Investors Bet on Global Warming

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02:00 AM Nov, 22, 2005 EST

The Earth is warming up, and many people see this as a very serious threat to the planet and its inhabitants. Among the short list of side effects: melting glaciers, rising seas, scorching summer heat waves and a spike in severe storms.

For investors -- particularly those fond of waterfront property and carbon-emitting fossil-fuel guzzlers -- climate change is also a factor worthy of weighty consideration in assembling a portfolio.

It's not just about averting risk. A good grasp on global warming could also offer benefits to savvy stock pickers. Businesses well-poised to meet mandates for reducing carbon emissions, developers of alternate energy sources and even forward-looking insurers could conceivably profit from climate-change concern, say analysts and institutional investors who follow climate change.

"(Global warming) started out as an environmental issue, but it crossed over to become a quite fundamental financial and economic issue," said Nick Robins, head of SRI (Socially Responsible Investment) Funds for Henderson Global Investors in London.

Today, Robins said, climate change is becoming a mainstream concern for portfolio managers. Publicly traded companies, in turn, are facing pressure to expand disclosure about how they're addressing the warming trend.

For those looking at how climate-change preparedness might affect potential investments, here are a few points to consider:

Science in a snapshot: Canada won't be turning into a tropical paradise anytime soon. But evidence shows our environment has gotten warmer over the past few decades and likely will continue to do so.

The increase in Northern Hemisphere temperatures in the 20th century is likely to have been the largest of any century in the past 1,000 years, according to the 2001 report of the Intergovernmental Panel on Climate Change.

Moreover, emissions of greenhouse gases and aerosols from human activities continue to alter the atmosphere in ways that are expected to affect the climate, according to research cited by the panel. Between 1990 and 2100, researchers project that temperatures will rise between 2.5 to 10.4 degrees Fahrenheit.

Assessing risks: Investors today have broadly accepted the science behind global-warming projections, said Dan Bakal, director of electric power programs at Ceres, a sustainable-investment research and advocacy group. The focus now, he said, is devising a strategy to address it.

"It's no longer a question of, is it happening and are humans causing it, so much as, what will the impacts really be?" he said. Calculating those impacts has gotten easier in recent years as more public companies disclose climate-related risks in securities filings.

Friends of the Earth, an environmental group, reported (.pdf) that 47 percent of 112 large publicly traded companies surveyed in the auto, manufacturing, oil and gas, insurance, utilities and petrochemicals sectors addressed climate change in securities filings last year. That's up from 37 percent the prior year.

Utilities, the group said, had the best record, with 24 out of 25 disclosing climate risks in 2004. Property and casualty insurers came in last, with a 15 percent disclosure rate.

But expect insurers to be more vocal about climate-change-related risks this year. A report published by Ceres and updated following Hurricane Katrina cites a 15-fold increase in insured losses from catastrophic weather events (those with over $1 billion of damages) in the past three decades. These losses, the report found, have far outstripped premium increases, inflation and population growth over the same time period.

While the catastrophes can't entirely be blamed on global warming, Ceres considers it an undeniable contributing factor.

Finding profitable opportunities: Climate-minded investors might want to consider the growing ranks of SRI mutual funds that seek out holdings with an environmentalist mindset. These funds don't focus specifically on global-warming-related investments, said Greg Carlson, SRI fund analyst at Morningstar. However, most will filter out companies that are heavy polluters or otherwise have a sub-par environmental record.

Alternative-energy-themed mutual funds offer another possibility. But there are drawbacks. First off, Carlson notes, there aren't many of them. The few that are around, like New Alternatives (NALFX), peaked around four years ago. Investors' enthusiasm for promising but still-unprofitable technologies such as fuel cells has a record of being short-lived.

"It's going to be a bumpy road, in all likelihood," Carlson said.

Another option likely to be available in the near future is index investing. KLD Research & Analytics, a firm specializing in socially responsible investing, recently launched the KLD Global Climate 100 Index, a list of companies it believes are effectively addressing climate-change concerns. The firm wants eventually to make the index publicly traded.

KLD's climate index contains a number of companies that one wouldn't ordinarily think of as environmentally proactive, including FedEx (FDX), Johnson & Johnson (JNJ) and Pulte Homes (PHM).

But according to Andrew Brengle, KLD research analyst, all these companies have a track record for acting on climate concerns. FedEx, for example, built California's largest corporate solar-electric system atop its airport hub in Oakland. Johnson & Johnson was the top company in an Environmental Protection Agency ranking of renewable-energy consumers. And Pulte Homes has a history of incorporating solar arrays in its buildings.

Follow the carbon: Companies operating in nations that signed the Kyoto Protocol on reducing greenhouse-gas emissions are typically subject to stricter record-keeping requirements regarding air pollution. Such rules make it easier for investors to assess a firm's responsiveness to global warming.

European nations, for example, have instituted a carbon emissions trading system in which firms can buy and sell permits to issue a stated amount of carbon dioxide. A survey (.pdf) commissioned by Henderson found that under half of firms traded on the U.K. FTSE 100 index disclose carbon emissions. Henderson's Robins, however, says disclosure practices appear to be improving.

Balancing act: Investors concerned about the impact of global warning will be hard-pressed to find a pure-play strategy to address climate change. A more practical approach, according to KLD research analyst Brengle, is to focus on companies that are leaders in their respective fields in reducing greenhouse-gas emissions. At times, he concedes, this makes for difficult choices.

"You get into some of these apparently conflicting situations. Toyota makes a lot of SUVS, but they're also the largest hybrid maker," he said. "You work with what you have."

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