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Climate Change, Global Warming and the Carbon Finance Business

Post Gore and the Coming Carbon Climbdown

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It's perhaps the greatest speculative bubble since Holland's 'Tulip Mania'.

At the peak of tulip mania, circa 1637, a single tulip bulb sold for more than 3,000 Dutch guilders – that's 10 times the annual income of a skilled craftsman in those days. It was great while it lasted, but reality eventually caught up with the creative opportunists.

Man-made global warming, or as it likes to be referred to these days as 'climate change', had a grand plan in its heyday. The mythology was underpinned by a new economic model, one which hoped to monetize CO2 emissions – or more accurately, *the absence of CO2.*

Think of Al Gore and his associates like David Blood as the Bernie Madoff of the environmental movement. They created a market which has been disintegrating from day one, including a total collapse of the Chicago Climate Exchange, but not before the principle players cashed in their shares and abandoned that hip. It's a epic story of modern day high priests and sooth sayers, political hubris and pseudo-scientific largess on a scale never before seen in history.

But their story is far from over. Get ready for the epic climbdown..

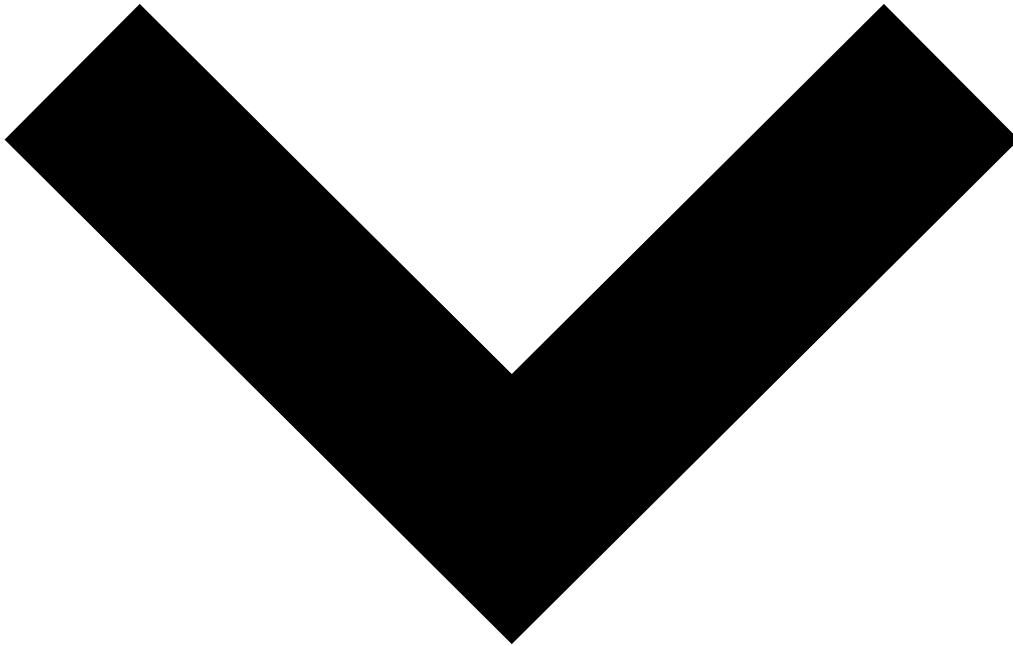

IMAGE: Blood and Gore: The carbon trading horror show.

Contrarian Pirouette from Al Gore

For **Al Gore** and his investor fund partner **David Blood**, their current thrust is more like dancing in the dark than out of the box thinking, due to "warmists" and "peakists" now having to fight on several fronts at the same time. Writing in 'Wall Street Journal' and similar outlets several times in 2013, they soldiered forward with the claim that "fossil carbon assets" are headed for a bust, and "green energy" can only soar. Along with Britain's **Lord Stern**, the former World Bank chief economist and author of the Stern Report on "fighting" global warming, they say all fossil fuels are so dangerous for the world's climate they must be completely phased out by 2050 or before.

Investing in these fossil carbon assets is therefore, they say, a guaranteed disaster.

Gore and Blood however know well through operating their climate-energy hedge fund, Generation Investment Management that the "carbon finance" business, especially emissions credits and related financial assets, has already suffered a bust. The world's only

mandatory credits trading scheme – in Europe – is struggling to keep itself afloat. Reasons why Europe's ETS is now on political life support and may be scrapped include massive over-issue of credits by European governments and the European central authorities, outright fraud and re-issue of already used credits, uncertainty concerning the future value of credits, and other factors such as the intrinsic worthlessness of 'hot air credits'.

In a winter during which Niagara Falls partly froze over, for only the second or third time in more than 100 years, the whine that global warming is alive, well and menacing becomes difficult to gurgle with a straight face, but it has been so profitable to proponents like Gore that we can understand why they are loath to invent a new *Doom Thing.* Their twin fight against climate-damaging and rapidly depleting oil, gas and coal reserves also has major real world logic problems.

ETS and Bad Bets

Massive over-issue of ETS tradable paper was operated not only to make warmists happy, but also to please the carbon market maker banks and climate hedge funds, who rapidly broke any link between this asset creation binge and its real world base or "underlying asset" – of actual European CO2 emissions. Which have heavily declined in most EU countries since 2008, except by supreme irony in Green Germany, presently constrained to rapidly increase its coal-fired power production. European emissions have shrunk due to economic recession, outplacement of energy-intensive industries, energy saving, and the development of "green" non-fossil energy.

The morph of the ETS system from potentially or possibly useful, to dysfunctional and totally perverse, took no more than about 6 or 7 years from its start in 2005. Today's credit prices are so low they are no incentive to not emit CO2, making cheap credits a subsidy to pollute and emit more CO2, while they also remain an incentive for energy intensive industries to delocalize and quit Europe spurred by fears that when ETS finally collapses, it will be replaced by straight and high energy taxes.

Other drivers of change than the sure and certain perversion of any credit-base asset creation and trading system by the "banksters and brokers" are at least as powerful. Timewarp has rapidly affected the public and political perception of two basic key issues for policy and political change – peak oil and global warming. What Stern, Gore and Blood regularly claim, that investing in "carbon assets" today is as crazy as speculating in subprime mortgages before 2008, now reads like schizoid black humor. They say that after the 2008 credit crisis and Great Recession it is (with hindsight) ridiculous to have imagined that subprime mortgages could work. The risk of giving around 7.5 million mortgages to people in the US who couldn't possibly pay them off was somehow "not on the radar screen" of most regulators and investors at the time. Stern, Gore, Blood and other carbon finance hopefuls still claim today that investing in fossil energy is exactly the same thing.

I can argue that peak oil was only a 'price panic' theme. In other words if oil prices rise enough, there will be no shortage of it, for reasons which include less demand and more supply. At the other end of the event horizon, if Detroit realty prices fall enough, there will be sufficient empty homes to house millions! In both cases the missing link which explains all is parasitic finance and the tyranny of "investor expectations", meaning bang for the buck.

At today's world prices for fossil energy, 1 barrel equivalent of coal costs far below $30 and US natural gas struggles to attain $30. If car drivers feel OK with oil at $100 a barrel that is obviously their own problem, but their inability or refusal to switch fuels, to natural gas for example, does not reflect any planetary shortages of oil. The outlook for serious oversupply of oil, today, is credible but Goldman Sachs and the market maker banks operating oil markets presently prefer not to see things that way.

Global warming, about 7 years ago, was certainly the next big thing. At the time, the No Limits warmist stance was that CO2 emissions – unless we completely stop them – will cause planetary disaster by sometime in the 2045-2099 period, so tailpipe or smokestack emissions must be taxed to extinction. One absolutely real, and only apparently contrarian, result would be a major fall of fossil energy prices as Black Carbon became an illegal fuel, something like weight watchers stacking shop windows with high-calorie foods they can't eat – and can't be sold.

Lord Stern claims the "surplus and unusable" financial assets of fossil energy stocks and resources held by major corporations total about two-thirds of all present corporate fossil energy stocks and their declared fossil energy resources, representing several trillion dollars of worthless "stranded value". The argument by Gore, Blood and Stern goes on to claim investors have made a fundamental error by failing to understand there is not a calculable risk of global fossil fuel reserves becoming worthless – but an absolute certainty. Investors have made a fundamental investing error by only treating it as a risk and they will pay the consequences as the industries they invested in collapse, possibly in less than 10 years time.

Warmist Consensus In Peril

Gore and Blood say that investors are foolishly delaying the inevitable move away from, and total abandonment of all fossil fuels. They say that investors and political deciders confused risk with uncertainty. According to hedge fund metrics, using "classical analysis" risk can be priced, but uncertainty cannot.

Lord Stern's theory of "stranded assets" (http://www.carbontracker.org/wastedcapital) certainly did not concern Europe's broken-backed carbon finance and trading system, or the excesses of carbon correct ranging from tree-planting in the Gobi desert to absorb CO2, to the proposed French "ecological tax" on all goods transport vehicles that supposedly would be partly used to build city center electric car and bicycle charging points. His argument was "pure warmist" – global temperatures will radically grow.

Science has already backed off from that kind of assertion. We can note that if we treated IPCC reports as credible, its latest says decadal (10-year) warming is presently set by the group of climate scientists reporting to the IPCC at 0.09 degC, meaning that warming of 2 degC will need well over 200 years.

For Stern, Gore and Blood the timeframe is vastly shorter, and they regularly cite the IEA's carbon-conscious-calculator, which in fact directly draws on the Stern Report of 2006, and claims that two-thirds of all global fossil fuel reserves "will never be used". Because they must never be used – due to warming of 2 degC being probable by or before 2045 or 2050 – the IEA says.

This underlines the massive logic gap and time gap between the latest IPCC warming

timetable, and the IEA's calculator. The IPCC says two-degree warming will likely take 200 years. Lord Stern and the IEA, and Gore and Blood of course, all say it will take about 33 years. This logic gap or chasm has opened up in only a few short years, from about 2005-2007 to today. In 2005, things were totally different for the warmists. That year, the UK's then-Labor government organized the "Avoiding Dangerous Climate Change" conference at the later-infamous Hadley Climate Research Center (home of the Hockey Stick curve). This event levered a huge number of global warming scare stories in UK and world media, followed by the Stern Report and the IEA creating its climate-conscious-calculator.

Continuing with Gore & Blood's logic, they say the subprime fossil fuel asset bubble is growing dangerously because most market participants are mistakenly treating carbon risk as an uncertainty, and are failing to incorporate it in their investment analysis. They are ignoring the crucial difference between a stranded asset, and a normally depreciating asset. They go on investing in fossil fuels.

A stranded asset is one that loses economic value well before the end of its anticipated life. Stranded carbon assets, Gore, Blood and Lord Stern say, include all fossil fuels as well as those assets which, given their dependence on fossil fuels, are CO2-emissions intensive. This for instance means any fossil fuel-power plant or any vehicle needing fossil fuels. Gore & Blood go on to say that energy projects with the highest break-even costs and emissions profiles will be stranded first, and give their claimed most-vulnerable cases. These are Canadian tar sands and coal, which makes a mockery of the very high EROI (energy returned on energy invested) of coal projects, compared to tarsand oil projects, uber-simply explained by the market fact that oil sells at well over 3 times the price of coal on a unit energy base.

They also argue that "they know" government policy is either soon going to make carbon assets vulnerable to stranding, directly by way of an international carbon price – or indirectly by way of increased pollution and environment controls, water usage limits and charges, public health regulations, renewable energy mandates, and energy efficiency regulations. Investors therefore have nowhere to run or hide and must not delay on the misinformed belief that fossil fuel assets will only be vulnerable to stranding when (or if) a global carbon price is enforced.

Stranded Assets or Stranded Markets?

To be sure, renewable energy technologies can be economically competitive with fossil fuels in a number of operating contexts and countries without subsidies such as feed-in tariffs. This however is a very small part of the global energy pie due to "legacy issues". One example of a giant legacy issue is the entire global economy, roughly 87% dependent on fossil fuels. Another example is the world's fossil-fuelled cities where over 50% of global population now lives.

Closely related to this, and hardly mentioned by warmists like Stern, Gore and Blood the crusade to develop "new renewables", that is wind power and solar electricity, has to concern public-sensitive issues starting with long-term pricing for electricity. No limit price increases for "green power", to ramp up its place in the energy economy, in fact and in reality do have limits.

In late 2013, using Eurostat data, German power prices for households, not corporate consumers eligible for rebates, ran at 25.3 euro cents per kilowatthour. This prices German

electricity for households at around $535 per barrel equivalent of energy. Obviously at that price, all sorts of alternatives become viable – certainly including not using electricity at all and literally freezing in the dark – but obviously not a Gore lifestyle habit !

Being mandarins, with a contempt for basic technical issues... Gore, Blood and Stern say the world must intensify or at least maintain the current rate of "backing out" fossil fuels for power generation. They ignore the critical problems faced by power producers in almost all developed countries, which start with the basic problem that when power prices are jacked up, and up, to feed in green power people consume less power . With no surprise this problem is the most acute in Europe, where the power sector crisis is only in part due to growing renewable-source power production and leftover (or legacy) impacts of European ETS.

Due to European energy transition being ahead of other world regions, the real world effect of cutting renewable energy subsidies – most dramatically in Spain – can be seen and studied by Messrs Stern, Gore & Blood. Renewables-intensive businesses have lost their "license to operate," thereby stranding their assets. Investor retreat is now a stampede.

They of course argue that delaying action to mitigate climate change will accelerate climate change itself. The relation of that decision (or non-decision) to stranding fossil fuel and fossil energy assets is not clear, but Gore & Blood claim there is a relation. They say that delaying the abandonment of all fossil fuels will cause a much larger stranding across all industries and all asset classes in the future. This line of argument is today heavily developed by Lord Stern, who says all portfolios must be scrutinized, including equity and corporate debt valuations, giving a radical new meaning for the term "prudent risk management".

Market Rout

There are four principal ways investors can handle the coming carbon asset collapse, according to Stern, Gore & Blood. They say that around 10%-30% of most major stock exchange capitalizations are exposed to the coming rout. As a result, at least in theory, all stock markets are overvalued by at least that amount and index-tracking funds must restructure their portfolios before it is too late.

Second, corporate directors and executives must disclose their plans to mitigate carbon asset risks. Investors should ask if companies have a shadow price on carbon, and if not, why not? Investors need to know what amount of carbon the company plans to burn, and how it relates to the company's long-term strategic plan. Cash flow must be diverted away from developing fossil fuels, and toward more productive non-carbon uses in the context of a transition to a low carbon economy.

Third, diversify investment to opportunities positioned to succeed in the future low-carbon economy. Investors should tilt portfolios away from assets with embedded carbon risks and toward assets with low or no carbon emissions. Gore & Blood identify "emerging solutions" such as: energy generation (solar, wind, geothermal); buildings (insulating materials, lighting, smart metering); and transport (electric vehicles, goods vehicle fleet logistics).

Fourth, although they admit it "can be complicated", investors and companies must divest their fossil fuel assets, the surest way to reduce carbon risk. Supposedly, somebody will be there to buy the divested and soon-to-be-worthless assets, but Gore & Blood do not say who. We are obliged to imagine that Big Government will have to be there, to buy the

useless assets TARP-style.

They end with a quote from John F. Kennedy to the effect that the risks and costs of an audacious plan can be less than the long run costs of “comfortable inaction”. As history tells us, we can be glad Kennedy’s rash and reckless action in the Bay of Pigs invasion of Cuba was followed by his inaction in the 1963 missile crisis with Russia.

Nowhere in this already-dated and heavily schizophrenic logic do we find the real missing links – the 2008 crisis was a stark proof that stock markets are wildly overvalued, with no help needed from carbon fear. Continued “recovery” of equity markets notably includes a major role for overvalued oil, and overvalued electricity, but the call to “back out carbon fuels” has been replaced and superseded by backing out low-carbon.

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