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RIP, Lumber-Futures Contract That Jumped During Covid-19

New, smaller contracts aim to boost trading and reduce price volatility

By Ryan Dezember Follow

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The longtime barometer of wood prices and building activity is being replaced with a new lumber-futures contract. PHOTO: DAVID PAUL MORRIS/BLOOMBERG NEWS

The lumber-futures contract that soared during the pandemic and heralded the Covid building boom, broken supply chains and inflation will trade in its final session on Monday.

The longtime barometer of wood prices and building activity is being retired and replaced with a new lumber-futures contract in an effort by exchange operator CME Group CME **0.80%** ▲ to boost trading.

Lumber-futures trading dwindled as prices and volatility surged and risk ballooned. By early last year they were so thinly traded and prices so wild that on many days buying and selling was nearly impossible. The price would race up or down at the open by the most allowed by exchange rules and trading would be frozen for the day.

To draw a larger pool of traders, the new futures contract represents a truckload of two-by-fours delivered to Chicago, instead of a train-car full sent to the British Columbia interior. The new futures also allow for eastern species and fulfillment from more sawmills than the outgoing contract, which could only be satisfied with spruce, pine or fir from a shrinking number of mills in the Pacific Northwest.

Though few in the futures market hold contracts through expiration and expect delivery, the changes are meant to make trading in two-by-four derivatives a more useful tool for sawmills, builders and lumber yards to manage the risks involved in trading actual wood.

At 27,500 board feet, instead of 110,000, each contract represents roughly the amount of lumber needed to build a house. Chicago is much closer to booming housing markets than Canada's inland rainforest and as a delivery point much better approximates freight costs. A greater number of smaller contracts makes the market more inviting to speculators, whose presence lumber traders say would help to smooth out the choppy trading.

The outgoing contract was launched in 1969, when the Northwest dominated lumber markets. Even as lumber production shifted south and east, futures remained a reliable gauge of home-building activity and the broader market for wood products.

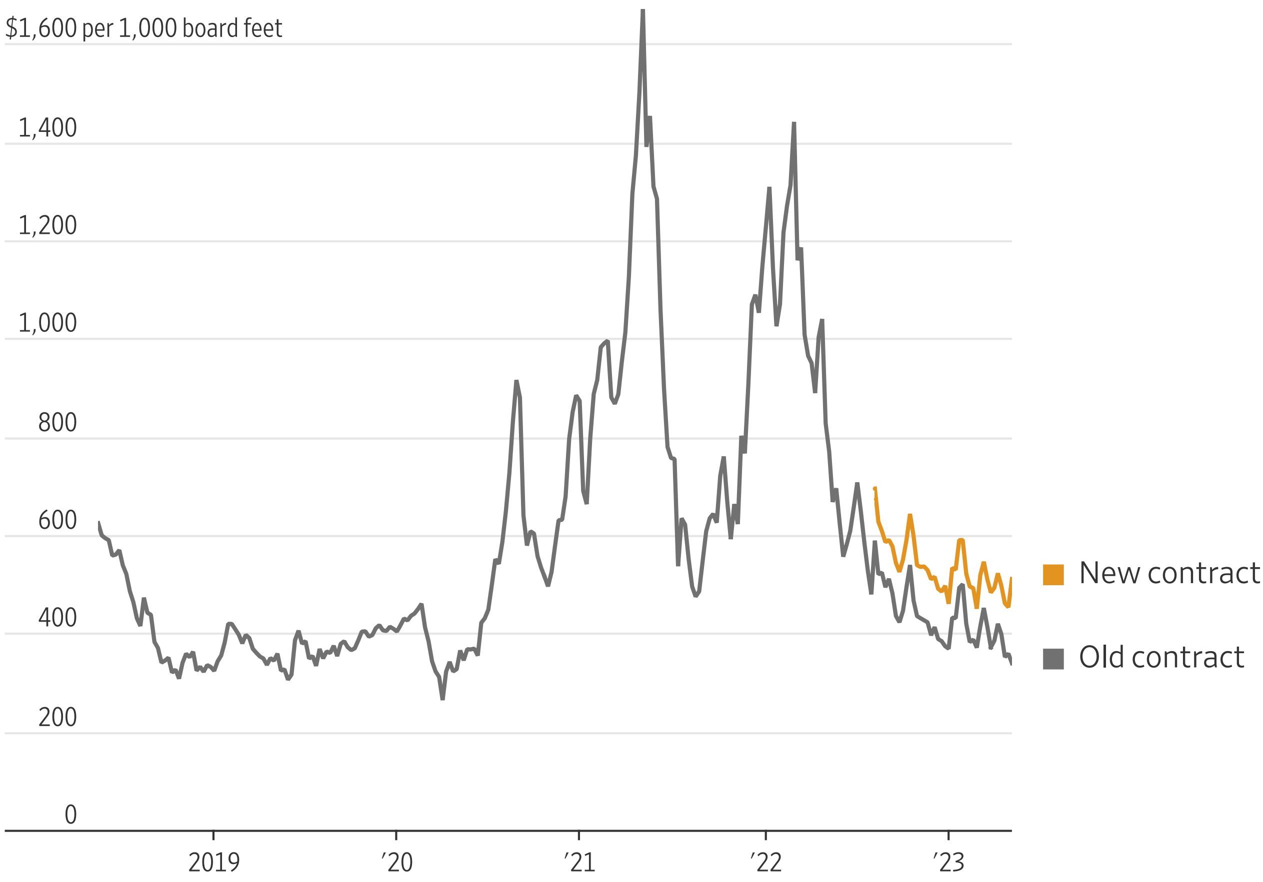
When the economy locked down in early 2020, lumber futures tanked along with other assets. But by summer they began to climb as stuck-at-home Americans remodeled all at once and historically low mortgage rates ignited the housing market. Lumber futures peaked at $1,711.20 per thousand board feet in May 2021, more than twice the prepandemic high.

When the Federal Reserve began raising interest rates in March 2022, lumber was among the first assets to deflate.

On Friday, the outgoing futures closed at $339 per thousand board feet, about 5% below the average price during the five years before the pandemic. Just 67 contracts changed hands in its penultimate trading session.

“There’s no mourning here. Good riddance,” said Greg Kuta, whose Westline Capital Strategies formulates futures-trading strategies for lumber producers and wood users.

Lumber-futures price, weekly



Source: FactSet

Mr. Kuta said liquidity, or the ability to transact at expected prices without causing big moves or disorderly trading, has improved. He has been on the road lately pitching the new futures to builders, mills and other potential traders. “You have a lot of people who have never traded lumber futures before showing interest in trading in it,” he said.

The new futures—ticker LBR—started trading last summer. Volume was light initially but has climbed steadily this year as the old futures rolled off. Futures for delivery this month ended Friday at $440 per thousand board feet while more heavily traded July futures closed at $510.50.

The new contracts have averaged about $100 more per thousand board feet than the outgoing contract, which traders say accounts for the difference in rail freight costs between British Columbia and Chicago.

“We have consistently seen tighter markets in the new contract compared to the legacy contract,” said Derek Sammann, CME’s global head of Commodities, Options & International Markets. “Although this contract is still new, it continues to grow and is poised to be the new price discovery and risk management benchmark in the lumber industry.”

Stinson Dean, president of Deacon Lumber, has been trading the new futures from the start and said the gaps between buyers and sellers has been much smaller than with the old contract, a sign that liquidity has improved.

“It’s been way less volatile; it’s been tradable,” he said.

Three years ago soaring prices signaled hoarding among builders worried about running out of wood. This year’s relatively steady and low prices show that buyers are more concerned with the expense of stockpiling lumber because of higher interest rates than they are about not receiving orders in time, Mr. Dean said.

“You haven’t had to carry extra inventory to buffer against supply chain hiccups and that has kept the market pretty muted,” he said. “Who wants to hold inventory and pay carrying costs when the supply chain is moving so smoothly?”

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