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**POLITICAL EXCHANGE**

By JUSTIN WOLFERS

**Sharp Shifts Raise Kaine***August 1, 2008*

The vice-presidential shortlists are getting a lot shorter -- and, on the Democratic side, prediction-market traders are moving sharply towards a new favorite. Virginia Governor Tim Kaine, who rated only one-in-ten odds a week ago, is now given a [one-in-three chance](#)<sup>1</sup> of winning the number two slot.

Even though [Democratic operatives have floated a shortlist](#)<sup>2</sup> with seven possible picks (Senators Biden, Bayh, Dodd, Clinton and Reed, plus Governors Kaine and Sebelius), prediction markets suggest there are really only four serious candidates. Beyond Mr. Kaine, Mr. Bayh is the second favorite with a [one-in-four chance](#)<sup>3</sup>, followed by Ms. Sebelius with a [one-in-six chance](#)<sup>4</sup>, and Mr. Biden with a [one-in-eight chance](#)<sup>5</sup>. Neither of the other three candidates listed above surpasses 5%.

Throughout the campaign, the VP prediction markets have responded quickly to both rumors and joint appearances with Sen. Barack Obama. Yet even relative to these continually shifting odds, the surge in Mr. Kaine's chances is quite remarkable, showing the most significant movement in this market to date. (You can track these ongoing changes at the Wall Street Journal's [own fantasy market](#)<sup>6</sup>.)


Opinion is also coalescing around the most likely nominees on the Republican side, where the two clear picks are either Minnesota Governor [Tim Pawlenty](#)<sup>7</sup>, or former Massachusetts Governor [Mitt Romney](#)<sup>8</sup>. Each man is rated around a one-in-three chance to win the nomination. This has been a particularly good week for Mr. Pawlenty, whose [chances have improved markedly](#)<sup>9</sup>.

It has proven much harder to get a useful reading on the alternative Republican candidates, simply because there has been much less trade on who the VP nominee will be. With that caveat in mind, it is worth noting that prediction market traders believe [Tom Ridge](#)<sup>10</sup>, the former Secretary of Homeland Security, and Alaska governor [Sarah Palin](#)<sup>11</sup> to be the next most likely contenders.

After this comes a long list of much-touted "possibles," including Rep. [Rob Portman](#)<sup>12</sup> from Ohio, Sen. [John Thune](#)<sup>13</sup> of South Dakota, and Florida Governor [Charlie Crist](#)<sup>14</sup>. Interestingly, two more of Sen. John McCain's defeated primary foes, [Rudy Giuliani](#)<sup>15</sup> and [Mike Huckabee](#)<sup>16</sup>, are also rated as serious possibilities.

Then there are the wild card candidates, including Democratic Sen. [Joe Lieberman](#)<sup>17</sup>, Louisiana Governor [Bobby Jindal](#)<sup>18</sup> or former H-P CEO [Carly Fiorina](#)<sup>19</sup>, each of whom have been the focus of a lot of

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discussion. While these candidates would change the narrative of the race, none of them is given even one-in-20 odds of becoming the vice-presidential nominee.

While I believe that these market-based estimates are better indicators than the narrative speculation that dominates press discussion, it is still worth issuing a note of caution. The race for VP differs from other political races, because the truly relevant information -- who really is on which shortlist and who the respective nominees favor -- is so heavily invested in a handful of people.

This can change the role played by the market. This column has often characterized prediction markets as aggregating widely dispersed local information. Instead, the VP markets are likely parsing publicly-available information, and pundits may be equally as adept at this task.

If there is the possibility that political insiders are betting, this further complicates things, as no trader wants to be on the losing end of a bet with a true insider. This anxiety, in turn, makes traders particularly sensitive to any new activity, as the fear of being beaten by an insider can lead informed speculation to be mistaken for inside information. In such an atmosphere, prices can move sharply even when only small amounts are bet.

Finally, it is worth recalling the historical tendency for campaigns to announce surprising vice-presidential candidates, such as George W. Bush choosing the head of his search team, Dick Cheney, as his nominee, or his father's selection of Dan Quayle. While John Edwards was a fairly predictable Democratic pick in 2004, Joe Lieberman was a surprise in 2000.

Compare this history of surprises with the fact that markets believe that they have narrowed the Democratic and Republican shortlists to four candidates --and, in each case, there is greater than an 80% chance that this shortlist contains the eventual nominee. Given the psychological evidence that traders are often overconfident, I think there is good reason to take these quantitative assessments with a grain of salt.

While it is likely that prediction markets have isolated the most likely VP candidates, don't discount the chances of "none of the above."

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