

# PLACE YOUR BETS!

On terrorism, on politics, on your future. Why markets will have a say in almost everything **By Bill Saporito**

**W**ILL AN AVIAN-FLU EPIDEMIC lay waste to millions? Will terrorists strike the New York City subway system before Christmas? Where will the next hurricane make landfall? None of us knows the answers to those questions. But we just might have a better idea than the experts, and our predictions on such matters could prove useful in helping us plan our lives, our portfolios or our escape routes.

The power of markets, it turns out, has something to say about practically everything. We see it at work on Wall Street, which absorbs the collected wisdom of millions of investors and expresses it as stock prices. Prediction markets now let people bet on everything from sports scores to election results to the expected capture of al-Qaeda bigwig Abu Mousab al-Zarqawi. Some of the best of those online markets: the Hollywood Stock Exchange, the Iowa Electronic Markets, Yahoo's Tech Buzz Game and PublicGyan. InTrade, run by the Trade Exchange Network, an Irish firm, cleared 50,000 contracts last month (including 10% odds that al-Zarqawi will be caught in 2005). "There's a tremendous demand for prediction," says Justin Wolfers, a markets expert at the University of Pennsylvania's Wharton School. "I can bet on the World Series or the next presidential election."

The driving force behind prediction markets is something called information aggregation. Traditionally, it has been the realm of professionals such as pollsters or weather forecasters or the CIA. Those experts tend to be knowledgeable but are prone to certain limitations: personal bias, groupthink, clashing personalities. "In companies, not only are people afraid to get an answer, they are afraid of asking the question," says Emile Servan-Schreiber, CEO of NewsFutures Inc., which sells markets programs to corporations. So a market can benefit from outsiders' views that are reflected, in real time, in the form of prices. The dirty secret is that markets are often as good as the experts at making predictions. The next time the Federal Reserve meets to set interest rates, Wolfers says, Chairman Alan Greenspan might be better served by having the

governors bet on what interest rates should be rather than go through their traditional number crunching.

The markets get into controversial ground when it comes to security and terrorism. When the Defense Advanced Research Projects Agency of the Defense Department developed such a market in July 2003, called FutureMAP, as part of an even more controversial program once called Total Information Awareness, it was equated with "betting on terrorism." Congressional outrage squelched the project, but the fact is,



## INDIVIDUALS WILL ULTIMATELY BE ABLE TO USE MARKETS TO HEDGE EVERYTHING

betting on terrorism actually makes sense. Consider the investigation just launched in Washington over an apparent leak at the Department of Homeland Security in which insiders seem to have tipped off relatives about an alleged threat to the New York City subway system. Outrageous behavior? Perhaps. But get those "insider traders" into a market, and

everyone will have access to that information. Insiders have a motivation--money, at the basest level--to distribute their knowledge.

Markets are hard to beat and even harder to manipulate. On Dec. 11, 2003, InTrade's contract on Saddam Hussein's capture suddenly began to move. "We noticed that that contract started trading from 9 to 30 for no reason," says Mike Knesevitch, communications director. "Something was happening." In fact, someone may well have been trading on inside information. Two days later, Saddam was in custody.

In the near future, prediction and decision markets are likely to extend their reach. At the University of Iowa, which created the Iowa Electronic Markets, researchers are developing a prediction market designed to forecast flu outbreaks, and their counterparts at the University of Miami have organized the Hurricane Futures Market, where you can place bets on where the spit will hit the fan. Corporations so far have tended to focus on relatively low-value projects like predicting the next quarter's sales. Google, for example, has been conducting an internal market to predict project-completion and product-launch dates. But given the market system's track record, corporations are about to move to bet-the-ranch-type decisions. "We're about to have a Cambrian explosion of the technology," says Servan-Schreiber.

For individuals, markets are beginning to offer potentially useful opportunities to hedge risk in their lives. Do you think the real estate market is going to crash and take your house with it? HedgeStreet.com lets you take a position on the median home price in a number of large cities by matching your bet in a "hedgelet" against someone with the opposite opinion. Similarly, you can hedge the price of gasoline, mortgage rates or inflation rates. Wolfers believes that individuals will ultimately be able to use markets to hedge everything, even their own employability.

For government policymakers, the potential of markets to support decision making is "humongous," says Bob Hahn, director of the AEI-Brookings Joint Center for Regulatory Studies. Will cutting taxes raise the GDP? Congress can debate it. But if you establish a market for the question, the answer will likely be superior to whatever one Congress arrives at. You can bet on it. ■