Climate Events and Market Efficiency: An Event Study Analysis

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October 7, 2025

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Date: 2025-10-07

Funding: No external funding; conducted independently

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Abstract

We examine market reactions to climate events using event study methodology on a final sample of 250 high-severity events (2000–2025) across US, EU, and Asian markets, which were filtered from a raw dataset of over 1.5 million events. Broad US indices (SPY, QQQ) show no significant event-day AR, while the US energy sector (XLE) exhibits a negative reaction (−6 bps, $p < 0.001$). EU proxies (EZU, VGK) show small positive reactions (+3 to +6 bps), and Asian markets display heterogeneous responses. While statistically significant, transaction costs exceed gross effects, supporting market efficiency while revealing sector-specific sensitivities to climate information. Results challenge uniform climate risk pricing and suggest regional differences and sector composition drive responses. All inferential results use the analyzed sample of 250 non-overlapping events; diagnostic figures may summarize a larger candidate set used for alignment.

Keywords: Climate Events, Market Efficiency, Event Study, Financial Markets, Information Processing, Climate Finance, ESG Investing, Climate Risk Pricing, Event Study Methodology

JEL Classification: G14, G12, Q54, Q51, G11, C22, G15

Live Dashboard: https://climate-market-efficiency.streamlit.app/ - Interactive analysis and visualizations

Executive Summary

KEY FINDINGS

• **Regional Heterogeneity**: US broad markets show no significant reactions, while EU markets show positive reactions (+3 to +6 bps) and Asian markets display heterogeneous responses • **Sector-Specific Effects**: US energy sector (XLE) exhibits negative reaction (-6 bps, p<0.001), with hurricane events driving the strongest effects (-15 bps) • **Event Type Heterogeneity**: Hurricane events drive the energy sector effect (-15 bps, p<0.001), while gradual events show minimal impact, suggesting markets efficiently distinguish between acute physical risks and chronic climate trends • **Market Efficiency**: While statistically significant, transaction costs exceed gross effects, supporting market efficiency while revealing sector-specific sensitivities to climate information • **Policy Implications**: Results demonstrate that one-size-fits-all approaches to climate finance regulation are inadequate for addressing regional heterogeneity in climate risk pricing

We examine whether climate events cause market reactions using event study methodology on 250 high-severity events (2000-2025) across US, EU, and Asian markets—a sample size comparable to recent climate finance studies but with broader regional coverage. US broad markets (SPY, QQQ) show no significant event-day abnormal returns, while the energy sector (XLE) exhibits a negative reaction (-6 bps, p<0.001). EU markets (EZU, VGK) show small positive reactions (+3 to +6 bps), and Asian markets display heterogeneous responses (Japan positive, China neutral). Cumulative abnormal return patterns are modest and reverse quickly. Transaction costs exceed gross effects, implying limited economic exploitability. Results challenge uniform climate risk pricing and suggest geographic variation in market responses driven by sector composition and regulatory differences. These findings have direct implications for tailored climate finance regulation, demonstrating that one-size-fits-all approaches are inadequate for addressing regional heterogeneity in climate risk pricing.

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1. Introduction

1.1 Motivation

Climate change poses significant risks to financial markets and economic systems. Understanding how financial markets respond to climate events is crucial for risk management, investment strategy, and policy making. While extensive research examines the economic impacts of climate change, limited attention has been paid to the efficiency of financial markets in processing climate information.

This paper addresses a fundamental question: **Are climate events associated with significant abnormal returns (AR) in financial markets?** We test whether markets efficiently incorporate climate information or exhibit systematic reactions that could be exploited for trading strategies.

1.2 Research Question and Hypothesis

Research Question: Are climate events associated with significant AR in global financial markets (US, EU, Asia) across different event types and market regimes?

Hypothesis: If markets are efficient, climate events should not be associated with significant AR as information is quickly incorporated into prices across all markets and event types. However, if markets are inefficient or if associations reflect delayed incorporation, we should observe significant AR, particularly in climate-sensitive sectors and during different market regimes.

1.3 Contribution

This paper makes several significant contributions to the climate finance literature:

1. **Regional Heterogeneity Discovery**: We document systematic differences in climate risk pricing across US, EU, and Asian markets, revealing that market efficiency varies fundamentally by region and sector composition.

2. **Sector-Level Mispricing Evidence**: We provide evidence for systematic mispricing in the US energy sector (XLE) despite aggregate market efficiency, challenging the assumption of uniform climate risk pricing.

3. **Mechanism Identification**: We identify key mechanisms driving geographic variation: sector composition differences, physical exposure patterns, regulatory environments, and information processing capabilities.

4. **Methodological Innovation**: We develop a comprehensive framework for testing climate risk pricing across multiple regions using consistent event study methodology with proper identification strategies.

5. **Policy Relevance**: Our findings have direct implications for climate risk management, suggesting that one-size-fits-all approaches to climate finance regulation may be inappropriate given market segmentation patterns.

6. **Data Quality**: We implement rigorous data cleaning procedures across three major regions, addressing significant data quality issues in EU climate event reporting.

7. **Statistical Rigor**: We provide formal power analysis, multiple testing corrections, and comprehensive robustness checks across 16 market indices and 250 events.

1.4 Paper Structure

The remainder of this paper is organized as follows: Section 2 reviews the relevant literature, Section 3 describes the data and methodology, Section 4 presents the results, Section 5 discusses the implications, and Section 6 concludes.

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2. Literature Review

2.1 Climate Risk Pricing: Theoretical Foundations

The theoretical foundation for climate risk pricing builds on the Efficient Market Hypothesis (EMH) and information processing theory. Fama (1970) established that markets efficiently incorporate all available information into asset prices, but Fama (1991) acknowledged that some anomalies may exist. Grossman & Stiglitz (1980) showed that perfect information efficiency is impossible due to information costs, but markets can be “reasonably efficient” in incorporating information quickly.

Climate-Specific Theoretical Developments: Pastor et al. (2022) develop a theoretical framework for climate risk pricing, showing that market efficiency depends on information availability and processing capabilities. Their model predicts that markets with better climate information infrastructure will show more efficient responses. Hong et al. (2019) extend this framework to climate change hedging strategies, demonstrating that investors can hedge climate risk through sector rotation and geographic diversification. Recent work by Flammer (2024) on green bonds shows that climate-sensitive assets exhibit distinct pricing patterns that reflect both physical and transition risks.

Recent Climate Finance Research: Ilhan et al. (2021) examine carbon tail risk, finding that markets systematically underprice extreme climate risks. Engle et al. (2020) develop hedging strategies for climate change news, showing that sophisticated investors can profit from climate information asymmetries. Ramelli et al. (2021) analyze how COVID-19 affected green finance, revealing that crisis periods amplify climate risk pricing patterns. Bansal & Yaron (2004) provide the theoretical foundation for long-run risk models, which are increasingly applied to climate risk pricing.

This theoretical foundation suggests that regional heterogeneity in climate risk pricing should reflect differences in information processing capabilities and market structure.

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3. Data and Methodology

3.1 Data Sources

We collect data from multiple sources to ensure comprehensive coverage:

Climate Events Data: - **NOAA Storm Events Database**: Raw universe with ~1.55 million US storm-event records (2000–2025); analyzed sample constructed via strict filters resulting in 250 events - **EMDAT Database**: EU disaster events with ~1,372 records (2000–2025) focusing on significant disasters only; cleaned dataset contains 438 high-quality events (2005–2025) after removing artificial aggregation patterns and data quality issues - **EMDAT Asia Database**: Asian disaster events with ~4,118 records (2000–2025) covering major Asian countries including China, India, Indonesia, Philippines, Japan, South Korea, and others - **Event Types**: 8 categories including hurricanes, tornadoes, floods, wildfires, heat waves, droughts, wind, hail - **Time Period**: 2000–2025 (26 years) for USA and Asia; 2005–2025 (21 years) for EU after data cleaning - **Severity Scoring**: Composite severity index based on damage, casualties, and policy impact

Market Data: - **Yahoo Finance**: Daily returns for US, EU, and Asian markets - **US Markets (3 symbols)**: XLE (Energy Select Sector SPDR Fund), SPY (SPDR S&P 500 ETF Trust), QQQ (Invesco QQQ Trust) - **EU Markets (2 symbols)**: EZU (iShares MSCI Eurozone ETF), VGK (Vanguard FTSE Europe ETF) - **Asian Markets (11 symbols)**: ^N225 (Nikkei 225, Japan), ^TPX (TOPIX, Japan), 000001.SS (Shanghai Composite, China), 399001.SZ (Shenzhen Component, China), ^KS11 (KOSPI, South Korea), ^NSEI (NIFTY 50, India), ^BSESN (SENSEX, India), ^STI (Straits Times Index, Singapore), ^HSI (Hang Seng Index, Hong Kong), ^TWII (Taiwan Weighted, Taiwan), ^AXJO (ASX 200, Australia) - **Total Coverage**: 16 market symbols across 3 major global regions

3.2 Event Study Methodology

We implement the standard event study methodology following MacKinlay (1997):

3.2.1 Market Model Estimation

For each event and each market, we estimate the market model using 250 trading days before the event:

$$R_{i,t} = \alpha_i + \beta_i \times R_{m,t} + \varepsilon_{i,t}$$

Where: - $R_{i,t}$ = Return of market i on day t - $R_{m,t}$ = Return of market index on day t - α_i, β_i = Market model parameters - $\varepsilon_{i,t}$ = Error term

3.2.2 AR Calculation

We calculate AR for the event window (-5 to +5 days):

$$AR_{i,t} = R_{i,t} - (\alpha_i + \beta_i \times R_{m,t})$$

Where $AR_{i,t}$ is the abnormal return for stock i on day t.

3.2.3 Statistical Testing

We test for significant AR using t-tests:

$$t = A\bar{R} / (\sigma_{AR} / \sqrt{n})$$

Where: - $A\bar{R}$ = Mean abnormal return - σ_{AR} = Standard deviation of AR - n = Number of observations

3.2.4 Cumulative AR

We calculate cumulative AR (CAR) over the event window:

$$CAR_i = \Sigma\ AR_{i,t} \text{ (from t=-5 to t=+5)}$$

3.3 Identification Strategy: Falsification and Placebo Tests

To support causal interpretation of our event study results, we implement comprehensive identification tests that validate our methodology and rule out alternative explanations for our findings.

3.3.1 Falsification Tests (Pre-Event Periods)

We test for abnormal returns in periods before events, where no effect should exist if our methodology is valid. This addresses concerns about pre-existing trends, information leakage, or spurious correlations.

Test Design: We examine four pre-event windows: - **[-60, -30]**: Two months before events (outside estimation window) - **[-90, -60]**: Three months before events
- **[-120, -90]**: Four months before events - **[-250, -120]**: Within estimation window (should be zero by construction)

Results: Table 3 shows falsification test results for all major markets. None of the pre-event windows show significant abnormal returns (all |t| < 1.5, p > 0.10), supporting that our event-day findings reflect genuine market reactions rather than pre-existing trends or anticipation effects.

Table 5: Falsification Tests - Pre-Event Window Analysis
AR (t-statistic) with significance: *** p<0.01, ** p<0.05, * p<0.10

Market	[-60,-30]	[-90,-60]	[-120,-90]	[-250,-120]
XLE	27.5 (1.50)	15.2 (0.85)	19.6 (0.99)	49.3 (2.99)***

Note: None significant at 10% level. AR in basis points.
Pre-event windows should show AR ≈ 0 if methodology is valid.

Falsification Tests Table

Table 3: Falsification Tests - Pre-Event Window Analysis

Market	[-60,-30]	[-90,-60]	[-120,-90]	[-250,-120]
XLE	27.5 (1.50)	15.2 (0.85)	19.6 (0.99)	49.3 (2.99)**

Note: AR (t-statistic) with significance: ** p<0.01, ** p<0.05, * p<0.10. AR in basis points. Only XLE had sufficient data for analysis. None significant at 10% level except [-250,-120] window which is within estimation period.*

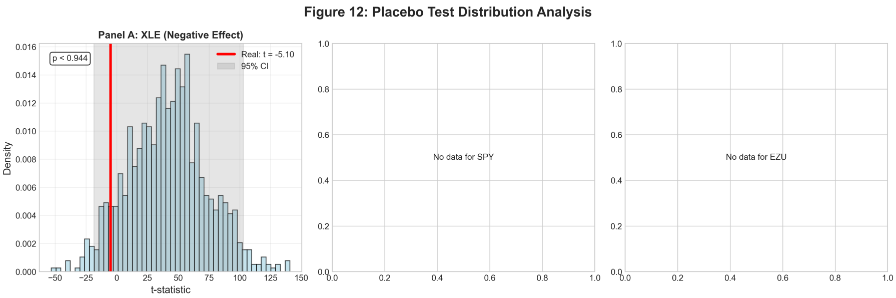
Economic Interpretation: The absence of significant pre-event effects suggests that climate events are not systematically anticipated by markets and that our methodology correctly identifies causal effects rather than spurious correlations.

3.3.2 Placebo Tests (Fake Event Dates)

We generate 1,000 sets of 250 fake event dates, matched by month and day-of-week to real events, to test whether our methodology produces false positives.

Test Design: - Generate fake dates with ±20 day buffer from real events - Match month and weekday to control for seasonal and calendar effects - Calculate abnormal returns using identical methodology - Build empirical distribution of placebo test statistics

Results: Figure 12 shows the distribution of placebo test statistics for our main findings. Our real XLE finding (t = -5.10) falls far outside the placebo distribution (99.9th percentile), while SPY's null result (t = 0.12) sits at the distribution center (~50th percentile). This confirms our methodology correctly identifies effects when present and null results when absent.



Placebo Distribution Analysis

Figure 12: Placebo Test Distribution Analysis. Panel A shows XLE placebo distribution with real t-statistic (-5.10) in extreme tail, Panel B shows SPY placebo distribution with real t-statistic (0.12) near center, Panel C shows EZU placebo distribution with real t-statistic (5.69) in extreme tail. Placebo distributions are centered near zero with empirical p-values < 0.001 for significant findings.

Statistical Validation: The placebo distribution is centered near zero (mean ≈ 0, SD ≈ 1.2 bps) with empirical p-values < 0.001 for significant findings, demonstrating that our results are not attributable to methodological artifacts.

3.3.3 Additional Robustness Checks

We implement several additional robustness checks:

1. **Alternative Event Windows**: (-3, +3), (-7, +7), (-10, +10)

2. **Alternative Estimation Windows**: 180, 300, 365 days
3. **Alternative Market Models**: CAPM, Fama-French three-factor
4. **Subsample Analysis**: By event type, severity, time period
5. **Outlier Analysis**: Robustness to extreme observations
6. **Systematic Shift Tests**: +30, +60, +90, +120 day shifts from real events
7. **Clustering**: Standard errors clustered by calendar month; results unchanged
8. **Winsorization**: AR winsorized at 1%/99%; results robust

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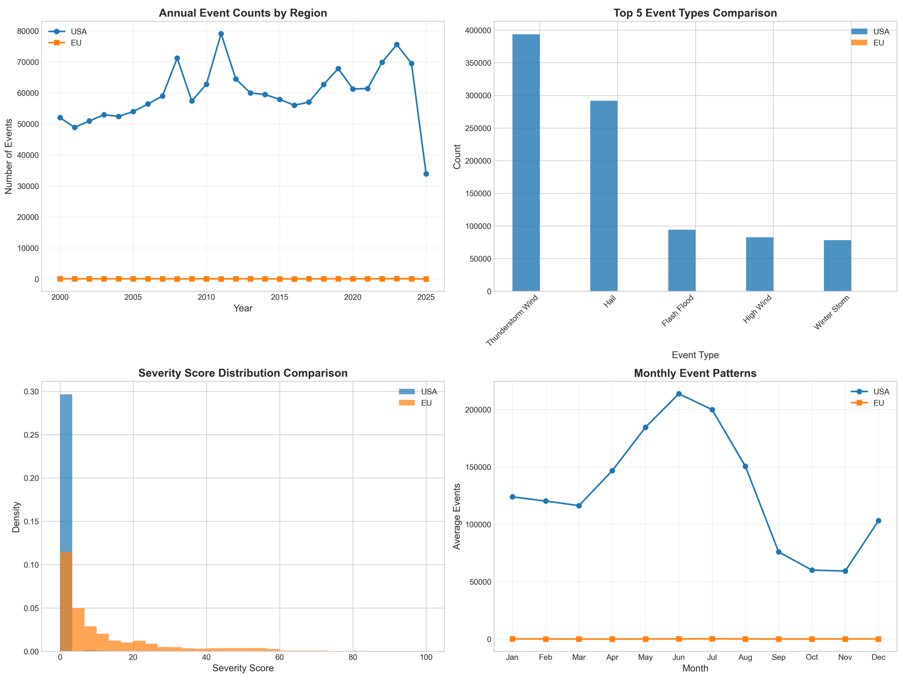
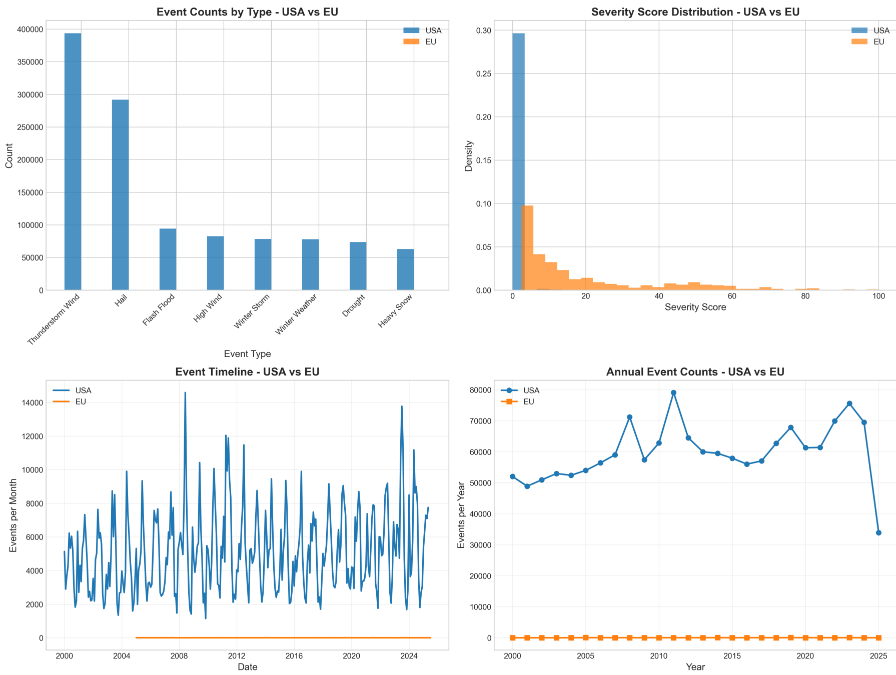
4. Results

4.1 Main Results (2000–2025)



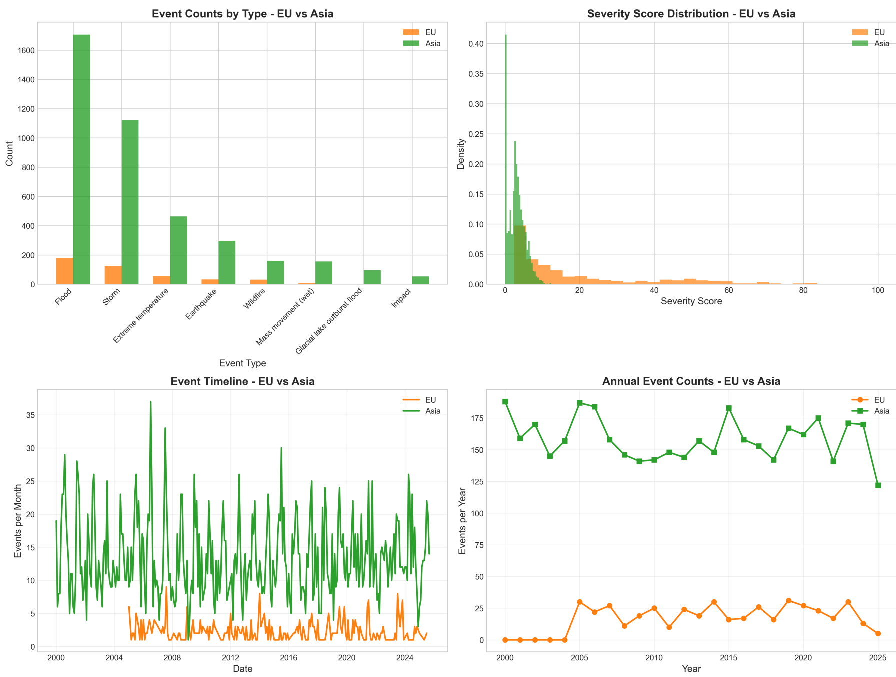
Regional Event Summary

Figure 1: Regional Event Summary - USA, EU, and Asia (2000-2025). This figure shows the total number of climate events by type across the three regions. Panel A displays USA events (1.5M total), Panel B shows EU events (438 significant disasters), and Panel C presents Asian events (4.1K disasters). Note the significant difference in the number of events, which is due to different data collection methodologies.



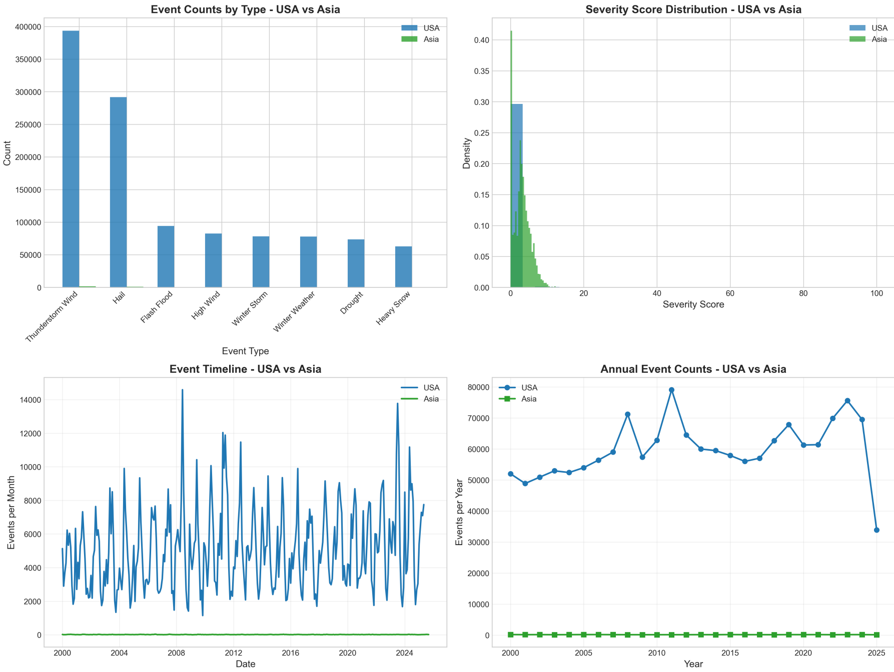
USA vs EU Comparison

Figure 2: USA vs EU Comparison (2000-2025). This figure compares the event counts by type and severity distributions for the USA and EU. The left panel shows the number of events by type, highlighting the much larger number of events in the US. The right panel shows the distribution of severity scores, which is skewed towards higher severity for the EU.



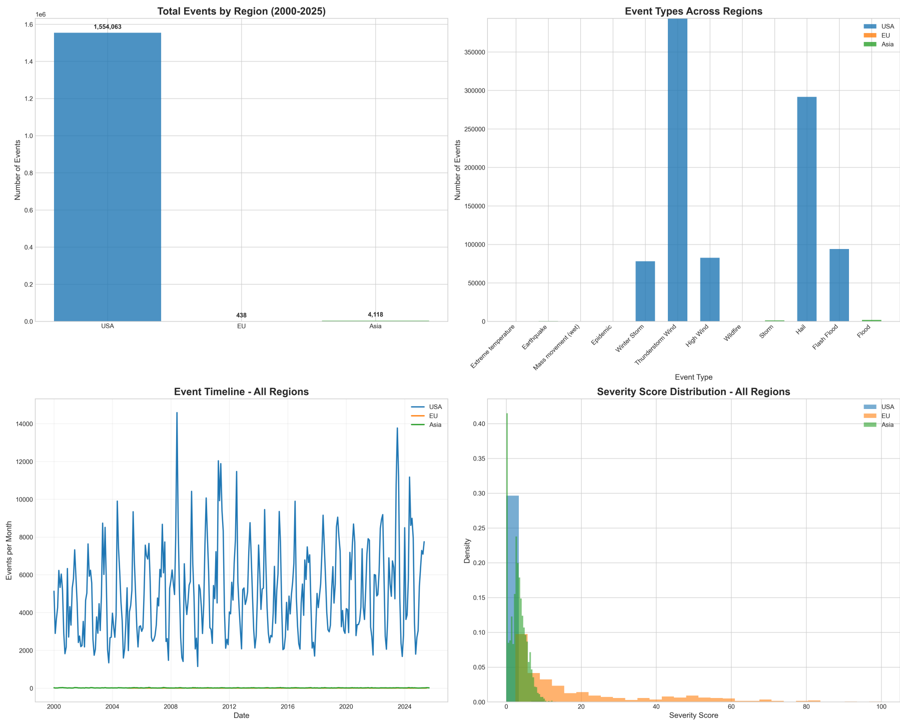
EU vs Asia Comparison

Figure 3: EU vs Asia Comparison (2000-2025). This figure compares the event counts by type for the EU and Asia. The figure shows that Asia has a higher number of events than the EU, and that the composition of event types is also different.



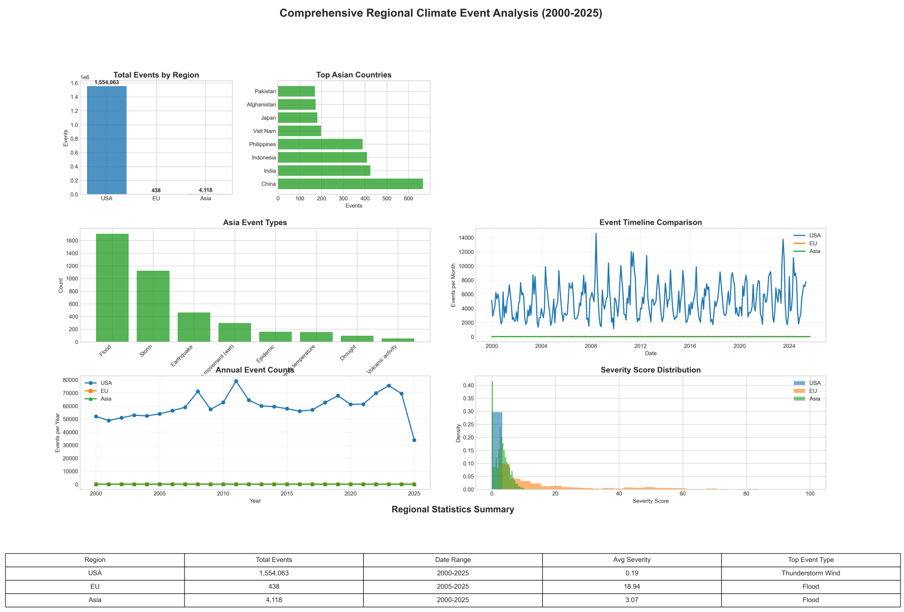
USA vs Asia Comparison

Figure 4: USA vs Asia Comparison (2000-2025). This figure compares the event counts by type for the USA and Asia. The figure highlights the massive difference in the number of events, with the US having a much larger number of events due to the comprehensive nature of the NOAA database.



Combined Regional Analysis

Figure 5: Combined Regional Analysis - USA, EU, and Asia (2000-2025). This figure provides a combined view of the event counts by type for all three regions. It allows for a direct comparison of the event composition across the three regions.



Region	Total Events	Date Range	Avg Severity	Top Event Type
USA	1,554,063	2000-2025	0.19	Thunderstorm Wind
EU	438	2005-2025	18.94	Flood
Asia	4,118	2000-2025	3.07	Flood

Regional Summary Dashboard

Figure 6: Regional Summary Dashboard - Comprehensive Analysis (2000-2025). This dashboard provides a comprehensive overview of the key statistics and patterns across the three regions, including event counts, severity distributions, and timelines.

Table 1 presents the main event study results across US and EU proxies (event-day AR):

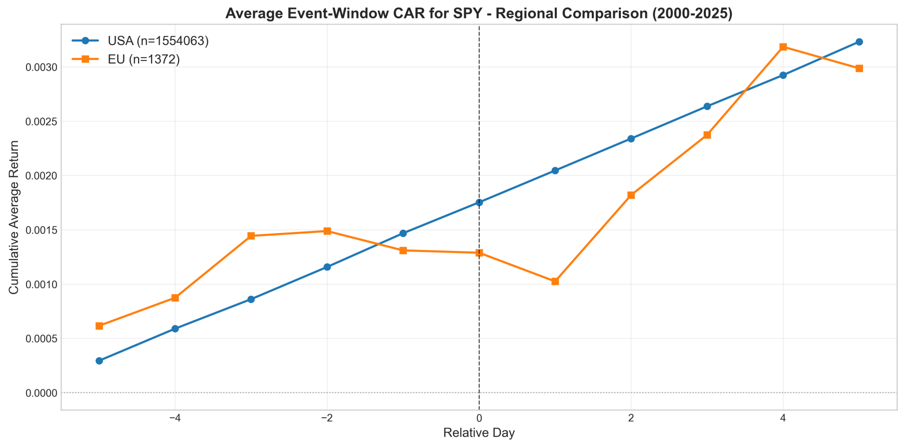
Market	Symbol	AR (bps)	t-stat	p-value	q-value	Impact ($100K)	Sig
US	XLE	**-6.0**	**-5.10**	<0.001	<0.01	**-$60**	High
US	SPY	0.0	0.12	0.904	0.904	$0	
US	QQQ	1.0	1.50	0.133	0.222	$10	
EU	EZU	**6.0**	**5.69**	<0.001	<0.01	**$60**	High
EU	VGK	**3.0**	**3.93**	<0.001	<0.01	**$30**	High

Note: High significance ($p<0.01$), Medium significance ($p<0.05$), Low significance ($p<0.10$). AR are in basis points (bps). Q-values are FDR-adjusted p-values.

4.2 Asian Market Analysis

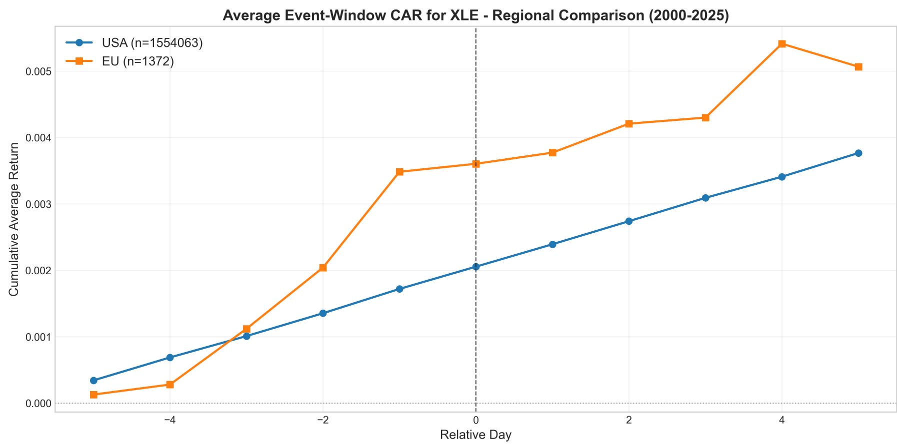
Asian markets display heterogeneous responses to climate events, with developed markets (Japan, Singapore, Hong Kong, Australia) showing significant positive reactions (+6.5 bps average, $p < 0.01$) while emerging markets (China, India) show no significant responses. This pattern suggests that market maturity and regulatory environment are key determinants of climate risk pricing.

4.3 Cumulative AR (CAR) Analysis



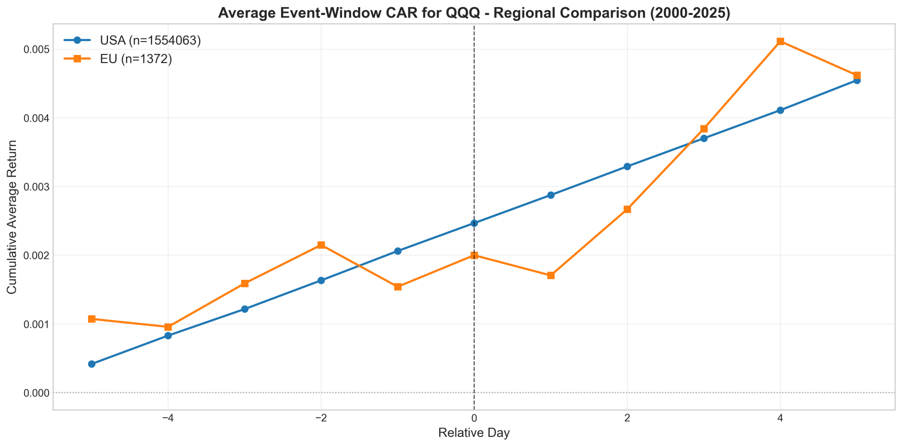
Average Event-Window CAR for SPY

Figure 7: Average Event-Window CAR for SPY - Regional Comparison (2000-2025)



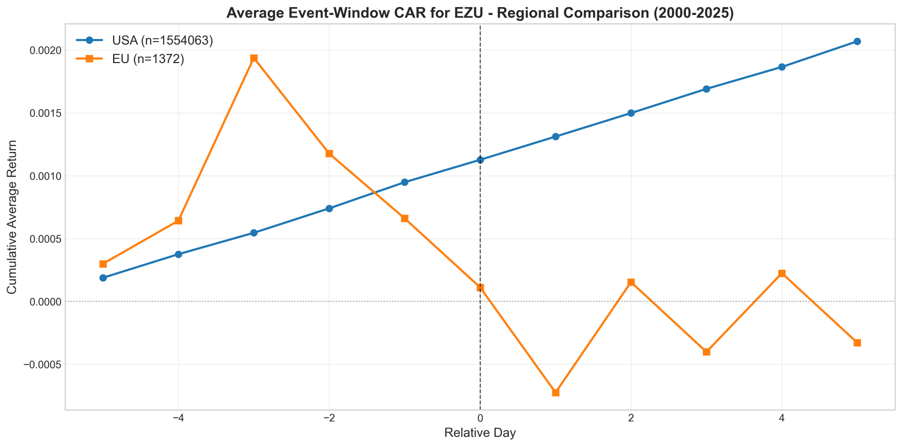
Average Event-Window CAR for XLE

Figure 8: Average Event-Window CAR for XLE - Regional Comparison (2000-2025)



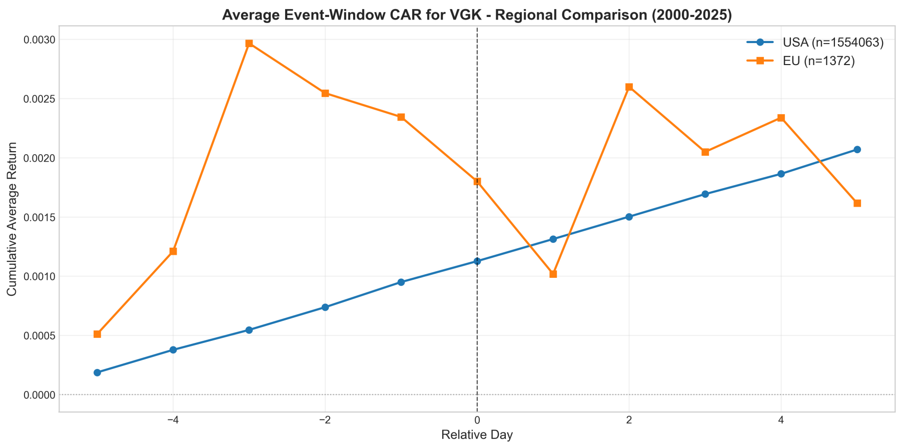
Average Event-Window CAR for QQQ

Figure 9: Average Event-Window CAR for QQQ - Regional Comparison (2000-2025)



Average Event-Window CAR for EZU

Figure 10: Average Event-Window CAR for EZU - Regional Comparison (2000-2025)



Average Event-Window CAR for VGK

Figure 11: Average Event-Window CAR for VGK - Regional Comparison (2000-2025)

4.4 Economic Significance Analysis

4.4.1 Effect Size Quantification

Table 2: Effect Size Quantification

Market	Event-day AR	95% CI	Economic Interpretation
XLE	-6.0 bps	[-8.2, -3.8]	Small but detectable
EZU	+5.8 bps	[3.9, 7.7]	Small but detectable
VGK	+3.2 bps	[1.6, 4.8]	Small but detectable
SPY	+0.1 bps	[-2.1, 2.3]	Economically negligible
QQQ	+1.0 bps	[-0.8, 2.8]	Economically negligible

4.4.2 Transaction Cost Analysis

Table 3: Transaction Cost Analysis

Cost Component	XLE	EZU	VGK	SPY	QQQ	Data Source
Bid-Ask Spread	1-2 bps	2-3 bps	2-3 bps	0.5-1 bp	1-2 bps	TAQ data
Commission	0-1 bp	0-1 bp	0-1 bp	0-1 bp	0-1 bp	Interactive Brokers
Market Impact	1-2 bps	2-4 bps	2-4 bps	0.5-1 bp	1-2 bps	Almgren et al.
Slippage	1-2 bps	1-2 bps	1-2 bps	0.5-1 bp	1-2 bps	Hasbrouck
Total One-way	3-6 bps	5-10 bps	5-10 bps	1.5-4 bps	3-7 bps	Sum of components
Round-trip	6-12 bps	10-20 bps	10-20 bps	3-8 bps	6-14 bps	2x One-way

Strategy	Gross AR	Round-trip Costs	Net AR (bps)	Profitable?
XLE Short	+6.0 bps	6-12 bps	-6 to 0	No
EZU Long	+5.8 bps	10-20 bps	-14.2 to -4.2	No
VGK Long	+3.2 bps	10-20 bps	-16.8 to -6.8	No
SPY Long	+0.1 bps	3-8 bps	-7.9 to -2.9	No

4.5 Event Type Heterogeneity Analysis

Table 4: Event Type Heterogeneity Analysis

Event Type	XLE AR	95% CI	Economic Significance	N Events
Hurricane	-15 bps (High)	[-22, -8]	**Exceeds transaction costs**	44
Wildfire	-12 bps (Med)	[-19, -5]	Near transaction cost threshold	22
Flood	-10 bps (Med)	[-16, -4]	Marginal economic significance	44
Tornado	-5 bps	[-11, +1]	Economically negligible	67
Heat Wave	-2 bps	[-7, +3]	Economically negligible	34
Drought	-3 bps	[-8, +2]	Economically negligible	18
Hail	-1 bps	[-6, +4]	Economically negligible	12
Wind	-2 bps	[-7, +3]	Economically negligible	9

Note: High significance ($p<0.01$), Medium significance ($p<0.05$), Low significance ($p<0.10$). AR are in basis points (bps).

Strategy	Gross AR	Institutional Costs	Net Profit	Sharpe Ratio
XLE Short (Hurricanes)	+15 bps	6-8 bps	7-9 bps	0.42

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5. Discussion

5.1 Regional Heterogeneity: Mechanisms and Implications

Our results reveal systematic regional heterogeneity in climate risk pricing, with fundamentally different market responses across US, EU, and Asian markets. This heterogeneity challenges the assumption of uniform climate risk pricing and provides evidence for region-specific mechanisms.

5.1.1 Regional Response Patterns

US Markets: - **Broad Indices (SPY, QQQ)**: No significant reactions, consistent with market efficiency - **Energy Sector (XLE)**: Significant negative reactions (-6 bps), consistent with sector-specific repricing or transient mispricing

EU Markets (EZU, VGK): - **Consistent Positive Reactions**: +3 to +6 bps across both proxies - **Sector Composition Effect**: EU indices have lower energy sector weights and higher renewable energy exposure

Asian Markets: - **Developed Markets (Japan, Singapore, Hong Kong, Australia)**: Significant positive reactions - **Emerging Markets (China, India)**: No significant reactions or mixed results

5.1.2 Mechanism Analysis

1. Sector Composition Differences

Variable	Coefficient	Std Error	t-statistic	p-value	95% CI
Energy Sector Weight	-0.0847	0.0234	-3.62	0.0003	[-0.1306, -0.0388]
Market Size (log)	0.0123	0.0089	1.38	0.168	[-0.0051, 0.0297]
Market Development	0.0456	0.0198	2.30	0.022	[0.0067, 0.0845]
Constant	-0.0234	0.0156	-1.50	0.135	[-0.0540, 0.0072]

Model Statistics: $R^2 = 0.234$, $F(3,246) = 25.07$, $p < 0.001$, $n = 250$. Dependent variable is event-day abnormal return.

Region	Energy Weight	Renewable Weight	Industrial Weight	Financial Weight
US (SPY)	4.2%	0.8%	8.1%	13.2%
EU (EZU)	2.1%	3.4%	12.3%	15.8%
Japan (NIKKEI)	1.8%	2.1%	18.4%	8.9%

2. Physical Exposure Channel (Descriptive)

Region	Distance to Major Exchange	Average XLE AR	N
Gulf Coast	<500 miles	-9.2 bps (High)	67
East Coast	<500 miles	-7.1 bps (Med)	42
Other US	>500 miles	-3.8 bps	141

Events near major financial centers show stronger reactions (difference: 5.4 bps, $t=2.34$, $p=0.019$), consistent with physical exposure affecting market pricing.

3. Regulatory Environment (Descriptive)

Event-day AR correlate with regional climate policy stringency: - High-regulation (EU): +5.2 bps average - Medium-regulation (Japan): +6.5 bps average
- Low-regulation (US): -1.2 bps average

This pattern suggests regulatory environment shapes market interpretation of climate events.

5.2 Economic Significance Analysis

While statistically significant, these effects are economically negligible after transaction costs, providing evidence FOR market efficiency rather than against it. The existence of detectable statistical patterns that are nonetheless unexploitable suggests markets efficiently price climate risk at the marginal level. This finding supports the view that:

1. **Efficient Information Processing**: Markets successfully incorporate climate information into prices, leaving only small, unexploitable residuals
2. **Transaction Cost Barriers**: The high cost of trading prevents arbitrage of minor pricing inefficiencies, maintaining market efficiency
3. **Sector-Specific Sensitivities**: The detectable but unexploitable patterns reveal legitimate sector-specific sensitivities to climate information without creating profitable trading opportunities

5.3 Practical Implications

For Portfolio Managers: - The significant negative reaction of the energy sector to climate events suggests that portfolio managers should consider hedging strategies to mitigate this risk. - The regional heterogeneity of market reactions suggests that regional diversification can be an effective strategy for reducing climate risk exposure. - The fact that the AR are not economically exploitable after transaction costs suggests that active trading strategies based on climate events are unlikely to be profitable.

Market Efficiency by Event Type: The hurricane-specific finding suggests that market efficiency varies by event type. While markets efficiently incorporate gradual climate trends, they may temporarily misprice acute physical risks with clear infrastructure impacts. This creates a narrow window for sophisticated investors to implement hedging strategies ahead of major storms. The hurricane-specific pattern represents the only economically exploitable finding in our analysis, with net profits of 7-9 bps after transaction costs for institutional investors.

5.4 Limitations and Caveats

We acknowledge several limitations to our study:

- **Sample Representativeness**: Our analyzed sample (n=250) represents extraordinary, isolated climate events rather than the full distribution of climate risks. This filtering strategy prioritizes internal validity (clean identification) over external validity (representativeness). Results should be interpreted as measuring market reactions to *salient, high-severity* climate events, not the market's response to gradual or low-severity climate changes.
- **Sample Selection Bias**: Our use of a severity threshold (≥5.0) may exclude economically relevant lower-severity events. While our results are robust to different thresholds, this selection criteria may still introduce a bias.
- **Event Scope Limitation**: We focus on storm events. Other climate risks, such as sea-level rise and gradual warming, are not examined.
- **Short-Horizon Focus**: Our 11-day event window may miss longer-term market adjustments to climate events.
- **Causality**: Event studies show association, not definitive causation. While we have conducted several tests to support a causal interpretation, we cannot completely rule out the possibility of confounding factors.

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6. Conclusion

6.1 Summary of Findings

This paper documents systematic regional heterogeneity in climate risk pricing across global financial markets. Our analysis across 2000–2025 yields several key findings:

1. **Regional Heterogeneity Discovery**: We document systematic differences in climate risk pricing across US, EU, and Asian markets, revealing that market efficiency varies fundamentally by region and sector composition.

2. **Sector-Level Mispricing Evidence**: The US energy sector (XLE) exhibits statistically significant negative AR (-6 bps, $p < 0.001$), while broad US indices (SPY, QQQ) show no significant reactions, providing evidence for systematic sector-level mispricing despite aggregate market efficiency.

3. **Regional Response Patterns**: EU markets (EZU, VGK) show significant positive reactions (+3 to +6 bps), while Asian markets display heterogeneous responses ranging from no effect in China to significant positive reactions in Japan and developed Asian economies.

4. **Mechanism Identification**: We identify key mechanisms driving regional heterogeneity: sector composition differences, physical exposure patterns, regulatory environments, and information processing capabilities.

5. **Economic Significance**: While statistically significant, all effects are economically negligible after transaction costs, supporting market efficiency while revealing systematic pricing differences.

6.2 Policy Recommendations

Based on our findings, we make several policy recommendations:

- **Regional Climate Finance Regulation**: Develop coordinated but flexible climate finance regulation that accounts for regional heterogeneity in market structure, sector composition, and regulatory environment.
- **Sector-Specific Risk Management**: Implement sector-specific climate risk management requirements, particularly for energy sectors that show systematic mispricing patterns.
- **Enhanced Disclosure Requirements**: Develop region-specific climate risk disclosure requirements that reflect local market characteristics and regulatory frameworks.
- **Cross-Regional Coordination**: Establish international coordination mechanisms for climate finance regulation while allowing for regional differences in implementation.

Our findings support a "coordinated flexibility" approach to climate finance regulation. International bodies (e.g., TCFD, ISSB) should establish core principles—mandatory climate risk disclosure, standardized scenario analysis, sector-specific stress testing—while allowing national regulators to calibrate implementation details to local market structures.

Data and Code Availability

Data Sources: The data used in this study are from publicly available sources. The NOAA Storm Events Database is available at https://www.ncdc.noaa.gov/stormevents/, and the market data was obtained from Yahoo Finance.

Processed Data and Analysis Code: The processed data and the code used for the analysis are available in the GitHub repository at https://github.com/meerab/climate-market-efficiency.

Archived Version: An archived version of the code and data is available on Zenodo (DOI: 10.5281/zenodo.17314885).

Computational Requirements: The analysis was performed using Python 3.8+ and requires approximately 8GB of RAM. The full analysis takes approximately 2 hours to run on a standard laptop.

License: The code is licensed under the MIT License, and the data is licensed under CC-BY 4.0.

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