primarily for export-oriented softwood plywood, increased 1.2% quarter-over-quarter and 2.8% year-over-year (Figure 17).

The price of larger diameter sawtimber continues to be driven by exports, particularly plywood and lumber. In Q1 (latest available data), Brazilian plywood exports to the US increased 26.2% year-over-year while Brazilian lumber exports to the US increased 56.5% year-over-year.

The global steel sector remains weak due to excess steel capacity and slower Chinese demand. This continues to negatively impact industrial wood charcoal (Figure 18, left axis), which is used to produce pig iron which in turn is used to make steel. Although charcoal prices have recovered from their lows, they remain somewhat challenged. In Q2, charcoal prices in Minas Gerais declined -2.4% quarter-over-quarter and -4.9% year-over-year. Charcoal pricing is normally reflected in the price of eucalyptus stumpage (Figure 18, right axis). In Q2, Minas Gerais eucalyptus prices were flat quarter-over-quarter, but declined -2.5% year-over-year, likely a reflection of continued accumulated timber supply in the region.

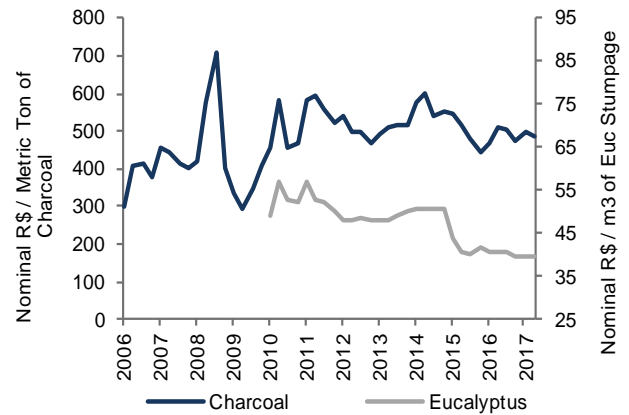
**Figure 17. Pine Sawtimber Stumpage Prices in Paraná State, Brazil.** Source: STCP. (STCP changed log diameters to 8-18 cm from 8-15 cm and 18-25 cm

from 15-25 cm in Q416 so revised historical data only extend back to 2014).



**Figure 18. Charcoal and Eucalyptus Stumpage Prices in Minas Gerais, Brazil.**

Sources: Associação Mineira de Silvicultura; Poyry Silviconsult.

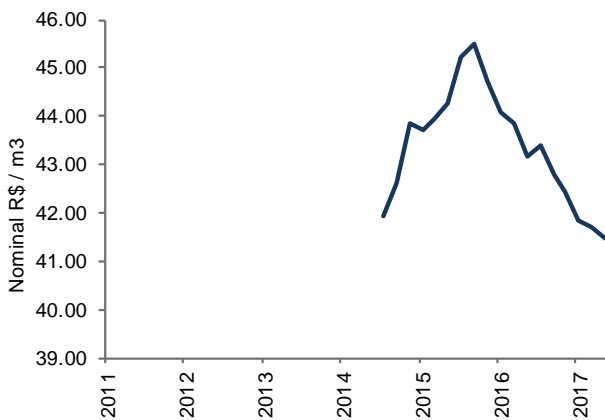


Meantime, eucalyptus pulpwood prices declined -0.6% quarter-over-quarter (ended June) and -4.0% year-over-year on a countrywide basis (Figure 19).

The price of pine resin, a secondary product that can be collected from pine plantations between harvests, and which is used in the production of synthetic rubber, glues, adhesives, printer inks, etc., slightly declined during Q2. Mixed tropical pine resin declined -0.3% quarter-over-quarter in Q2 while slash pine resin declined -0.1% quarter-over-quarter (Figure 20).

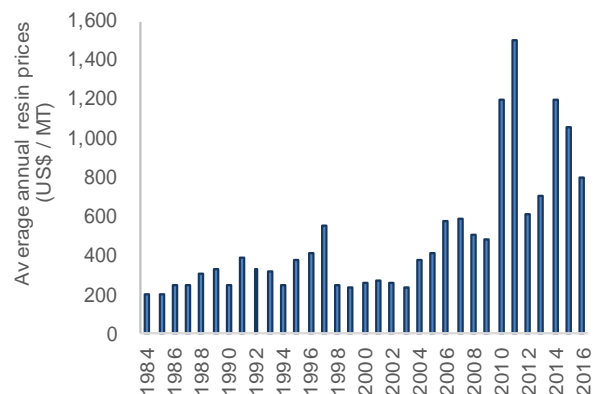
**Figure 19. Brazil Eucalyptus Pulpwood (8-18 cm) Stumpage Prices.** Source: STCP (STCP changed log diameters to 8-18 cm from 8-15 cm during Q416 so

revised historical data only extend back to 2014).



**Figure 20. Average Annual Resin Prices in Brazil.**

Source: Associação dos Resinadores do Brasil

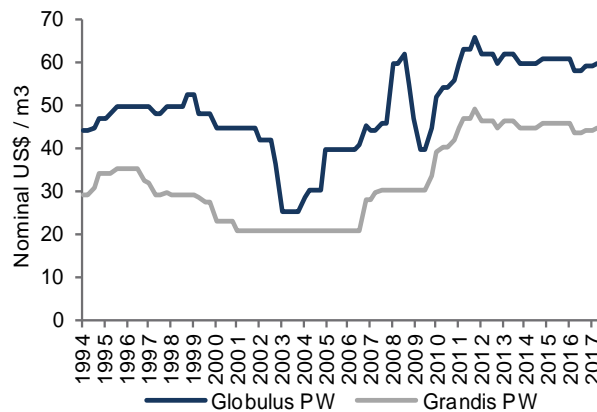


### Uruguay

Uruguayan real GDP increased 4.3% year-over-year in Q1 versus 3.4% year-over-year growth in Q4. The agriculture, cattle raising, hunting & silviculture sectors increased 5.4% year-over-year while commerce increased 8.7% year-over-year. Manufacturing was the weakest sector declining -1.6% year-over-year. Gross fixed capital formation increased 5.0% year-over-year in Q1 versus 14.4% year-over-year in Q4 while household spending increased 4.3% year-over-year versus 1.3% year-over-year in Q4. Exports increased 4.9% year-over-year versus an increase of 3.6% year-over-year in Q4 while imports grew 3.6% year-over-year versus an increase of 5.8% year-over-year in Q4. During Q1, the Uruguayan peso appreciated around 9.7% year-over-year and 0.2% quarter-over-quarter.

In Uruguay, both *E. globulus* and *E. grandis* pulpwood prices increased 1.7% quarter-over-quarter and 3.4% year-over-year in Q2 (Figure 21). Meantime, in Q1 (latest available data), Uruguayan plywood exports to the US declined -25.5% year-over-year while Uruguayan lumber exports to the US increased 51.7% year-over-year.

**Figure 21. Uruguay *E. globulus* and *E. grandis* Pulpwood Prices (Nominal US\$ / m3).** Source: Litenco.



In June, Weyerhaeuser entered into an agreement to sell its Uruguayan operations including timberlands, a plywood mill, and biomass cogeneration facility to BTG Pactual’s TIG.

### Chile

In Q1, Chile’s economy marginally expanded with real GDP growing a slight 0.1% year-over-year following 0.5% year-over-year growth in Q4. This slower growth was expected given the strike at Escondida, the world’s largest copper mine, which ended on March 25 after 44 days. Mining declined -13.8% year-over-year with copper declining -14.4% year-over-year. Construction declined -2.2% year-over-year while business services declined -3.6% year-over-year. Positively, fishing increased 34.0% year-over-year while manufacturing increased 0.9% year-over-year.

Given the economic weakness, Chile's government cut its 2017 real GDP forecast to 1.5% from a prior 2.25%. Moreover, Chile's central bank in May cut its base rate to 2.5%, which is now down 100bps since the end of 2016. That said, the central bank indicated that it will stop its easing bias and allow rates to remain flat.

Gross fixed capital formation declined -2.4% year-over-year, government spending increased 5.1% year-over-year, and consumer spending increased 2.0% year-over-year. Exports declined -4.9% year-over-year while imports increased 4.2% year-over-year. The decline in exports occurred despite a 6.5% year-over-year appreciation in the Chilean peso versus the US dollar in Q1.

### **Argentina**

Argentina's economy showed continued improvement in Q1, with real GDP increasing 1.1% quarter-over-quarter versus 0.7% growth quarter-over-quarter in Q4. On a year-over-year basis, real GDP increased 0.3% versus a decline of -1.9% year-over-year in Q4. Argentina's year-over-year improvement is the result of a 0.9% year-over-year increase in private consumption, a 1.0% year-over-year increase in public consumption, and an increase of 3.0% year-over-year in investments, largely driven by notably stronger transportation equipment (20.5% year-over-year). During Q1, the Argentinian peso depreciated -8.3% year-over-year (-1.5% sequentially) against the US dollar.

On the political front, President Mauricio Macri, Energy & Mining Minister Juan Jose Aranguren, and provincial governors signed a mining accord which standardized rules and reconciled federal and provincial legislation. The objective of this accord, which still has to be approved by Congress, is to encourage investment, particularly by foreign companies, as there is a pipeline of mining projects through 2025 involving companies such as Albemarle Corp., Soc. Quimica y Minera de Chile SA, Eramet SA and Jiangxi Ganfeng Lithium Co. Separately, Argentine federal agents searched the offices of Brazilian construction conglomerate Odebrecht in Buenos Aires in late May as part of an investigation into alleged bribes in the granting of construction contracts for a water treatment plant. The raid was ordered by a judge as part of a probe into the alleged bribe during the 2007-2015 presidency of Cristina Fernandez. Meantime, in mid-June, Former Argentine President Cristina Fernandez announced a new political party, the "Citizen Union" party, as she is running for a Senate seat in October's mid-term election. In late June, Argentina's government sold US\$ 2.75 billion of 100-year bonds priced at 7.9%. This issuance comes just 14 months after Argentina issued its first international bonds since 2001.

### **Guatemala**

Guatemalan real GDP improved in Q4 (latest available data) rising 3.0% versus 2.6% year-over-year growth in Q3. All industries improved versus the prior year except mining & quarrying which declined -10.3% year-over-year. Exports increased 4.4% year-over-year in Q4 versus a decline of -1.5% year-over-year in Q3 while imports increased 0.9% year-over-year in Q4 versus an increase of 2.2% year-over-year in Q3. During Q4, the Guatemalan quetzal appreciated around 1.9% year-over-year and 0.7% quarter-over-quarter.

## Europe

In the euro zone, Q1 real GDP increased 0.6% quarter-over-quarter as compared to 0.5% quarter-over-quarter growth in Q4. Year-over-year, real GDP increased 1.9%. On an individual country basis, growth increased in Germany, Italy, and Spain, but slightly declined in France.

Gross fixed capital formation grew 1.3% quarter-over-quarter in Q1 versus an increase of 3.4% quarter-over-quarter in Q4. Personal consumption increased 0.3% quarter-over-quarter, slightly below last quarter, while government spending grew 0.4% quarter-over-quarter, slightly better than the prior quarter. Unemployment remained flat at 9.3% in May versus April, but was slightly down from 9.4% in March.

Industrial production increased 1.3% month-over-month in May after increasing 0.3% month-over-month in April. This increase is due to production of capital goods rising by 2.3%, durable consumer goods by 1.8%, non-durable consumer goods by 1.2%, energy by 0.9% and intermediate goods by 0.3%.

June's Composite Purchasing Manager's Index declined to 55.7 from 56.8 in both May and April. While manufacturing output rose at the fastest level since April 2011, service sector growth declined to a five-month low. New order growth eased, reflecting weaker inflows of new business into the service sector. Employment growth continued in both manufacturing and the service sector.

Meantime, European net exports (exports less imports) declined year-over-year. In May (latest month reported), exports increased 12.9% year-over-year while imports increased 16.4% year-over-year, resulting in a euro zone trade surplus of €21.4 billion versus a surplus of €23.4 billion in May 2016.

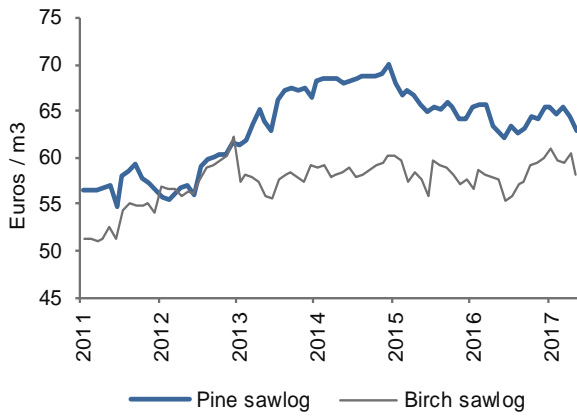
### **Estonian forest products and timber markets**

During the last few months, sawlog prices softened. In Estonia, pine sawlog prices (latest data available May 2017) declined -2.5% from three months earlier, but were slightly up 0.3% year-over-year. Birch sawlog prices declined -2.6% from three months earlier, but increased 0.9% year-over-year (Figure 22).

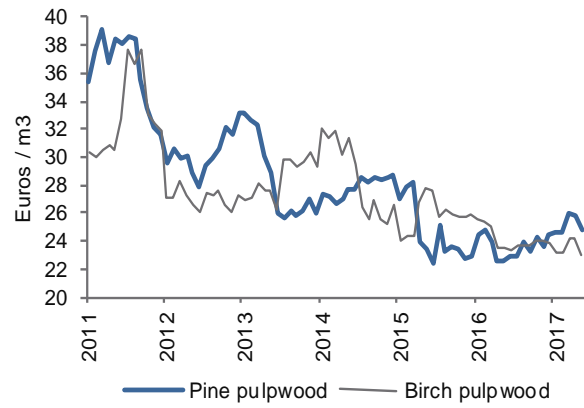
Estonian pulpwood prices were mixed. Pine pulpwood prices (latest data available May 2017) declined -0.9% from three months earlier and -2.5% year-over-year. However, birch pulpwood prices increased 0.9% from three months earlier and 10.4% year-over-year (Figure 23).

**Figure 22. Estonia Sawlog Prices (Nominal € / m3).**

Source: RMK (Estonia State Forest Agency).



**Figure 23. Estonia Pulpwood Prices (Nominal € / m3).** Source: RMK (Estonia State Forest Agency).



## South Africa

In Q1, South Africa's economy entered into a recession with real GDP declining -0.7% quarter-over-quarter following a decline of -0.3% quarter-over-quarter in Q4. The main contributors to the GDP decline were: 1) trade, catering and accommodation (-5.9% quarter-over-quarter) and 2) manufacturing (-3.7% quarter-over-quarter). On a positive note, the agriculture, forestry and fishing industry increased 22.2% quarter-over-quarter (first increase in nine quarters), which could be indicative of a recovery from the harsh drought the country has experienced.

On the political front, plans to debate a no-confidence motion in South African President Jacob Zuma were blocked by the executive committee chairman of the meeting of the African National Congress. Opposition to the president has increased since he fired Finance Minister Pravin Gordhan in late March. In late May, South Africa's main opposition party, Democratic Alliance, sued President Jacob Zuma and 11 other individuals over corruption and influence-peddling by the wealthy Gupta business family. The family is suspected of obtaining lucrative state contracts and even influencing ministerial appointments due to their friendship with President Zuma. Meantime, following moves by S&P and Fitch, in June, Moody's downgraded South Africa's credit rating by one notch from Baa2 to Baa3, keeping it at investment grade with a negative outlook. Separately, in July, South Africa's central bank cut its benchmark repurchase rate by 25 basis points to 6.75% given the recession and easing inflation.

### South African forest products and timber markets

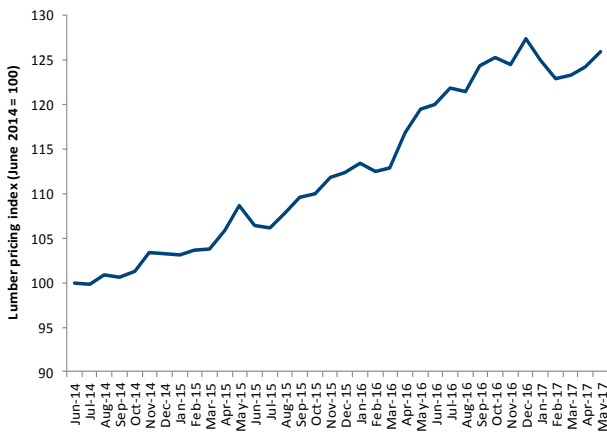
In May, lumber prices increased 2.5% versus the prior three months and 5.4% from May 2016, as measured by the South African Lumber Index, a composite price series (Figure 24).

Softwood log prices were also generally positive (Figure 25). Sawlogs in South Africa are categorized into A, B, C or D grades, with A grade logs being the smallest and D grade logs being the largest. In nominal terms in Q1 (latest data available): A grade logs declined -2.9% for the quarter and -0.7% year-over-year, B grade logs increased 1.6% for the quarter and 5.5% year-over-year, C grade logs rose 1.5% for the quarter and 6.5% year-over-year, and D grade logs increased 1.2% for the quarter and 6.2% year-over-year.

While some of the aforementioned price gains seem steep, it is worth noting that annual inflation in South Africa is 5.1%, so in real terms most of the gains are less notable (i.e., B grade logs: 0.4% real year-over-year, C grade logs: 1.4% real year-over-year, and D grade logs: 1.1% real year-over-year). Meanwhile, the rand appreciated around 16.3% year-over-year against the US dollar in Q1 (Figure 26) serving as a tailwind for the aforementioned year-over-year price changes. Separately, the rand appreciated around 19.3% year-over-year against the Euro (Figure 27).

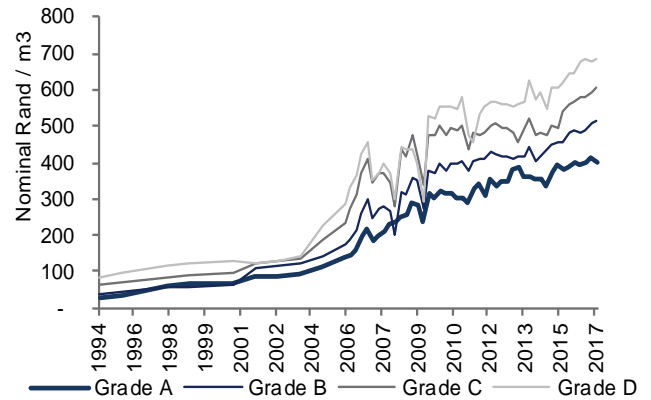
**Figure 24. South Africa Lumber Index.**

Source: Crickmay and Associates.



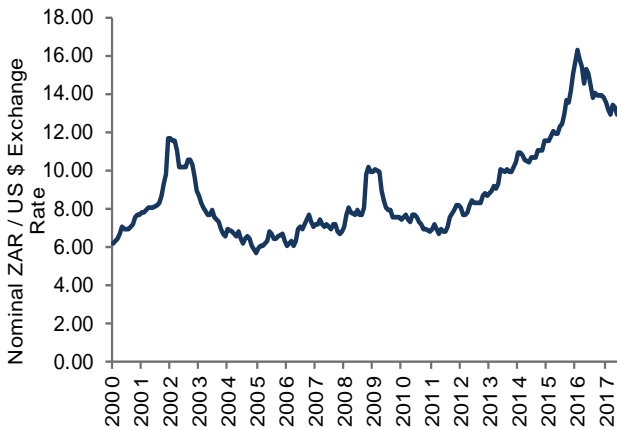
**Figure 25. South Africa Pine Sawlog Prices.**

Source: Crickmay and Associates.



**Figure 26. Nominal South Africa Rand to US\$ Exchange Rate.**

Source: Federal Reserve Bank of St. Louis.



**Figure 27. Nominal South Africa Rand to Euro Exchange Rate.**

Source: Bloomberg.





## New Zealand

In Q1, New Zealand’s economy marginally improved versus the prior quarter, with real GDP growing a modest 0.5% quarter-over-quarter versus growth of 0.4% quarter-over-quarter in Q4. Agriculture increased 4.3% quarter-over-quarter due to higher milk production while retail trade and accommodation increased 1.8% quarter-over-quarter. Construction declined -2.1% quarter-over-quarter, the first decline since June 2015. Meantime, exports declined -0.4% quarter-over-quarter due to lower exports of dairy products while imports increased 1.3% quarter-over-quarter largely driven by imports of consumption goods and passenger cars. In Q1, the New Zealand dollar slightly appreciated 0.1% quarter-over-quarter against the US dollar (Figure 28).

### New Zealand timber markets

New Zealand A-grade export logs continued to firm in March increasing to NZ\$ 165/m<sup>3</sup> from NZ\$ 157/m<sup>3</sup> in December and NZ\$ 143/m<sup>3</sup> in March 2016 (Figure 29). This increase has been driven by strong demand for logs from China, New Zealand’s largest export market. That said, Chinese log inventories are elevated which could discourage future log exports. Meantime, domestic structural logs used for construction (S1 and S3) improved given continued housing strength driven by low interest rates and strong demand from the horticulture industry, which uses poles in foundations and retaining walls.

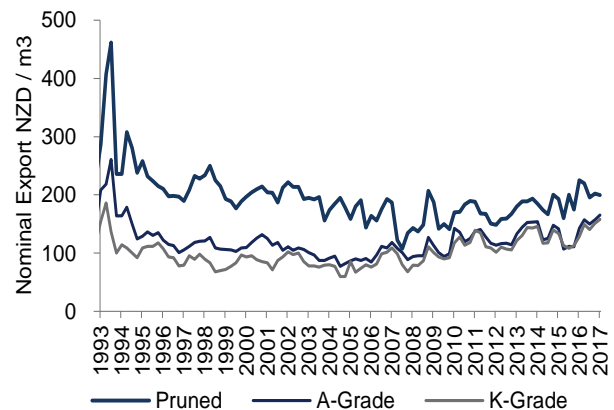
Figure 28. Nominal New Zealand Dollar to US\$ Exchange Rate.

Source: Federal Reserve Bank of St. Louis.



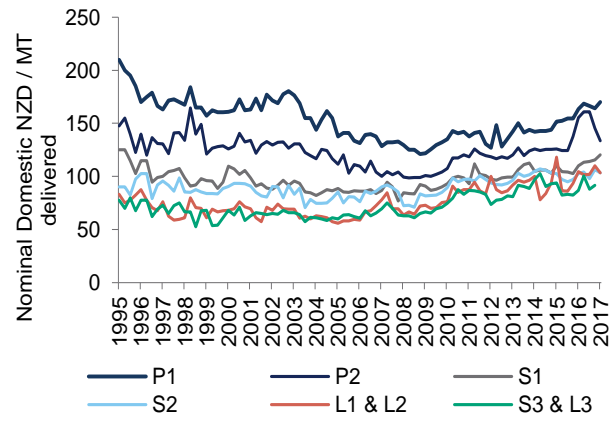
Figure 29. New Zealand Export Log Prices. Source: New Zealand

Ministry for Primary Industries.



**Figure 30. New Zealand Domestic Log Prices.**

Source New Zealand Ministry for Primary Industries.



## Australia

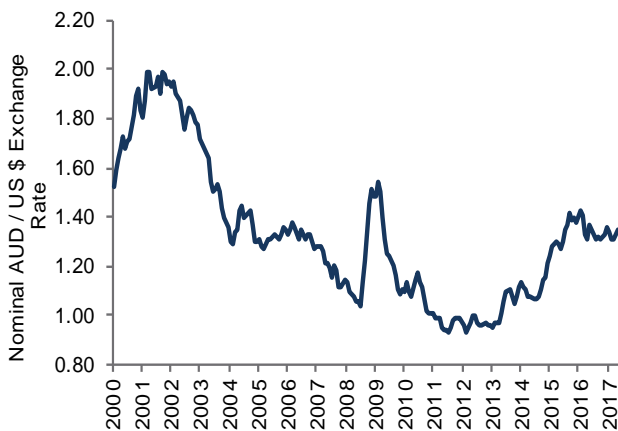
In Q1, Australia’s economy slowed versus the prior quarter with real GDP increasing 0.3% quarter-over-quarter versus growth of 1.1% quarter-over-quarter in Q4. Agriculture, forestry and fishing declined -5.6% quarter-over-quarter due to a decline in grains and other crops while mining increased 0.5% quarter-over-quarter due to oil and gas extraction (3.1%), coal mining (1.6%), and other mining (0.9%). That said, manufacturing declined -1.0% quarter-over-quarter due to wood and paper products (-6.3%) and textile, clothing and other manufacturing (-6.9%). Meantime, exports declined -1.6% quarter-over-quarter while imports increased 1.6% quarter-over-quarter. In Q1, the Australian dollar appreciated around 1.1% quarter-over-quarter (Figure 31).

### Australian timber markets

Softwood roundwood prices increased 1.3% quarter-over-quarter to US\$ 79/odmt (“oven dry metric ton”) from US\$ 78/odmt in Q4 given continued improving Chinese demand (Figure 32). Hardwood logs increased 3.2% quarter-over-quarter to US\$ 97/odmt from US\$ 94/odmt in Q4 (Figure 33). Both softwood and hardwood chips moved higher in Q1, increasing 3.9% and 6.2%, respectively.

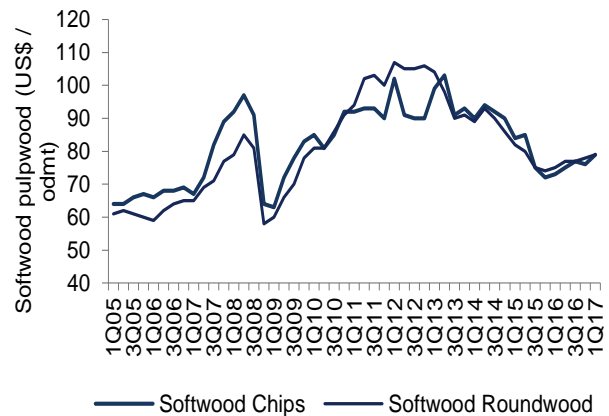
**Figure 31. Nominal Australia Dollar to US\$ Exchange Rate.**

Source: Federal Reserve Bank of St. Louis.



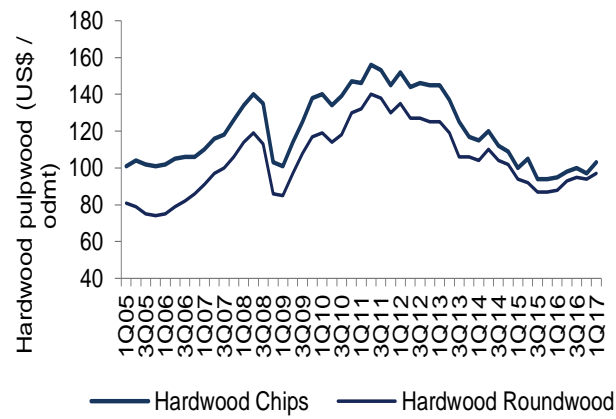
**Figure 32. Australian Softwood Pulpwood Prices.**

Source: Wood Resource Quarterly.



**Figure 33. Australian Hardwood Pulpwood Prices.**

Source: Wood Resource Quarterly.



## Baltic Dry Index

Since the beginning of the year, the Baltic Dry Index, which provides a benchmark for the price of transporting major raw materials including grains, coal, and iron ore by sea, has declined around -6.2% (Figures 34 & 35). The index had increased during Q1, but then started to sell off through most of Q2 before beginning to modestly increase in mid-June. This decline corresponds with a slowdown in commodity prices (e.g., benchmark iron ore prices declined around 32% from the high price point reached in Q1). At a value of 901 on June 30, 2017, the index remains well below its peak of 11,793 reached in May 2008.

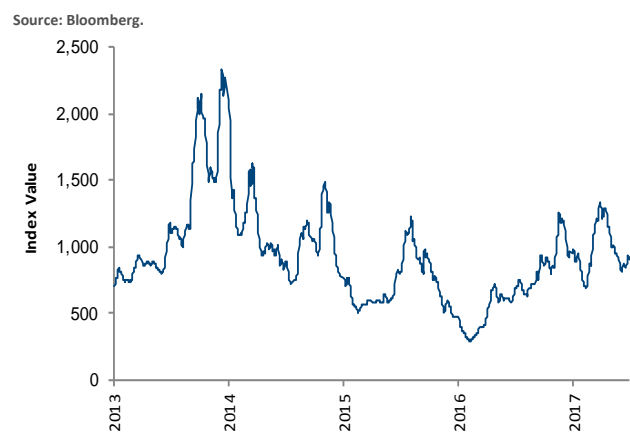
Looking ahead though, there are a number of factors that could spur higher freight rates. In particular, there are upcoming regulations that may encourage the retirement of older vessels, resulting in less shipping capacity. The Ballast Water Management Convention, which goes into effect in September 2017, aims to prevent the spread of harmful aquatic organisms from one region to another by requiring all ships in international traffic to manage their ballast water and sediments to a certain standard. As a result, most ships will be required to install on-board ballast water treatment systems.

Separately, the International Maritime Organization (“IMO”) announced that it is proceeding with a global sulfur cap of 0.5% on marine fuels starting from January 1, 2020. These regulations require the switch to low sulphur fuels such as marine gas oil for all international maritime voyages. Alternatively, shippers may install scrubbers, a system that removes sulphur from exhaust gas emitted by bunker fuel.

**Figure 34. Baltic Dry Index Performance over Time.**



**Figure 35. Baltic Dry Index Recent Performance.**



## Global Pulp and Paper Markets

During Q2, the price of Bleached Softwood Kraft Pulp (“BSK”) in Europe, a bellwether of the pulp and paper sector, averaged around US\$ 860/MT, up 5.4% versus the prior quarter and 8.0% year-over-year (Figure 35). BSK includes both Northern and Southern Bleached Kraft grades (“NBSK” and “SBSK”, respectively).

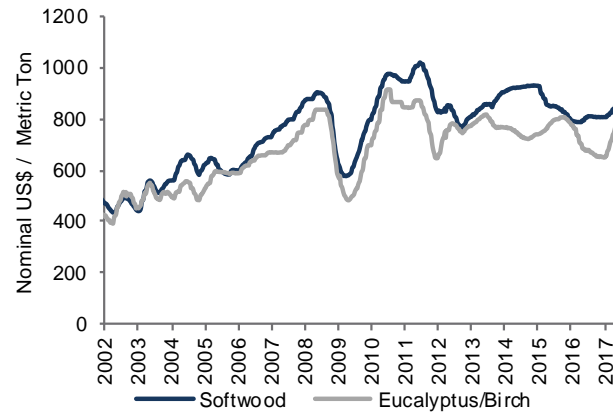
During the quarter, softwood pricing continued to improve given better demand and as the effects of downtime earlier in the year (International Paper took down its Port Wentworth mill for over two months for a major recovery boiler build; Sodra is slowly ramping the rebuilt line at its Varo mill, etc.) continue to ripple through the market. The increase in hardwood prices (see below) also likely caused some substitution into softwood from hardwood thereby causing prices to increase. However, in early June, softwood prices in China began to decline (Chinese prices usually lead European prices). Moreover, there is less demand for BSK during the slower consuming summer months in the Northern Hemisphere and capacity is increasing given SBSK/fluff pulp capacity starts beginning in Q3.

Bleached Hardwood Kraft (“BHK”) prices in Europe, a benchmark, increased 15.0% quarter-over-quarter and 12.9% year-over-year in Q2, averaging around US\$ 783/MT. Prices improved given strong demand, tight supply, and lower inventories.

That said, Chinese hardwood demand is moderating, global inventories are rising, and supply is increasing. Per the Pulp & Paper Products Council (“PPPC”), shipments to China declined -8.7% year-over-year in May while global hardwood inventories increased one day to 37 days of supply. Meantime, Chinese pulp imports as reported by China Customs declined -4.7% year-over-year in May (following a -5.7% year-over-year decline in April) while pulp inventories at European ports as reported by Europulp increased 2.8% month-over-month in May. Further, there is the potential for hardwood pulp supply to increase. APP noted that it started the second line (1.4mn MT) at its Oki mill in South Sumatra, Indonesia in May and began production in June. Moreover, Fibria’s second line at its Três Lagoas mill (1.95mn MT) in Brazil will be starting up in early September and could potentially produce close to 400,000 MT this year. Further, Metsä Group is planning to begin production at a new 1.3mn MT pulp and bioproduct mill in Äänekoski, Finland in mid-August (500k MT of hardwood pulp and 800k MT of softwood pulp).

Figure 36. Global BSK and BHK Pulp.

Source: FOEX.



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