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The Upshot

THE 2016 RACE

Prediction Markets' Sudden New Favorite: Third-Place Rubio

Justin Wolfers @JustinWolfers FEB. 2, 2016

Ted Cruz beat all comers in Monday's Iowa caucuses. He also beat expectations. Yet according to political prediction markets, Marco Rubio was the night's biggest winner. Mr. Rubio's third-place showing led his political stock to soar, and markets now rate him as a strong favorite to win the G.O.P. nomination.

Indeed, it is signaling he is now more likely to win than not.

In the hours after the Iowa caucus, bettors raised the chances of a nomination victory by Mr. Rubio to 54 percent from 33 percent. By contrast, Mr. Cruz remains a long shot; his chances to win the nomination rose from only 8 percent on the morning before the caucuses to 13 percent in the hours after the results became clear.

The biggest loser was Donald Trump, whose second-place finish came as a disappointment after he led both the polls and markets leading up to the caucus. Markets have slashed his chances of winning the nomination to 25 percent from 51 percent. Of this 26-point decline, 21 percentage points went to Mr. Rubio, and only five to Mr. Cruz. To be sure, these early market reactions are based on relatively thin trading volume, and so the numbers may well bounce around a bit in coming days.

Jeb Bush is the only other candidate given much of a chance, although he must be disappointed to have finished sixth, with less than 3 percent of the vote. Markets have downgraded his chances of recovering to 4 percent from 6 percent.

Scoring early primaries is hard, as the question of who is winning is easily confounded with the question of who is beating expectations. Prediction markets answer each question separately. The candidate rated most likely to win can be judged to be winning the campaign. And because prediction markets measure expectations, they rise only when a candidate outperforms these expectations. So the sharp uptick in Mr. Rubio's chances should be read as evidence that he handily beat expectations.

One of the strengths of prediction markets is that they tend to be relatively measured in their response to new information, as they try to distinguish transitory shifts in public opinion from more lasting changes in the dynamics of a race. In the 2012 cycle, for instance, the markets remained largely unimpressed as Rick Perry, Herman Cain, Newt Gingrich and Rick Santorum took turns in pushing ahead of Mitt Romney in national polls.

Similarly, in late 2015, markets discounted the transitory polling booms enjoyed by Ben Carson and Carly Fiorina. This same dynamic has meant that it has taken months for prediction market traders to be convinced that they should take Mr. Trump's impressive polling numbers seriously.

By contrast, today's shift in the markets appears to be sharp and decisive, suggesting that they believe that the early rounds of voting reveal a lot about the underlying state of this election. And as sharp as today's shift against Mr.

Trump has been, it pales in comparison with the crash in Howard Dean's market odds after his poor showing in the 2004 Democratic Iowa caucus. That assessment turned out to be justified.

While it is too early to count out Mr. Bush entirely, the G.O.P. contest is increasingly looking like a three-horse race. And perhaps that explains Mr. Rubio's bounce. The dominant story line of this race has been one of outsiders versus the establishment, with outsiders like Mr. Cruz and Mr. Trump helped by the fact that the establishment lane has looked overcrowded. That no longer seems to be the case; markets have not only written down Mr. Bush's odds, but they've also largely written off the chances of Chris Christie and John Kasich.

To put it all together, after the Iowa caucus, prediction markets tell us that the winner didn't win, that the runner-up was the biggest loser, and that the biggest surprise Monday night came when the expected third-place getter came in third. It's that sort of election season.

Justin Wolfers is a professor of economics and public policy at the University of Michigan. Follow him on Twitter at @justinwolfers