



# Timberland Investment Group Market Report

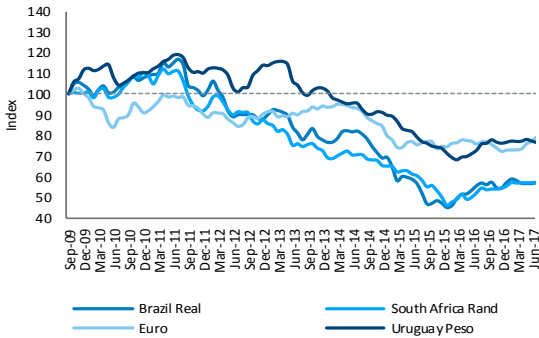
## 3<sup>rd</sup> Quarter 2017

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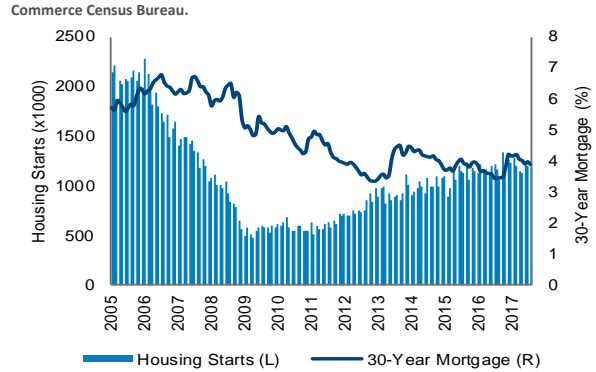
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# Timberland Investment Dashboard

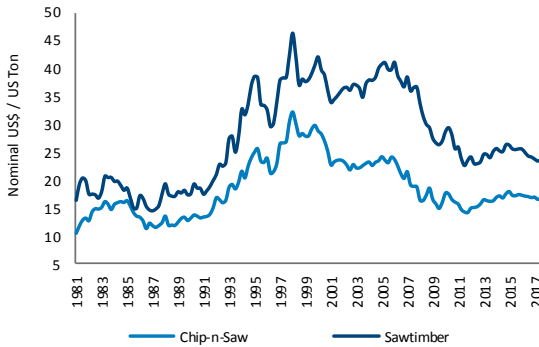
**Indexed Exchange Rates of Selected Countries vs. the US Dollar (2009=100).** Sources: Federal Reserve Bank; Bloomberg.



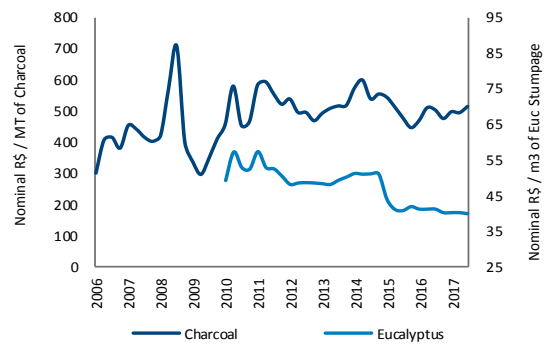
**Annual US Housing Starts, Seasonally Adjusted Annual Rate, and 30-year Mortgage Rates.** Sources: Federal Reserve Bank; US Dept. of Commerce Census Bureau.



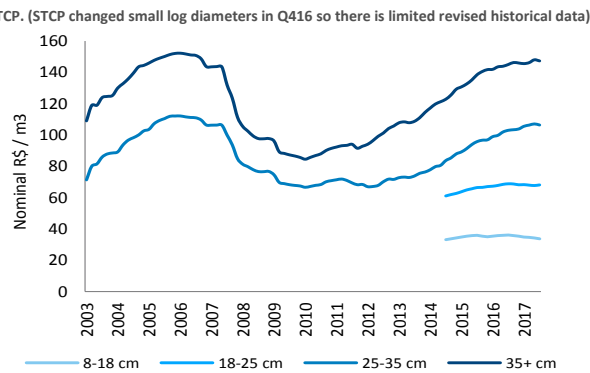
**US Southwide Quarterly Pine Chip-n-Saw and Sawtimber Prices.** Source: TimberMart-South.



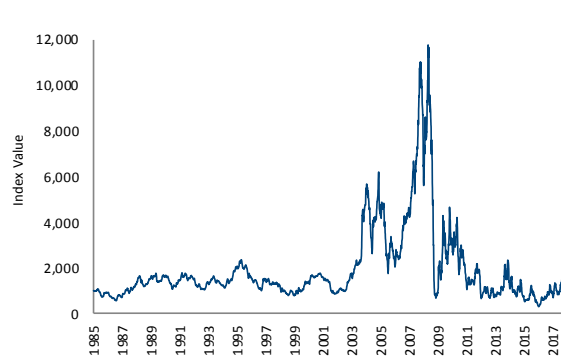
**Quarterly Charcoal and Eucalyptus Stumpage Prices in Minas Gerais, Brazil.** Sources: Associação Mineira de Silvicultura, Silviconsult.



**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 3.1% (real GDP) in Q2 reflecting growth in personal consumption, nonresidential fixed investment, exports, federal government spending, and private inventory investment. Imports, residential fixed investment, and state and local government spending were drags on growth.
- Unemployment slightly increased from 4.3% in July to 4.4% in August as labor force participation remained flat.
- The ISM Purchasing Managers Index increased to 58.8% in August versus 56.3% in July.
- The US housing market continues to strengthen moderately, although the recovery is following an uneven pace. August housing starts declined -0.8% over the prior month, but increased 1.4% versus August 2016; multifamily starts accounted for 27.9% of August starts versus 29.6% in June, 30.7% in March, and a historic average of 23.1% since 1990.
- Southern pine sawtimber prices increased 1.1% for the quarter, but were lower -2.6% year-over-year.
- Chip-n-saw prices increased 1.5% sequentially in Q3, but were lower -1.4% year-over-year.
- Southern mixed hardwood sawtimber prices increased 1.8% for the quarter, but were lower -9.3% year-over-year.
- In the US South, softwood pulpwood prices increased 1.1% quarter-over-quarter, but were lower -8.4% year-over-year while hardwood pulpwood prices declined -0.6% quarter-over-quarter and -11.9% year-over-year.

### Latin America

- In Q2, Brazil's economy expanded for the second consecutive quarter with real GDP increasing 0.2% quarter-over-quarter versus an increase of 1.0% quarter-over-quarter in Q1.
- The Brazilian government continues to pursue economic reforms, including pension reform, despite ongoing political turmoil.
- Brazilian softwood sawtimber prices were mixed, depending on assortment, although larger-diameter sawtimber grades experienced year-over-year gains.
- Brazilian charcoal prices increased 4.1% quarter-over-quarter. However, the price of eucalyptus used in charcoal production declined -0.8% quarter-over-quarter.
- Eucalyptus pulpwood prices in Brazil declined -0.2% for the three months ended August and -4.7% year-over-year.
- In Q2, Chile's real GDP increased 0.9% year-over-year following 0.1% year-over-year growth in Q1.
- Argentina's economy showed continued improvement with real GDP growth of 2.7% year-over-year in Q2 versus growth of 0.4% year-over-year in Q1.
- Guatemala's real GDP increased 2.3% year-over-year in Q2 following 3.0% year-over-year growth in Q1.
- Uruguay's real GDP increased at an annualized rate of 2.8% in Q2 versus 4.3% growth in Q1.
- Eucalyptus pulpwood prices in Uruguay were flat quarter-over-quarter in Q3, but increased 3.4% year-over-year.

### Europe

- Q2 euro zone real GDP increased 0.6% quarter-over-quarter as compared to 0.5% quarter-over-quarter growth in Q1.
- Gross fixed capital formation grew 0.9% quarter-over-quarter in Q2 versus a decline of -0.3% quarter-over-quarter in Q1 while industrial production increased 1.4% month-over-month in August after increasing 0.3% month-over-month in July.
- In August, exports increased 6.8% year-over-year while imports increased 8.6% year-over-year.
- In Estonia, pine sawlog prices increased 5.2% from three months earlier and 5.7% year-over-year, while birch sawlog prices increased 1.9% from three months earlier and 3.4% year-over-year.
- Estonian pulpwood prices also improved. Pine pulpwood prices increased 9.0% from three months earlier and 13.2% year-over-year, while birch pulpwood prices increased 5.5% from three months earlier and 2.5% year-over-year.

### South Africa

- In Q2, South Africa's economy emerged from a short recession with real GDP growing 2.5% quarter-over-quarter versus a decline of -0.6% quarter-over-quarter in Q1.
- Political conditions continue to trouble South Africa, with opposition parties continuing to pursue impeachment charges against President Jacob Zuma.
- In July, lumber prices increased 0.9% versus the prior three months and 2.9% from July 2016.
- Softwood log prices were generally positive except for B grade logs. In Q2: A grade logs increased 3.8% for the quarter and 5.1% year-over-year, B grade logs declined -8.9% for the quarter and -3.1% year-over-year, C grade logs rose 0.2% for the quarter and 4.1% year-over-year, and D grade logs increased 2.5% for the quarter and 3.5% year-over-year.

### New Zealand

- In Q2, New Zealand's real GDP grew 0.8% quarter-over-quarter versus growth of 0.5% quarter-over-quarter in Q1. Retail trade and accommodation and manufacturing were better while construction was weaker.
- New Zealand A-grade export log prices continued to increase in June driven by strong demand for export logs from China, New Zealand's largest export market. Domestic log prices also increased as winter weather restricted domestic log availability and as domestic consumers aggressively competed with export markets for wood.

### Australia

- In Q2 Australia's real GDP increased 0.8% quarter-over-quarter versus growth of 0.3% quarter-over-quarter in Q1. Agriculture, forestry & fishing and manufacturing were better.
- Australian softwood roundwood prices declined given slower residential construction while prices on hardwood logs also declined. Both softwood and hardwood chips moved lower.

### Global Pulp & Paper Markets

- In Q3, bleached softwood kraft pulp (“BSK”) prices increased 3.9% versus the prior quarter and 10.2% year-over-year.
- During the quarter, softwood pulp pricing increased given better demand, particularly from China, and as some buyers substituted hardwood for softwood given rising hardwood prices.
- Softwood pulp supply is increasing given the recent start of Metsä Fibre’s new mill.
- Bleached hardwood kraft pulp (“BHK”) prices increased 11.5% in Q3 versus the prior quarter and 30.0% year-over-year.
- Prices have been supported by unexpected mill downtime, strong Chinese demand, and lower inventories.
- Similar to softwood, hardwood pulp capacity has increased given the start of Fibria’s second line at its Três Lagoas mill.

\*GDP is reported in real terms while timber pricing is reported in nominal terms

\*\*For every country mentioned in this report, real GDP reflect 2Q2017; 3Q2017 real GDP will be released between late October 2017 and early January 2018

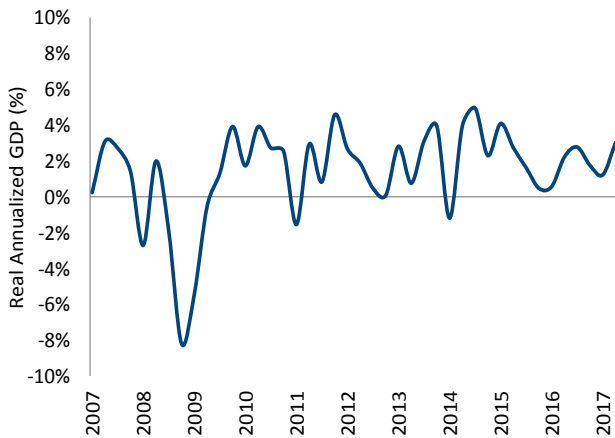
## United States

In Q2 (the latest GDP data available; 3Q2017 GDP expected to be released late October) the US Department of Commerce reported that the economy expanded at an annual rate of 3.1% (real GDP). This was above the 1.2% real GDP gain from the prior period (Figure 1). The Q2 increase in real GDP reflected growth in personal consumption, nonresidential fixed investment, exports, federal government spending, and private inventory investment. These were partly offset by negative contributions from residential fixed investment and state and local government spending. Imports also increased, which reduced GDP. The unemployment rate slightly increased from 4.3% in July to 4.4% in August while the change in total nonfarm payroll employment (seasonally adjusted) was 189,000 in July versus 156,000 in August. Meanwhile, the labor force participation rate remained flat at 62.9% in August versus July, continuing to trend along low levels (Figure 2).

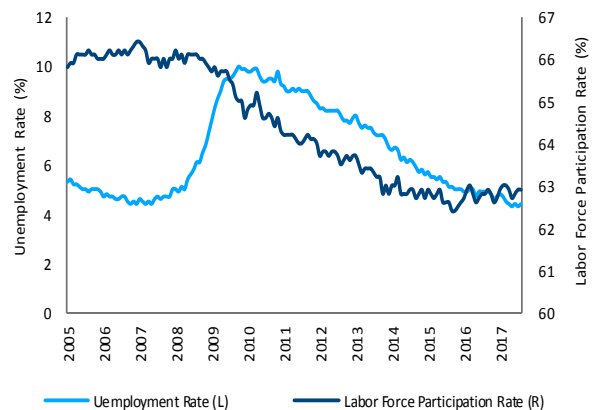
Manufacturing improved in recent months. The Institute for Supply Management (“ISM”) Purchasing Managers Index, a bellwether of manufacturing activity, increased to 58.8% in August from 56.3% in July and 57.8% in June (Figure 3).

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

Sources: US Dept. of Commerce, BEA.

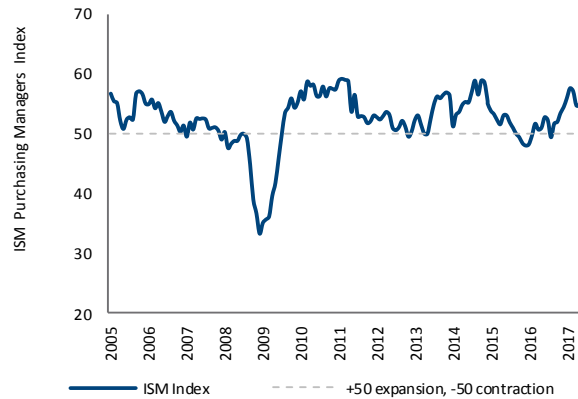


**Figure 2. US Unemployment, and Labor Force Participation Rate.** Sources: Sources: US Dept. of Labor, BLS.



**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.

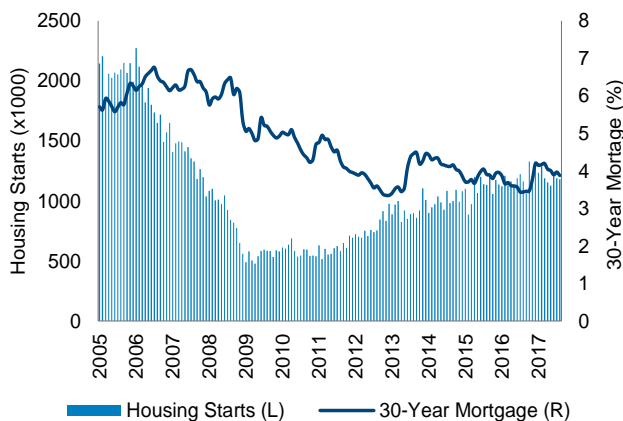
In August, housing starts totaled 1.180 million units. This figure is down -0.8% versus July's 1.190 million units, but up 1.4% versus August 2016's 1.164 million starts (Figure 4). The share of multifamily starts as a percentage of total starts declined to 27.9% versus 29.6% in July.

New single-family home sales declined -3.4% month-over-month in August (Figure 5). Sales declined -4.7% month-over-month in the South, -2.7% month-over-month in the West, and -2.6% month-over-month in the Northeast. Sales were flat month-over-month in the Midwest.

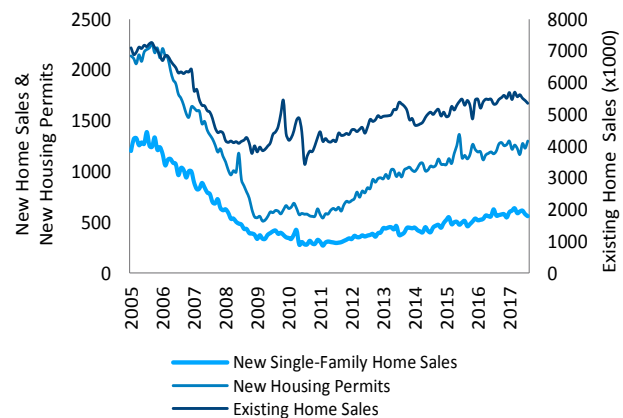
With respect to current housing stock, existing home sales declined -1.7% month-over-month in August (+0.2% year-over-year) to 5.35 million units. Inventories of existing homes remained flat at 4.2 months in August versus July, still low by historical standards.



**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 August, building permits increased 5.7% month-over-month. This increase was driven more by multi-family permits, which increased 19.6% month-over-month versus single-family permits, which declined -1.5% month-over-month.

**US forest products and timber markets**

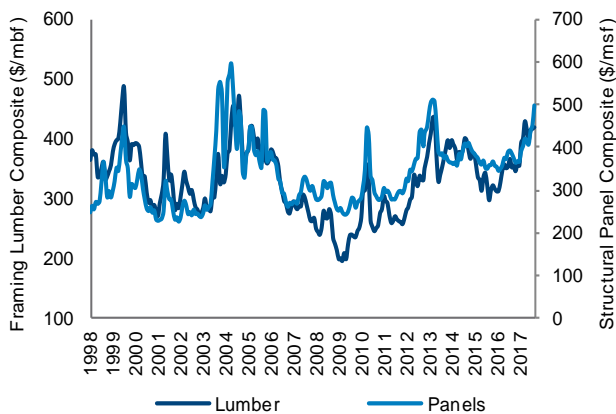
Softwood lumber prices increased 1.0% quarter-over-quarter in Q3. This compares to a historical average sequential decline of -0.7% over the last decade (Figure 6). Prices jumped in mid-July given wildfires in British Columbia’s Interior, causing a total of eight lumber mill closures and impacting around 14% of the province’s lumber production and 3% of North American lumber production. Prices softened in August given lower consumption, but increased again in September due to stronger order files, particularly following Hurricanes Harvey and Irma, and inventory replenishment. Meanwhile, US lumber exports slightly increased 0.3% year-over-year in Q2 (export data are released on a one-quarter lag).

During Q3, structural panel pricing increased 12.8% versus Q2. This compares to a historical average sequential increase of 0.8% over the last decade (Figure 6). Similar to lumber, Oriented Strand Board (“OSB”) prices jumped in mid-July due to expanding order files and concerns regarding OSB availability given wildfires in western Canada. Prices leveled off in August, but then started to increase again in September given limited product availability and strong demand following Hurricanes Harvey and Irma. In Q2, US OSB production increased 2.5% year-over-year, imports declined -2.9% year-over-year, and exports declined -21.4% 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 Canadian wildfires, which limited product availability. Prices softened for a brief period in mid-August as buyers reduced inventories before jumping in September due to thin inventories, better demand partially due to Hurricanes Harvey and Irma, and log shortages in the West from wildfires.

In Q2, US plywood production increased 1.8% year-over-year, imports increased 6.7% year-over-year, and plywood exports increased 13.9% year-over-year.

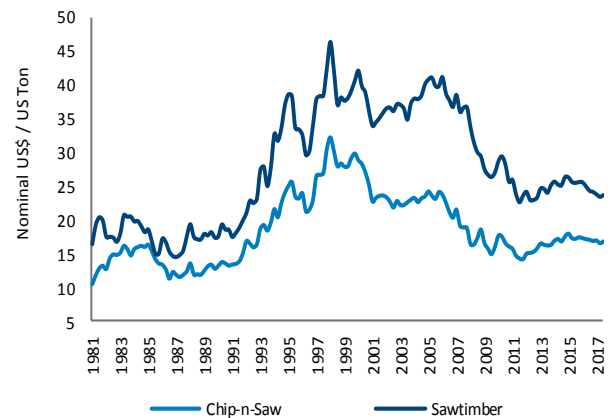
**Figure 6. US Framing Lumber Index and Panel Composite Index.**

Source: Random Lengths.



**Figure 7. US Southwide Quarterly Pine Chip-n-Saw and Sawtimber Prices.**

Source: TimberMart-South.



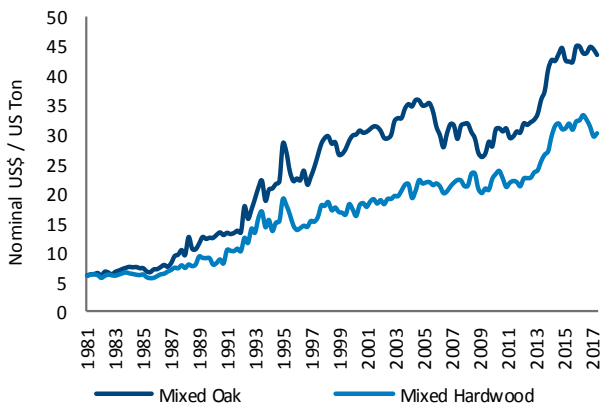
Throughout the US South, pine sawtimber prices increased 1.1% in Q3, but were lower -2.6% year-over-year according to TimberMart-South (Figure 7). Chip-n-saw prices increased 1.5% sequentially in Q3, but were lower -1.4% year-over-year. Hurricanes Harvey and Irma flooded a number of areas in the US South and made logging conditions more challenging, thereby resulting in higher stumpage prices.

Southern hardwood sawtimber prices were mixed during Q3. Region-wide, mixed hardwood prices increased 1.8% for the quarter, but were lower -9.3% year-over-year. Oak sawtimber prices declined -2.2% quarter-over-quarter and -0.7% year-over-year (Figure 8).

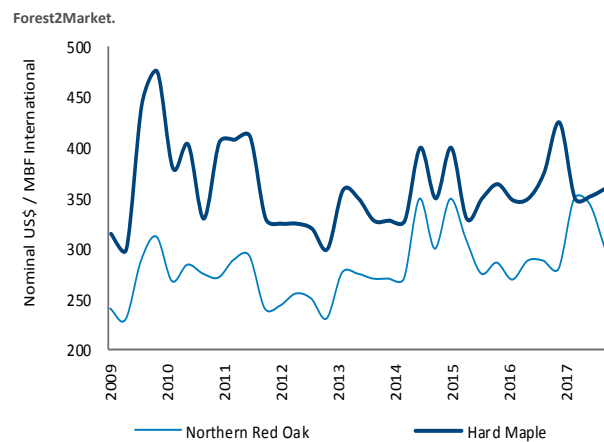
During Q3, West Fraser entered into an agreement to acquire Gilman Companies comprised of six sawmills (700 mmbf) and a finger joint mill in FL and GA as well as an administrative office in St. Marys, GA for US\$ 430 million. Roseburg Forest Products announced that it intends to build a new engineered wood products plant (laminated veneer lumber) in Chester, SC with construction beginning in early 2018 and production beginning in mid-2019, while Egger Group is planning to build a new particleboard plant in Lexington, NC with construction beginning in late 2018 and production beginning in 2020. Georgia-Pacific also announced that it is beginning construction on a new US\$ 100 million lumber mill in Talladega, AL, which is expected to initially produce 230mmbf in 2018 and could eventually produce 300mmbf. Separately, a number of paper companies announced machine closures. Resolute Forest Products announced the closure of its No. 3 and No. 5 newsprint and uncoated mechanical paper machines, respectively, at its Calhoun, TN mill removing around 356,000 MT of capacity. The closures are expected to occur before September 30<sup>th</sup>. Calhoun's remaining tissue machine (66,000 tons) and No. 4 uncoated free sheet and paper bag grade machine (148,000 MT) will remain operational. Similarly, Verso announced that it will permanently close its No. 3 paper machine at its Androscoggin mill in Jay, ME by September 30<sup>th</sup> reducing coated paper capacity by around 200,000 tons. In September, Verso further announced that it is exploring strategic alternatives for the company including the potential sale of some

mills. Further, Glatfelter announced the closure of paper machine No. 24 at its Chillicothe, OH facility by September 30<sup>th</sup> removing around 80,000 tons of specialty papers. In late September, International Paper announced that it will invest US\$ 300 million to convert its uncoated free sheet paper machine (235,000 tons) at its Riverdale Mill in Selma, AL to whitetop linerboard and containerboard. The conversion is targeted to be completed by mid-2019 and will add around 450,000 tons of capacity.

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



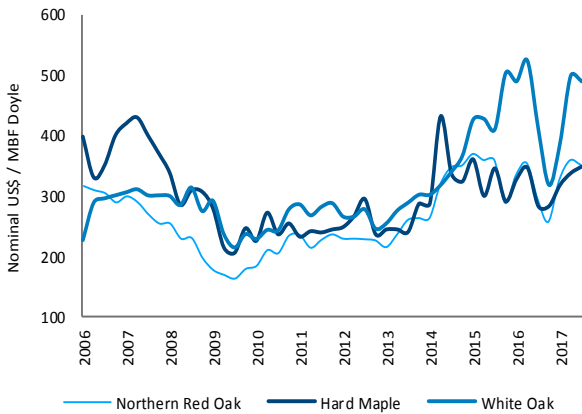
**Figure 9. Quarterly Northern Red Oak and Hard Maple Sawtimber Prices in New York.** Source: Forest2Market.



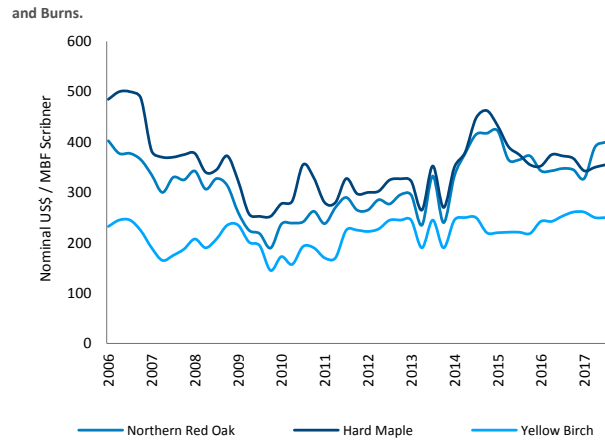
In other timber markets, prices were mixed during the quarter. In New York’s Adirondack region, northern red oak declined -13.0% quarter-over-quarter, but increased 4.2% year-over-year (Figure 9). Hard maple increased 2.3% quarter-over-quarter in Q3, but declined -4.0 year-over-year. In Ohio, red oak declined -2.1% compared to Q2, but increased 18.9% year-over-year. Hard maple increased 3.3% during the quarter and 23.4% year-over-year. White oak declined -1.9% quarter-over-quarter, but increased 19.0 % year-over-year (Figure 10).

In Wisconsin, northern red oak increased 2.6% quarter-over-quarter in Q3 and 15.1% year-over-year (Figure 11). Hard maple increased 1.4% for the quarter, but declined -4.7% year-over-year. Yellow birch sawtimber was flat quarter-over-quarter in Q3, but declined -1.2% year-over-year.

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



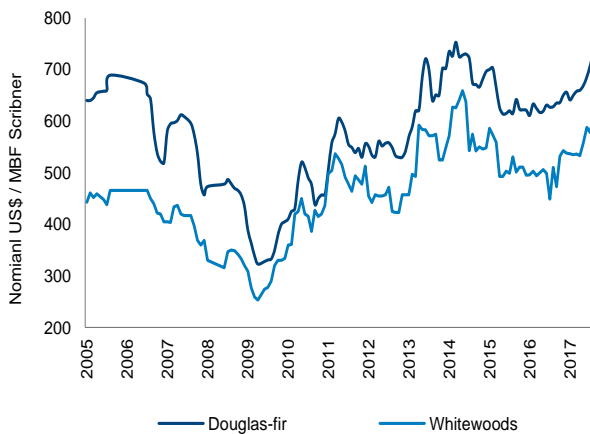
**Figure 11. Northern Red Oak, Hard Maple, and Yellow Birch Sawtimber Prices in Wisconsin.** Source: Steigerwaldt and Burns.



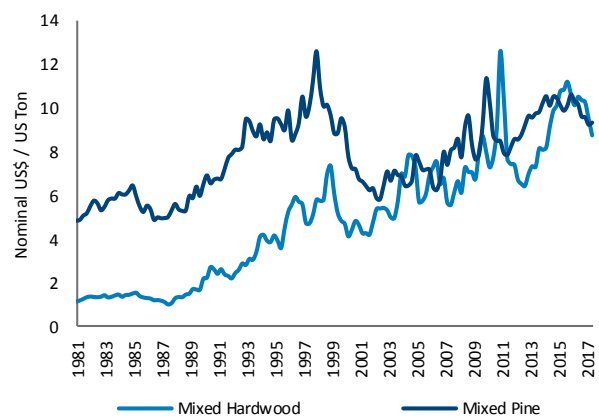
In Oregon, softwood sawlog prices increased. The price of Douglas-fir #2 increased 8.4% sequentially and 17.6% year-over-year (Figure 12). As of August 2017 (latest data available), Douglas-fir has now returned to its prior 2014 peak. The price of Whitewood #2 logs increased 6.5% for the quarter and 24.8% year-over-year. As of August 2017, Whitewoods are still down -7.0% from their 2014 peak. In June 2017 (the latest available data), total softwood log exports to China declined -26.6% year-over-year to 97.71mmbf from 133.21mmbf in June 2016, softwood log exports to Japan increased 8.5% year-over-year to 38.36mmbf from 35.34mmbf in June 2016, and softwood log exports to South Korea increased 135.1% year-over-year to 13.61mmbf from 5.79mmbf in June 2016.

In the US South, hardwood pulpwood prices declined -0.6% in Q3 and -11.9% year-over-year while pine pulpwood prices increased 1.1% quarter-over-quarter, but were lower -8.4% 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, sales improved following Hurricane Harvey as mills sought to rebuild extremely lean inventories, something they typically do mid-quarter every year, but were unable to do this quarter given the hurricane. As a result, prices for sawtimber situated on challenging terrain has increased around 10% while prices for sawtimber situated on highly operable ground has increased at least 12%. Meanwhile, Roy O. Martin’s new OSB mill in Corrigan, Texas has started to accept 70 loads of pulpwood per day (around 2,000 tons per day assuming around 28 tons per load). In Arkansas, Q3 was uneventful with market conditions remaining largely the same as the prior quarter. That said, there is the potential for sawtimber prices to improve in south central Arkansas as Conifex’s El Dorado mill began accepting wood deliveries the last few weeks ahead of its mill restart while pulpwood prices have the potential to improve in southeastern Arkansas given the Highland Pellets expansion.

In South Carolina, North Carolina, Georgia, and Northeast Florida, Q3 was largely uneventful. In September, there was much anticipation regarding Hurricane Irma’s impact, although the hurricane wound up shifting west thereby leaving those regions relatively unharmed. In anticipation of the hurricane, a number of mills idled their operations for a few days, which served to mute the impact of positive pricing pressure (normally experienced after storms) as those mills required less wood after restarting.

In Virginia, one of the two large pulp/board companies driving market demand has seen inventory levels in its wood yard decline and appears to have become more receptive to wood purchases. This restocking has helped timber prices stabilize after declining earlier in the year due to the closure of White Birch’s newsprint mill (240,000 MT).

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

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

In Wisconsin, demand across most species generally remains steady while prices are generally flat.

In the Pacific Northwest, markets remain robust with timberland owners continuing to pull some harvests forward to take advantage of higher 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. As a result, the spread between domestic and export log pricing has significantly narrowed.

### **US Softwood Lumber Duties**

In late August, the US Department of Commerce announced that it would postpone final determinations in the ongoing antidumping (“AD”) and countervailing duty (“CVD”) investigations of Canadian lumber imports from September 6 to “no later than November 14.” This came on the heels of the expiration of the preliminary CVD on August 25. These duties, which total around 27% (CVD - around 20%; AD – around 6.87%) for most Canadian lumber producers, were imposed to penalize those producers that priced their products in the US below prices in their home market and/or below the cost of production. As a result, Canadian lumber imports will only face the preliminary AD on Canadian lumber imports. Around year-end there will be a short period of time in which Canadian producers will have no duties on lumber shipments to the US as the preliminary ADs also expire. In January 2018, the US International Trade Commission is expected to make a final injury determination.

## Latin America

### Brazilian economy in Q2

In Q2 (the latest GDP data available; 3Q2017 GDP expected to be released around December 1), the Instituto Brasileiro de Geografia e Estatística reported that Brazil’s economy expanded for the second consecutive quarter with real GDP increasing 0.2% quarter-over-quarter following a 1.0% quarter-over-quarter increase in Q1. Agriculture was flat quarter-over-quarter in Q2, industry declined -0.5% quarter-over-quarter, and services increased 0.6% quarter-over-quarter. Investment declined -0.9% quarter-over-quarter following a -0.7% quarter-over-quarter decline in Q1. BTG Pactual’s Brazilian Economics team currently expects 2017 real GDP of 0.6% year-over-year as the economy begins to slowly improve following the recession.

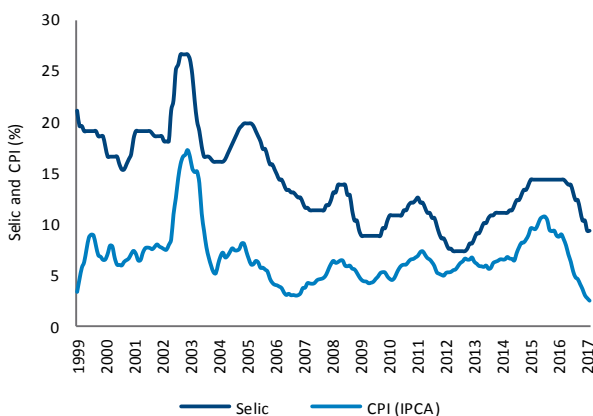
As part of this improvement, household consumption was better, increasing 1.4% quarter-over-quarter in Q2 versus flat in Q1. Unemployment also improved declining to 12.6% in August from 13.3% in May, though it still remains elevated. Moreover, industrial production increased 4.0% year-over-year in August after increasing 2.9% year-over-year in July.

In August, inflation (Índice de Preços ao Consumidor Amplo or “IPCA”) continued to decline, falling to 2.46% from 3.0% in June and 6.29% in December, the lowest reading since 1999 (Figure 14). Real rates have also trended lower as evidenced by declining Treasury inflation-protected bond yields (Figure 15). In September, Brazil’s central bank cut the Selic rate by another 100bps to 8.25% following a 100bps cut in July as inflation continues to slow and the government looks to spur economic growth.

Meanwhile, exports increased 0.5% sequentially in Q2 following a 5.2% quarter-over-quarter increase in Q1. Imports declined -3.5% in Q2 after increasing 0.6% in Q1. Separately, in Q3, the real appreciated around 1.8% sequentially and 2.9% year-over-year (Figure 16).

**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.



The Brazilian government is looking to privatize a variety of assets in a number of different industries, most notably Centrais Eletricas Brasileiras SA (Eletrobras), the country’s largest electric utility. Other potential privatizations include airports, oilfields, hydro power plants, ports, and roads. The purpose of these privatizations is to limit the growth of government debt and minimize the government’s investment spending. Meanwhile, the government is still attempting to address pension reform, although any significant changes are unlikely to occur in the near-term and are more likely to occur after general elections in 2018. In late August, the Brazilian government announced a bare-bones pension overhaul with more controversial items including rules for rural workers being excluded. Given the slowly improving economy, the Brazilian government loosened its annual budget targets through 2020 increasing the amount of deficits it could incur. The government also adopted measures to cut spending and increase revenue, including reducing tax breaks for exports and higher taxes for closed investment funds targeting large investors.

Separately, in September, Brazil’s government announced a financial rescue package for cash-strapped Rio de Janeiro state which allows the local government to pay salaries and debt through 2020. As part of the package, Rio must cut spending and raise revenues. It also calls for the mandatory privatization of the state water and sewer company Cedae. In addition, Brazilian and French authorities announced in early September that they had discovered an international corruption scheme (Operation “Unfair Play”) aimed at buying votes in awarding the 2016 Olympic Games to Rio de Janeiro.

On the political front, the Lava Jato (“Car Wash”) scandal continues to unfold with far-reaching consequences. In mid-September, President Michel Temer was again charged with obstruction of justice and being part of a criminal conspiracy that involved a plot to prevent the authorities from learning about a wide-ranging kickback scheme. In August, President Temer managed to avoid standing trial in a case based on the same investigation as Congress’ Lower House blocked the charges from reaching the Supreme Court. Meanwhile, the Prosecutor General officially charged ex-president Dilma Rousseff and Luiz Inacio Lula da Silva with racketeering for plotting to skim funds from Petrobras, the state oil company. In July, Brazil’s former president 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.



In addition, the Brazilian Prosecutor General revoked immunity benefits given to Joesley Batista, co-owner with his brother Wesley of J&F Group, and Ricardo Saud, a former J&F Group executive, for omitting relevant criminal facts and disregarding clauses of their plea agreements with the government. Specifically, Joesley indicated in a taped recording that he had improper contact with a former prosecutor from the Prosecutor General's office while he was seeking a plea deal. J&F Group, the holding company of meatpacking company JBS, has been accused of making illegal payments to politicians including President Temer. Subsequently, a Brazilian judge converted the temporary arrest warrants for both Joesley and Ricardo into preventive arrest orders. Separately, Wesley Batista was arrested by police as part of an investigation into allegations of insider trading.

As a result of these scandals, J&F agreed to a US\$ 3.2 billion (R\$ 10.3 billion) corruption settlement with the Brazilian government and has been selling assets to address that settlement. In September, J&F agreed to sell its hardwood pulp business Eldorado to Netherlands-based Paper Excellence, which produces 2.3 million MT of pulp a year and has five plants in Canada and two in France.

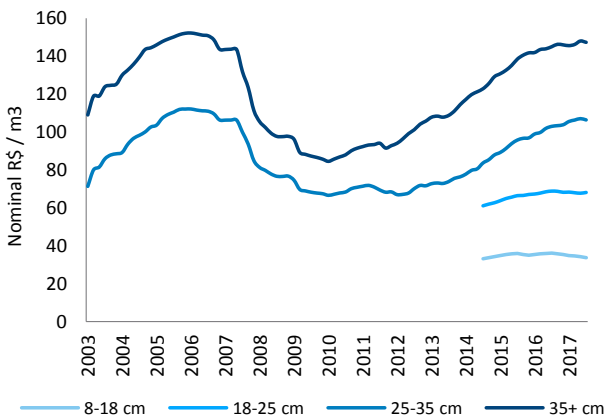
#### **Brazilian forest products and timber markets**

The price of pine timber in Brazil was mixed during the quarter depending on the assortment. Through the end of August, pulpwood (8-18 cm) in Parana State declined -1.7% quarter-over-quarter and -6.8% year-over-year in local currency terms. Small sawtimber (18-25 cm) increased 0.6% quarter-over-quarter, but declined -1.0% year-over-year and large-diameter sawtimber (25-35 cm) declined -0.6% quarter-over-quarter, but increased 3.3% year-over-year. Veneer logs (>35 cm), used primarily for export-oriented softwood plywood, declined -0.5% quarter-over-quarter, but increased 1.6% year-over-year (Figure 17).

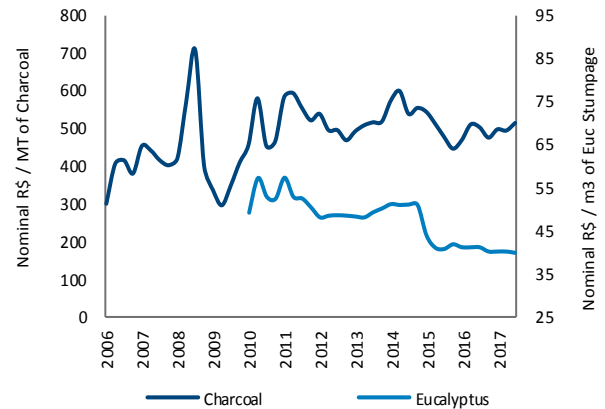
The price of larger diameter sawtimber continues to be driven by exports, particularly plywood and lumber. In Q2 (latest available data), Brazilian plywood exports to the US increased 3.9% year-over-year while Brazilian lumber exports to the US increased 33.3% year-over-year.

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. That said, charcoal prices in Minas Gerais increased 4.1% quarter-over-quarter in Q3 (2.3% year-over-year) alongside a general improvement in commodity demand after a weak Q2. Charcoal pricing is normally reflected in the price of eucalyptus stumpage (Figure 18, right axis). However, in Q3, Minas Gerais eucalyptus prices declined -0.8% quarter-over-quarter and -3.2% 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).



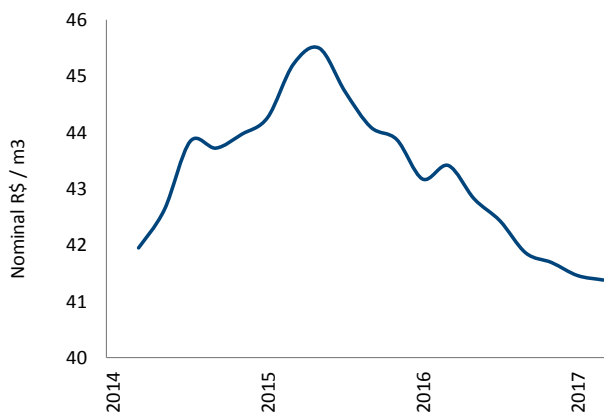
**Figure 18. Charcoal and Eucalyptus Stumpage Prices in Minas Gerais, Brazil.** Sources: Associação Mineira de Silvicultura; Poyry Silviconsult.



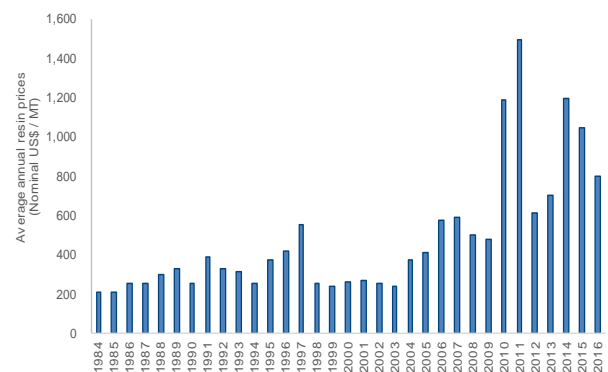
Meantime, eucalyptus pulpwood prices declined -0.2% quarter-over-quarter (ended August) and -4.7% year-over-year on a countrywide basis (Figure 19).

The price of pine resin, a secondary product that can be collected from pine plantations between harvests and is used in the production of synthetic rubber, glues, adhesives, printer inks, and other products, was mixed during Q3. Mixed tropical pine resin increased 0.8% quarter-over-quarter in Q3 while slash pine resin declined -0.3% 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

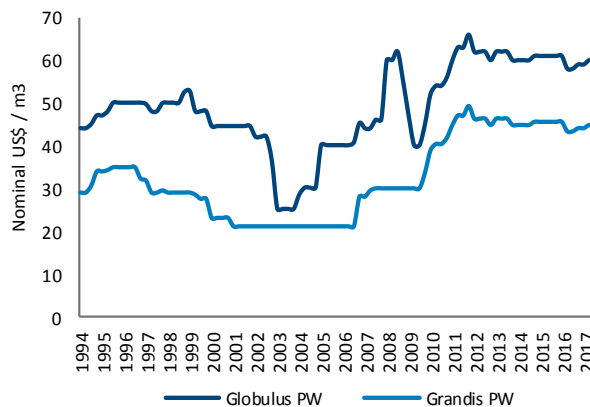


### Uruguay

In Q2 (the latest GDP data available; 3Q2017 GDP expected to be released around mid-December), the Banco Central del Uruguay reported that Uruguayan real GDP increased 2.8% year-over-year versus 4.3% year-over-year growth in Q1. The agriculture, cattle, hunting, and timberland sectors increased 4.9% year-over-year while transportation increased 9.4% year-over-year. Manufacturing was the weakest sector declining -6.4% year-over-year. Gross fixed capital formation declined -19.1% year-over-year in Q2 versus a decline of -1.1% year-over-year in Q1 while household spending increased 4.4% year-over-year versus 4.3% year-over-year in Q1. Exports increased 9.3% year-over-year versus an increase of 4.9% year-over-year in Q1 while imports declined -0.8% year-over-year versus an increase of 3.6% year-over-year in Q1. During Q2, the Uruguayan peso appreciated around 9.5% year-over-year and 0.6% quarter-over-quarter.

In Uruguay, both *E. globulus* and *E. grandis* prices were flat quarter-over-quarter in Q3, but increased 3.4% year-over-year (Figure 21). Meantime, in Q2 (latest available data), Uruguayan plywood exports to the US declined -26.2% year-over-year while Uruguayan lumber exports to the US increased 30.5% year-over-year.

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



In mid-August, the government of Uruguay announced project “Central Railway,” which calls for the construction of a railroad between the Port of Montevideo and the city of Paso de los Toros, a potential location for a second pulp mill from UPM. The length of the railway is expected to be around 273 kilometers and the project is expected to be completed within 36 months. In September, the government of Uruguay, labor unions, business chambers, and UPM signed a labor agreement establishing a general framework of labor relations in addition to creating an environment supporting UPM’s investment in Uruguay. The agreed upon goals include creating conditions for the plant’s commissioning and start up within the planned schedule, promoting occupational health and safety, and contributing to the training and strength of skilled Uruguayan labor once the investment decision is made.

## Chile

In Q2 (the latest GDP data available; 3Q2017 GDP expected to be released around November 20), the Banco Central de Chile reported that Chile's real GDP increased 0.9% year-over-year following 0.1% year-over-year growth in Q1. Mining declined -3.0% year-over-year with copper declining -2.3% year-over-year. Construction declined -3.7% year-over-year while business services declined -2.0% year-over-year. Positively, fishing increased 9.5% year-over-year while financial services increased 3.6% year-over-year.

In early September, the Chilean central bank raised the lower end of its 2017 GDP forecast to 1.25-1.75% from a prior 1.0-1.75% on higher copper prices while maintaining its 2018 GDP growth forecast of 2.5-3.5%.

Meanwhile, gross fixed capital formation declined -4.1% year-over-year, government spending increased 2.7% year-over-year, and consumer spending increased 2.6% year-over-year. Exports declined -3.5% year-over-year while imports increased 7.0% year-over-year. The decline in exports occurred despite a 1.3% sequential depreciation in the Chilean peso versus the US dollar in Q2.

In July, S&P downgraded Chile's credit rating to A+ from AA- citing a combination of weak growth from low global copper prices, mounting social demands, and a widening fiscal deficit. This was followed by downgrades by both Fitch Ratings and Moody's. In late August, Finance Minister Rodrigo Valdés, Undersecretary of Finance Alejandro Micco, and Economy Minister Luis Carlos Céspedes all resigned over the government's decision to reject a US\$ 2.5 billion iron-ore project in northern Chile for environmental reasons. Moreover, the Chilean government announced that it intends to pursue pension reform aiming to increase mandatory pension contributions to 15% from the current 10%.

In mid-September, Arauco's board approved the Valdivia dissolving pulp project, which involves the modification and installation of equipment in order to add dissolving pulp to the mill's production. The project is estimated to cost US\$ 185 million. Currently, Valdivia has capacity to produce 550,000 MT of bleached hardwood and softwood kraft pulp.

## Argentina

In Q2 (the latest GDP data available; 3Q2017 GDP expected to be released around December 20), the Instituto Nacional de Estadística y Censos reported that Argentina's economy slightly slowed with real GDP increasing 0.7% quarter-over-quarter versus 1.2% growth quarter-over-quarter in Q1. On a year-over-year basis, real GDP increased 2.7% versus 0.4% growth year-over-year in Q1. Argentina's year-over-year improvement is the result of a 3.8% year-over-year increase in private consumption, a 2.9% year-over-year increase in public consumption, and an increase of 7.7% year-over-year in investments, largely driven by notably stronger transportation equipment (14.0% year-over-year) and construction (11.5% year-over-year). During Q2, exports declined -1.2% year-over-year despite the Argentinian peso depreciating -10.6% year-over-year (-0.4% sequentially) against the US dollar.

On the political front, in October mid-term elections, President Mauricio Macri's center-right coalition achieved significant victories in major Argentinian provinces, including some of the largest population areas, thereby strengthening his political standing. Despite being second in the electoral contest in the province of Buenos Aires, former Argentine President Cristina Fernández de Kirchner still managed to win a seat in the Senate.

Meanwhile, Argentina imposed antidumping duties (“AD”) of 39.56% on Chinese coated paper or paperboard that are 10-50% furnished with fiber obtained by the mechanical or chemi-mechanical process. Since 2012, Argentina had already been imposing a 39.56% AD on Chinese coated paper containing 10% or less mechanical fiber.

Separately, in July, Austrian-based panel producer Egger Group acquired a Concordia, Argentina plant from Masisa, its first production site outside of Europe. The Concordia plant has facilities for the production and lamination of particleboard and MDF panels, producing 165,000 m<sup>3</sup> of particleboard, 280,000 m<sup>3</sup> of MDF boards, and 274,000 m<sup>3</sup> of lamination in 2016.

### **Guatemala**

In Q2 (the latest GDP data available; 3Q2017 GDP expected to be released around early January), the Banco de Guatemala reported that Guatemalan real GDP increased 2.3% year-over-year versus 3.0% year-over-year growth in Q1. All industries generally improved versus the prior year except manufacturing which declined -0.7% year-over-year and mining & quarrying which declined -0.2% year-over-year. Exports declined -0.8% year-over-year in Q2 versus an increase of 5.5% year-over-year in Q1 while imports increased 4.0% year-over-year in Q2 versus an increase of 5.0% year-over-year in Q1. During Q2, the Guatemalan quetzal appreciated around 4.4% year-over-year and 1.2% quarter-over-quarter.

## Europe

In the euro zone, Eurostat reported that Q2 real GDP (the latest GDP data available; 3Q2017 GDP expected to be released around October 31) increased 0.6% quarter-over-quarter as compared to 0.5% quarter-over-quarter growth in Q1. Year-over-year, real GDP increased 2.3%. On an individual country basis, growth increased in Spain, was flat in France and Italy, and slightly declined in Germany.

Gross fixed capital formation grew 0.9% quarter-over-quarter in Q2 versus a decline of -0.3% quarter-over-quarter in Q1. Personal consumption increased 0.5% quarter-over-quarter, slightly above last quarter, while government spending grew 0.5% quarter-over-quarter, better than the prior quarter. Unemployment remained flat at 9.1% in August versus July.

Industrial production increased 1.4% in August after increasing 0.3% month-over-month in July. This increase is due to production of capital goods rising by 3.1%, durable consumer goods by 1.3%, intermediate goods by 1.2%, and energy by 0.2%, while production of non-durable consumer goods remained stable.

September's Composite Purchasing Manager's Index increased to 56.7 from 55.7 in August. Manufacturing output rose at the fastest level since April 2011 while service sector growth improved to a four-month high. New order growth improved in both manufacturing and the service sector, causing an increase in backlogs and higher employment.

Meantime, European net exports (exports less imports) declined year-over-year. In August (latest month reported), exports increased 6.8% year-over-year while imports increased 8.6% year-over-year, resulting in a euro zone trade surplus of €16.1 billion versus a surplus of €17.5 billion in August 2016.

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

During the last few months, sawlog prices in Estonia have improved. Pine sawlog prices (latest data available August 2017) increased 5.2% from three months earlier and 5.7% year-over-year. Birch sawlog prices increased 1.9% from three months earlier and 3.4% year-over-year (Figure 22).

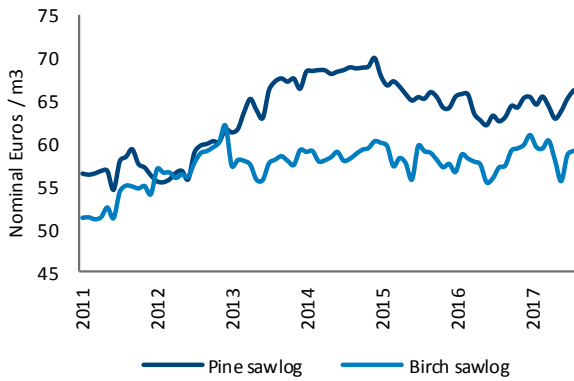
Estonian pulpwood prices also increased. Pine pulpwood prices (latest data available August 2017) improved 9.0% from three months earlier and 13.2% year-over-year while birch pulpwood prices increased 5.5% from three months earlier and 2.5% year-over-year (Figure 23).

### **European forest products capacity changes**

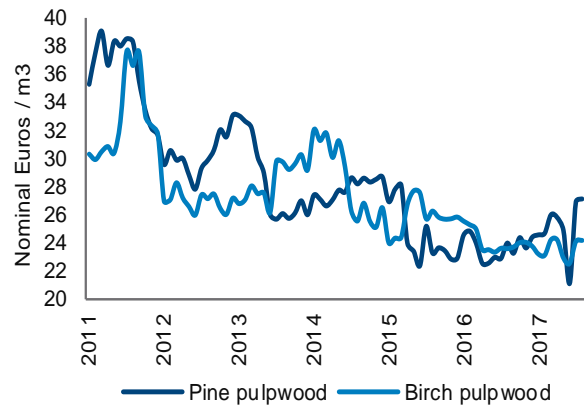
During Q3, Ence, one of the main producers of bleached eucalyptus kraft pulp in Europe, announced plans to increase production capacity at its Navia and Pontevedra mills in Spain. Ence is aiming to increase production capacity at Navia to 685,000 MT from a current 605,000 MT by 2020 while capacity at Pontevedra (currently 465,000 MT) is expected to increase 70,000 MT in two phases (30,000 MT in March 2018 and 40,000 MT in 2019). Separately, Metsä Fibre has started production at its new Äänekoski mill in Finland (700-800k MT of softwood; 500-600k MT of hardwood).

**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 Q2 (the latest GDP data available; 3Q2017 GDP expected to be released around December 5), South African government statistics reported that South Africa's economy grew with real GDP increasing 2.5% quarter-over-quarter following a decline of -0.6% quarter-over-quarter in Q1 ending the country's short recession. Following a strong Q1 (23.1% quarter-over-quarter growth), the agriculture, forestry, and fishing industry increased 33.6% quarter-over-quarter in Q2 as the country continued to recover from a significant drought. Other contributors to the GDP improvement included electricity, gas, and water (+8.8% quarter-over-quarter) and mining (+3.9% quarter-over-quarter).

On the political front, opposition parties again pursued impeachment charges against President Jacob Zuma over corruption in early September. The Constitutional Court, South Africa's top court, was also asked to order Parliament to investigate President Zuma's conduct over publicly-funded upgrades to his private residence. Meanwhile, Parliament debated a proposal by the Democratic Alliance calling for early elections. In August, President Zuma survived a no-confidence vote, which was partially supported by some members of his own African National Congress Party.

### South African forest products and timber markets

In July, lumber prices increased 0.9% versus the prior three months and 2.9% from July 2016, as measured by the South African Lumber Index, a composite price series (Figure 24).

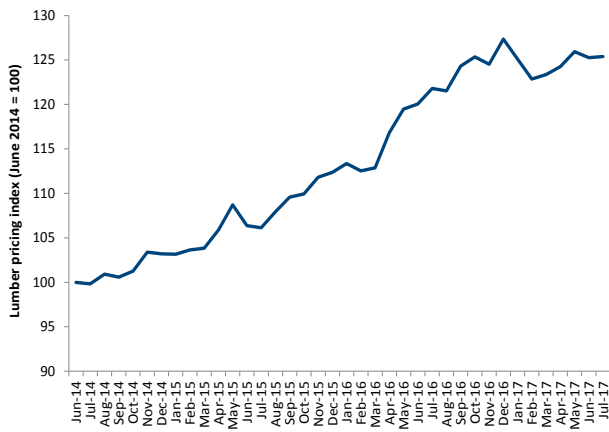
Softwood log prices were also generally positive except for B grade logs (Figure 25). Sawlogs in South Africa are categorized into A, B, C or D grades, with A grade logs being the smallest and D grade logs being the largest. In nominal terms in Q2 (latest data available): A grade logs increased 3.8% for the quarter and 5.1% year-over-year, B grade logs declined -8.9% for the quarter and -3.1% year-over-year, C grade logs rose 0.2% for the quarter and 4.1% year-over-year, and D grade logs increased 2.5% for the quarter and 3.5% year-over-year.

While some of the aforementioned price gains seem steep, it is worth noting that annual inflation in South Africa is 4.8%, so in real terms most of the gains are less notable and in some cases even negative (i.e., A grade logs: 0.3% real year-over-year, C grade logs: -0.7% real year-over-year, and D grade logs: -1.3% real year-over-year). Meanwhile, in Q2, the rand appreciated around 11.9% year-over-year against the US dollar (Figure 26) and around 14.2% year-over-year against the Euro (Figure 27).



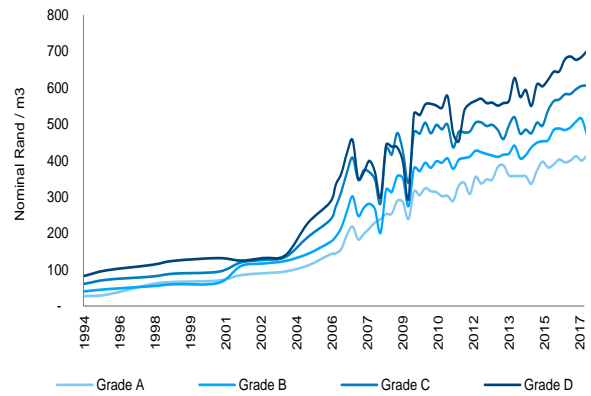
**Figure 24. South Africa Lumber Index.**

Source: Crickmay and Associates.



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

Source: Crickmay and Associates.



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

Source: Federal Reserve Bank of St. Louis.



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

Source: Bloomberg.



## New Zealand

In Q2 (the latest GDP data available; 3Q2017 GDP expected to be released around December 21), New Zealand government statistics reported that New Zealand’s economy marginally improved versus the prior quarter, with real GDP growing 0.8% quarter-over-quarter versus growth of 0.6% quarter-over-quarter in Q1. Retail trade and accommodation increased 2.8% quarter-over-quarter while manufacturing increased 1.8% quarter-over-quarter. Construction declined -1.1% quarter-over-quarter. Meantime, exports increased 5.2% quarter-over-quarter due to greater exports of dairy products and higher tourist spending while imports increased 0.6% quarter-over-quarter largely driven by imports of immediate goods and capital goods. In Q2, the New Zealand dollar depreciated -1.1% quarter-over-quarter against the US dollar (Figure 28).

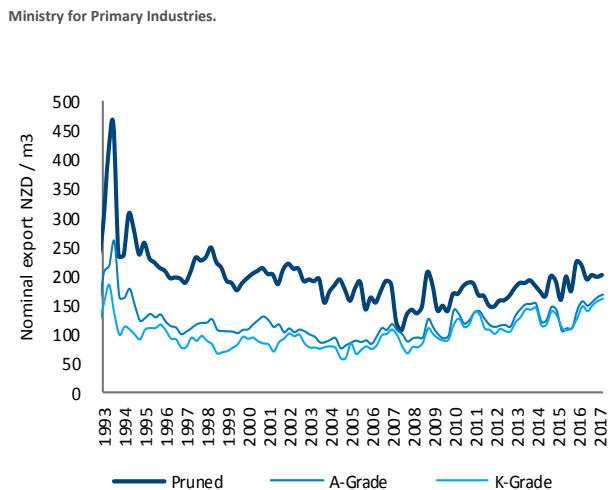
### New Zealand timber markets

New Zealand A-grade export logs increased 2.4% quarter-over-quarter in June to NZ\$ 169/m<sup>3</sup> from NZ\$ 165/m<sup>3</sup> (Figure 29). This increase has been driven by strong demand for export logs from China, New Zealand’s largest export market, partially due to a Chinese ban on commercial logging of its remaining natural forests to protect the environment and a reduced tariff on imported logs to 11% from 13%. Meantime, domestic structural logs used for construction (S1 and S3) improved as winter weather restricted domestic log availability and as domestic consumers aggressively competed with export markets for wood (Figure 30). Strength in the local housing market also helped to support domestic demand for logs.

**Figure 28. New Zealand Dollar to US\$ Exchange Rate.** Source: Federal Reserve Bank of St. Louis.

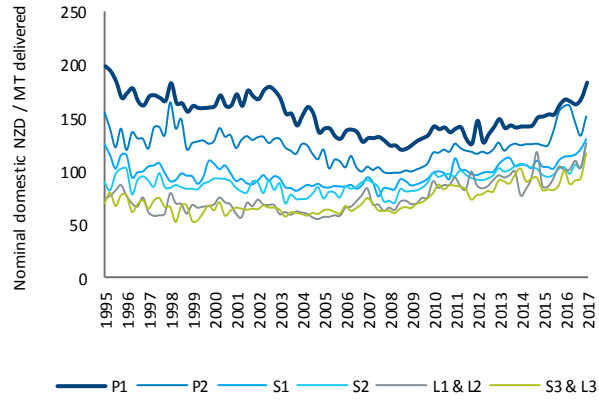


**Figure 29. New Zealand Export Log Prices.** Source: New Zealand Ministry for Primary Industries.



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

Source New Zealand Ministry for Primary Industries.



## Australia

In Q2 (the latest GDP data available; 3Q2017 GDP expected to be released around December 5), the Australian Bureau of Statistics reported that Australia’s economy improved versus the prior quarter with real GDP increasing 0.8% quarter-over-quarter versus growth of 0.3% quarter-over-quarter in Q1. Agriculture, forestry and fishing increased 0.4% quarter-over-quarter due to an increase in livestock while manufacturing increased 1.8% quarter-over-quarter due to strength in food, beverage and tobacco products (0.4%), metal products (3.0%), and machinery and equipment (2.5%). Meantime, exports increased 2.7% quarter-over-quarter while imports increased 1.2% quarter-over-quarter. In Q2, the Australian dollar depreciated around -1.0% quarter-over-quarter (Figure 31).

### Australian timber markets

Softwood roundwood prices declined -1.3% quarter-over-quarter to US\$ 78/odmt (“oven dry metric ton”) from US\$ 79/odmt in Q1 (Figure 32) given slower residential construction. Hardwood logs declined -1.0% quarter-over-quarter to US\$ 96/odmt from US\$ 97/odmt in Q1 (Figure 33). Both softwood and hardwood chips moved lower in Q2, declining -1.3% and -1.0%, respectively.

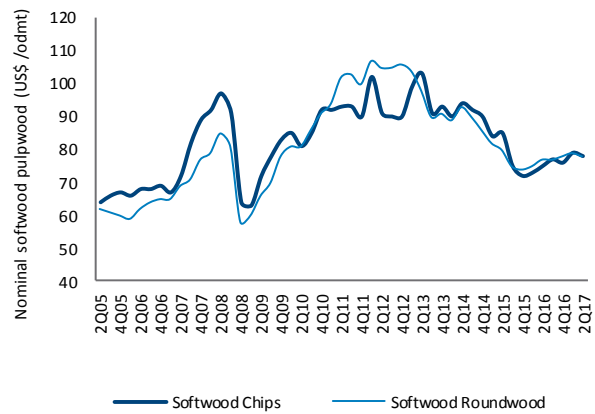
**Figure 31. Australia Dollar to US\$ Exchange Rate.**

Source: Federal Reserve Bank of St. Louis.



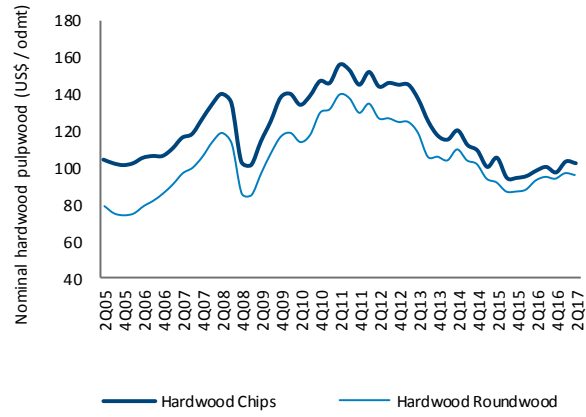
**Figure 32. Australian Softwood Pulpwood Prices.**

Source: Wood Resource Quarterly.



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

Source: Wood Resource Quarterly.



## Global Pulp and Paper Markets

During Q3, the price of Bleached Softwood Kraft Pulp (“BSK”) in Europe, a bellwether of the pulp and paper sector, averaged around US\$ 894/MT, up 3.9% versus the prior quarter and 10.2% year-over-year (Figures 34 & 35). BSK includes both Northern and Southern Bleached Kraft grades (“NBSK” and “SBSK”, respectively).

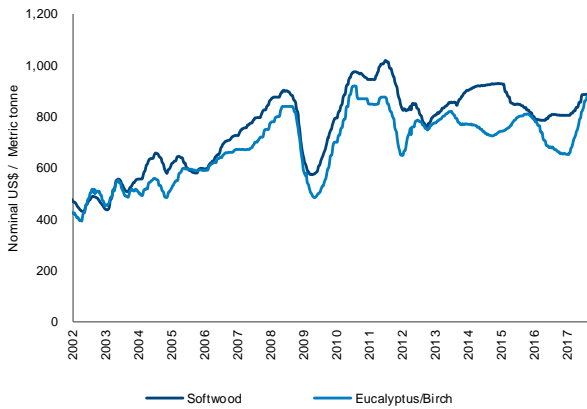
During the quarter, softwood pulp pricing increased given better softwood demand and as some buyers substituted hardwood for softwood given rising hardwood prices (Figures 34 & 35). Demand for BSK also increased given greater competition for resale unbleached softwood kraft pulp as Chinese recycled containerboard producers are increasingly using it as furnish to replace old corrugated containers imported from the US. Meanwhile, Chinese plants increased their pulp buying in August in order to prepare for the traditional peak period for paper and board production beginning in September ahead of year-end holidays. With respect to supply, as mentioned previously, Metsä Fibre has started production at its new Äänekoski mill in Finland (700-800k MT of softwood; 500-600k MT of hardwood).

Bleached Hardwood Kraft Pulp (“BHK”) prices in Europe, a benchmark, increased 11.5% quarter-over-quarter and 30.0% year-over-year in Q3, averaging around US\$ 873/MT (Figures 34 & 35). Prices improved given unexpected mill downtime, strong Chinese demand, and lower inventories.

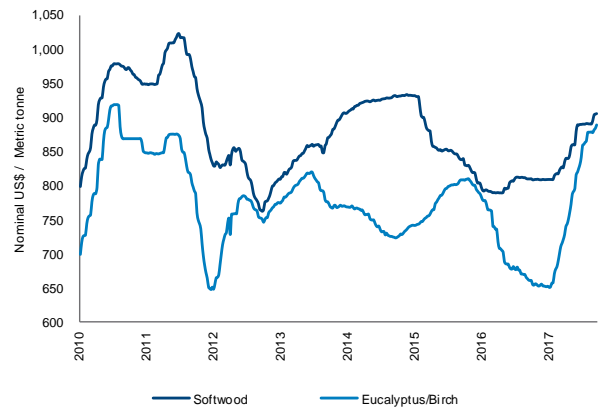
Prices have been buttressed by the extended closure of CMPC’s Guaiba 2 plant in Brazil, which is expected to result in a loss of around 400,000 MT of hardwood pulp, tightening the hardwood pulp market. This line began production in 2015, but has been plagued by recovery boiler problems this year causing it to run at a reduced operating rate. The line is expected to resume production on November 11. Meanwhile, Chinese demand remains strong with shipments to China increasing 7.8% year-over-year in August and 8.9% year-to-date per the Pulp & Paper Products Council (“PPPC”). Chinese demand for virgin pulp has also been aided by recovered paper closures, which has caused recovered paper prices to spike and papermakers to shift their furnish more towards virgin pulp. Meanwhile, hardwood inventories remained flat at 39 days of supply in August, below the 45-day average witnessed over the last five years. With respect to capacity, hardwood pulp supply is increasing given Fibria’s second line at its Três Lagoas mill (1.95mn MT), which produced its first bale at the end of August, three weeks ahead of schedule, and the new Metsä Fibre mill.

**Figure 34. Global BSK and BHK Pulp Prices over Time.**

Source: FOEX.



**Figure 35. Global BSK and BHK Pulp Prices Recent Performance.** Source: FOEX.

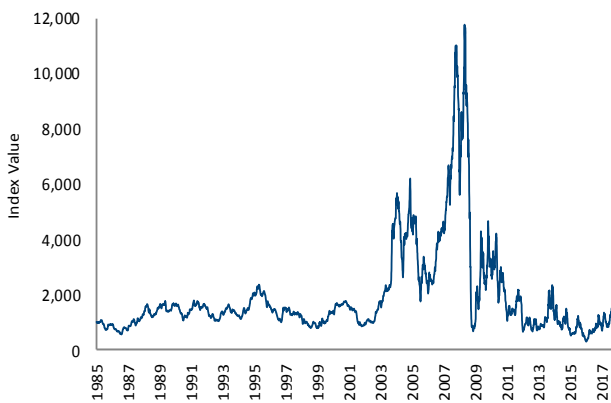


## Baltic Dry Index

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 increased by around 41.1% (Figures 36 & 37). After declining through most of Q2, the index jumped 50.5% in Q3 corresponding with an improvement in commodity prices (e.g., benchmark iron ore prices increased around 16.3% from the low price point reached in Q2). At a value of 1356 on September 30, 2017, the index remains well below its peak of 11,793 reached in May 2008.

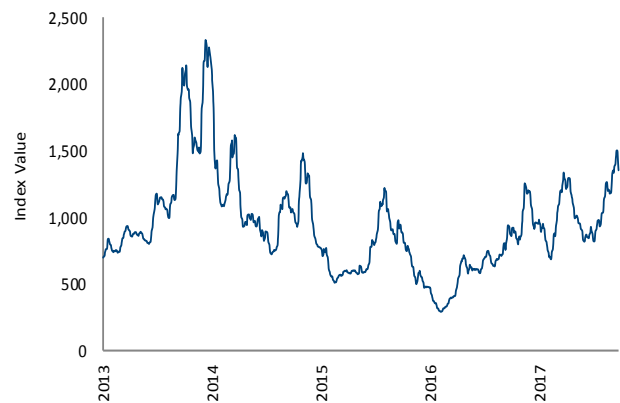
**Figure 36. Baltic Dry Index Performance over Time.**

Source: Bloomberg.



**Figure 37. Baltic Dry Index Recent Performance.**

Source: Bloomberg.





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