



## Do Investors Need to Keep an Eye on Climate Change?

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I got a question last week that I thought was excellent: how does climate change do when we apply the same set of crisis tests we did to [Evergrande](#) and the [great financial crisis \(GFC\)](#)? It may seem to be a political question—and quite possibly it was intended as such. But in my mind, applying this set of nonpolitical tests is a great way to take it out of the realm of politics, where I have no special expertise, and into the realm of economics and data analysis, where I do. Today, let's take a nonpolitical look, based on the data, at whether climate change is something that we, as investors, should be keeping an eye on.



To recap, there are four tests. First, is this an immediate problem? Second, is it a surprise? Third, is it big enough to command attention, but small enough to be actually solved? And fourth, by the time it hits the headlines, is it a real threat or already being solved? Let's take a look at the data and see where it leads us.

### Is It Immediate?

As to whether climate change is an immediate problem, this could be a tough one as "immediate" can have a different meaning here. If we look at the drought out West, for example, we might say this is a long-term trend and not immediate. If we look at the low levels of Lakes Mead and Powell, we might say there are still a couple of years before we hit a crisis point, so not immediate. So, there are reasons to say this is still not immediate. On the other hand, if we look at the record wildfires in the U.S. and Australia, the killing heatwaves in the U.K. and Europe, and the storms rolling in, immediacy becomes fairly compelling. While things are not as bad as the worst projections indicate, for me, there is enough unexpected damage happening in 2021 to give this a yes.

### Is It a Surprise?

For the second test, we need to evaluate whether this is a surprise. Again, there is a spread here. The drought out West has been in place for years. Fires have been getting worse over the same time frame, as have hurricanes. In that sense,

none of this is a surprise, just a continuation of long-existing trends. And yet, judging by the headlines, which are meaningful indicators of surprises, the fact that all of this is happening at once, at unprecedented severity, is a surprise. You could argue any individual component, but the world seems to have been taken by surprise not only by the severity of each individual component but by their global nature. Again, I think there is enough data here to indicate that this year was indeed a surprise.

## How Big (or Small) Is It?

The headlines also indicate that climate change passes the “big enough to command attention” test. Everyone is now at least aware of the issue. Whether it passes the “small enough to be solved” test is an open question. The fact that it may fail the small enough to be solved test increases the risk, however, rather than decreasing it.

## Is It Being Solved?

And that takes us to the fourth test, which is whether it is a real threat or already being solved. As conditions continue to worsen, generating more surprises every year, the problem does not appear to have been solved. At the same time, multiple solutions are at least partially underway. Whether they will be enough to stem the damage, or whether it will continue to get worse, is still an open question. In other words, given that climate change passes the first three tests and is not clearly being solved, it could well fall into the last category—that of a real threat.

## Prepare for the Unusual

If you compare this with the GFC, it's possible we're not at the point where the hedge funds have failed, and the systemic risks are becoming clear, but the U.S. Congress has not yet agreed to fund a solution. At that time, the threat was still unproven, but the risks were rising. This analysis suggests we might well be in the same place with climate change. Note that there are no politics in this analysis, any more than there were in the financial collapse of the GFC—and no assumption of causality. It doesn't matter how or why this is happening, just that it is. Here we are looking at actual events, judged against previous history and expectations. Unless you believe that all of the events cited, and others not cited, are in fact normal, then there is a real possibility that there is something unusual going on here. As investors, we need to understand and prepare for the unusual.

[Larry Fink](#), of Blackrock, one of the largest investment firms in the world, is doing just that. Looking at our crisis tests, his conclusions make a lot of sense.