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Michael Brush

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**Company Focus**

**How will stocks handle the Big Chill?**



Through an ironic quirk of nature, global warming may soon take a back seat to a dramatic reduction in temperatures. Here's how to invest with such a forecast in mind.

By [Michael Brush](#)

Investors in weather-sensitive sectors like insurance and travel are smugly confident of unusually mild temperatures ahead, thanks to global warming and another date with El Niño this winter.

But they may be in for a nasty surprise that could dramatically upset their portfolios -- in the form of a Big Chill the likes of which we haven't seen for decades. An unconventional doomsday forecast of global *cooling* is making the rounds among oceanographers and hedge-fund managers. The catalyst behind the forecast: an ominous mass of fresh water building up in the Northern Atlantic.

Simply put, that mass threatens to block Gulf Stream currents that normally bring warmth up from the south. If this scenario plays out, it could lower average temperatures dramatically in Europe and North America for years, with vast economic and political consequences.

On the investment side, the Big Chill would hurt sales at many travel-related companies like airlines and hotels, of course. Insurers would suffer, too, because unusually cold weather leads to heavy property losses from too much rain, flooding, snow, ice and wind.

In contrast, unexpected global cooling would boost profits at companies that produce natural gas and food. Cruise lines offering warm-weather getaways would also see business take off. Some retailers would benefit

while others would suffer. On the political front, expect more border conflicts and migration and a rise in the popularity of conservative political parties, if past cold cycles are any guide.

### **Origins of the Big Chill**

If you haven't yet heard much about the Big Chill, that's no surprise. It's off the radar screen because of three factors -- none of which mean you shouldn't take it seriously.

First, most people turn to meteorologists for their weather updates. That makes sense. But meteorologists tend to focus mostly on the atmosphere when they make forecasts. They overlook or dismiss the ocean currents that could spark the Big Chill.

Second, long-term weather forecasting has become highly politicized -- wrapped up in intense debate about whether industrial activity causes global warming. In this setting, theories about global cooling can get glossed over because they aren't politically correct. Third, what we know for certain about how fast the ocean's currents impact the weather is limited. That makes it hard to know for sure when changes in the ocean might spark the Big Chill.

None of these factors make what's happening in the Labrador and Greenland seas stretching out between Canada, Greenland, the United Kingdom and Norway any less troublesome.

"We are finding a lot more fresh water in the high latitude North Atlantic, and this is a bit alarming because evidence from the past tells us this can set back global warming for a thousand years," says Raymond Schmitt, an oceanographer with Woods Hole Oceanographic Institution in Massachusetts.

### **The Gulf Stream diverted**

The problem boils down to this. Fresh water is lighter than salt water. So when it builds up in the Northern Atlantic, either because the polar ice caps are melting or rain has increased or some other reason, it blocks the Gulf Stream from bringing warmer water up from the equator.

Over the past 30 years, an extra 10 feet of fresh water has amassed in the high-latitude North Atlantic. "All the models tell us this should lead to a cooling in Europe and North America, but we don't know how rapidly that cooling will occur," says Schmitt. He thinks the change could happen anytime over the next 10 to 100 years.

Meteorologists like Richard Rosen of Atmospheric and Environmental Research in Lexington, Mass., don't rule out an abrupt shift, in part

because it's simply too hard to predict how the changes in the ocean can have an impact.

"Because of the volume of water, all you need is a current of fresh water coming down, and we will see a huge impact on the weather," says one hedge-fund manager who is following the issue closely. Bottom line: It could begin having an impact as soon as this winter, or it could take several years.

In a worst-case scenario, winter temperatures could drop by 10 degrees in the northeastern United States and Europe on average, say scientists at Woods Hole. That's enough to clog harbors and shipping lanes with ice, disrupt ground and air transportation, drive up energy needs and disrupt food supplies. Europe would suffer worse than the United States because it depends more on the Gulf Stream for warmth during the winter.

Here's a look at what industries might benefit -- or suffer -- the most from an unexpected Big Chill.

### **Natural Gas**

A Big Chill would probably have the most profound impact on energy stocks, because it would spark demand at a time when there are already growing regional shortages. In North America, natural gas supplies have been flat to declining for years as energy companies put off the hunt for reserves that are getting harder to find.

The key thing to remember is that markets for natural gas are regional -- gas is difficult to transport long distances. So unusually cold weather could throw the North American market into a tizzy because supplies are already tight.

"A colder-than-normal winter is not priced in to these stocks, so North American natural gas stocks are going to go through the roof if that happens," says Rikard Ekstrand, who oversees energy holdings at First Pacific Advisors. His firm already has positions in several natural gas-related companies because of the underlying supply-demand imbalance, which FPA thinks will get worse even without a Big Chill.

Ekstrand's firm owns shares of **Patterson-UTI Energy** ([PTEN](#), [news](#), [msgs](#)) and **Nabors Industries** ([NBR](#), [news](#), [msgs](#)), which rent rigs used in producing natural gas. These land rigs become more valuable as demand for natural gas increases. FPA also owns **Ensco International** ([ESV](#), [news](#)) a supplier of "jack up" rigs used to produce natural gas in the Gulf of Mexico. Ekstrand also likes **National-Oilwell** ([NOI](#), [news](#), [msgs](#)), which makes drilling equipment for land and offshore drilling rigs.

Petrie Parkman oil analyst Steve Enger identifies four companies that control a lot of North American gas reserves: **Burlington Resources** ([BR](#), [news](#), [msgs](#)), **XTO Energy** ([XTO](#), [news](#), [msgs](#)), **Western Gas Resources** ([WGR](#), [news](#), [msgs](#)), and **Tom Brown** ([TBI](#), [news](#))

## Oil

A period of unusually cold weather over the next several years could drive up the price of oil dramatically for the same reasons that haunt North American gas markets. Long-term trends point to declining supplies as the number of highly productive wells declines, notes Charles Maxwell, an energy analyst with Weeden & Co.

Because good crude reserves are getting harder to find, Maxwell thinks non-OPEC oil production could peak around 2008, and overall oil production will peak around 2015 -- depending on how much price increases impact demand along the way.

The major oil companies may not be the best way to play this long-term shortage. Their production will decline even as prices go up because it will get harder to find productive wells. Companies that extract oil from tar sands might be a better play, says Maxwell. They can easily increase production by deploying more trucks and shovels to extract tar sands more quickly. One example is Canada-based **Suncor Energy** ([SU](#), [news](#)),

## Travel and Leisure

Clearly, unusually cold weather would be bad for travel-related businesses like the major airlines and hotel companies, including **Marriott International** ([MAR](#), [news](#), [msgs](#)), **Starwood Hotels & Resorts** ([HOT](#), [news](#)), **Hilton Hotels** ([HLT](#), [news](#), [msgs](#)), **Four Seasons Hotels** ([FS](#), [news](#), [msgs](#)) and **Pegasus Solutions** ([PEGS](#), [news](#), [msgs](#)), a provider of room-reservation services.

Amusement park operators like **Six Flags** ([PKS](#), [news](#), [msgs](#)) and **Cedar Fair** ([FUN](#), [news](#), [msgs](#)), which runs several parks in northern states, might also suffer. On the other hand, cruise lines like **Carnival** ([CCL](#), [news](#)), **Royal Caribbean** ([RCL](#), [news](#), [msgs](#)) and **P&O Princess Cruises** ([POC](#)), would enjoy better demand as people seek out warmer surroundings. You might think **Vail Resorts** ([MTN](#), [news](#), [msgs](#)) would benefit. But not if harsh weather discourages skiers. Besides, summer resort and golfing business at its ski-area locations might suffer.

## Retail

Conventional wisdom holds that people shop less in extremely cold weather. Any stores selling lots of heavy winter clothing, however, would do well. Not only would they enjoy better demand, but this kind of clothing

produces high profit margins, notes Frank Olanso, a retail sector analyst with T. Rowe Price. Stores that typically sell or make a lot of winter clothing are **Talbots** ([TLB](#), [news](#), [msgs](#)), **Christopher & Banks** ([CBK](#), [news](#)) and **Columbia Sportswear** ([COLM](#), [news](#), [msgs](#)).

Higher energy costs would mean that retailers with lots of floor space to heat might suffer, notes Allan Roopan, who oversees a portfolio of weather derivatives at Chubb Financial Services. Think of **Home Depot** ([HD](#), [news](#), [msgs](#)) or **Wal-Mart Stores** ([WMT](#), [news](#), [msgs](#)).

### Insurers

Despite massive rate hikes recently, insurance companies have weak capital structures that make them vulnerable. In many cases reserves are low and investment returns have suffered in recent years. Unusually cold weather that sparked lots of property damage because of snow, ice, high winds and flooding could push some over the edge. "The problem is the insurance industry cannot afford another major catastrophe," said one hedge fund manager.

Companies running potential risks because of exposure to property and casualty losses include firms like: **Allstate** ([ALL](#), [news](#), [msgs](#)), **RenaissanceRe Holdings** ([RNR](#), [news](#), [msgs](#)), **ACE Limited** ([ACE](#), [news](#)), **XL Capital** ([XL](#), [news](#), [msgs](#)), **Allianz AG** ([AZ](#), [news](#), [msgs](#)) and **PartnerRe Limited** ([PRE](#), [news](#), [msgs](#)).

### Food

Since Europe would suffer more from a Big Chill, U.S.-based agricultural supply companies might see some upside because U.S. farmers would have a better shot at producing more food to meet higher demand.

Their willingness to spend to increase yields could help equipment producers like **Deere** ([DE](#), [news](#), [msgs](#)), **Agco** ([AG](#), [news](#), [msgs](#)), **CNH Global** ([CNH](#), [news](#), [msgs](#)), **Valmont Industries** ([VMI](#), [news](#), [msgs](#)) and **Lindsay Manufacturing** ([LNN](#), [news](#), [msgs](#)), says Lewis Johnson, an agricultural sector analyst at T. Rowe Price. It would also help fertilizer and seed companies like **Potash** ([POT](#), [news](#), [msgs](#)), **Agrium** ([AGU](#), [news](#)) and **IMC Global** ([IGL](#), [news](#), [msgs](#)).

But if U.S. food producers get hit too hard, those bets are off. In that scenario, winners will be the professional investors smart enough to hold agricultural commodity options that lock in grain prices before they start to rise on news that cold weather is hurting crop yields. Unfortunately for most individual investors, it's a lot easier to stock up at the grocery store than understand safe ways to place bets on grain options.

At the time of publication, Michael Brush did not own or control shares in any of the companies listed in this column.

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