



ANALYSIS-Going long on the Republicans so far a losing bet

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NEW YORK, Oct 27 (Reuters) - Whatever your view of political pundits, polls and prognosticators, there's no arguing that a bet on the Republicans in the U.S. Congressional elections next month has so far been a losing wager.

The price of a contract predicting the GOP retains a majority in the U.S. House of Representatives has lost 60 percent of its value over the past year, according to Tradesports.com.

The Irish company runs an online venue for laying bets on the outcome of events ranging from football games to the "Dancing with the Stars" television show.

A bet that Republicans will keep the U.S. Senate has done marginally better since last October, but that contract trades more than 17 percent off its high early this year, and the price has swung wildly over the past few weeks.

Exactly what odds does this "prediction exchange" give the Republicans in the Nov. 7 mid-term congressional contest? A 36 percent chance of keeping the House, but a 74 percent likelihood of holding their Senate majority.

A quagmire in Iraq, slowing U.S. economic growth, falling house prices, and a spate of political scandals have all dogged the Republicans fortunes and driven down the price of election contracts predicting GOP success.

Once viewed as little more than a sideshow, the contracts now have an impressive track record for predicting outcomes accurately and a growing number of observers have been turning to these quasi-financial markets, rather than traditional opinion polls, to gauge how the vote will swing.

"Without a doubt they are a better guide than the polls," says Jim Bianco, president of the financial market research firm Bianco Research in Chicago, Illinois.

"That's because the people trading these markets are there for one reason and one reason only: to make money, not to make political statements."

AN OLD GAME

Betting on election results is nothing new. Between 1868 and 1940 traders used to leave their offices and jostle on the curb of the New York Stock Exchange to bet on presidential elections. Betting odds were quoted in the New York Times.

In recent years election betting has enjoyed a resurgence, largely through the listing of elections contracts on platforms such as tradesports.com and intrade.com, also based in Ireland, as well as the Iowa Electronic Markets in the United States, an online prediction market set up by the University of Iowa.

"We get everyone from financial market types to political scientists betting on the elections," says John Delaney, chief executive officer of Tradesports.com.

The outcome of elections is no trivial matter for financial markets. According to one study of U.S. presidential elections since 1880 for the U.S. National Bureau of Economic Research, Republican administrations have tended to raise stock prices by 2 to 3 percent. They also tend to boost bond yields.

For this reason investors closely watch the polls. But traditional opinion polls are prone to error if the small sample of voters is not representative. On top of that, breaking political scandals and other news can make these snapshot views obsolete within hours.

By contrast the price of election contracts, traded around the clock, reflects traders' best assessment of the odds given all the information already in the market.

"The traders out there are already following the polls quite avidly, and the real power of these markets comes from aggregating all these different judgement calls out there," says Eric Zitzewitz, a researcher at Stanford University.

FAST MONEY FOLLOWS THE NEWS

In the 2004 U.S. presidential election the price of a security paying \$10 if George W. Bush was re-elected tumbled to \$3 from \$5.50 early on election day after exit polls predicted a victory by Democratic challenger John Kerry. The price then rebounded to \$9.50 later in the day as it became clear those early exit polls had missed the mark.

If history is any guide, trading volumes are likely to swell in the leadup to the midterm elections, and spike on Nov. 7, election day, said Delaney. Tradesports saw some \$15 million trade in its main election contract in the 2004 U.S. presidential election, with \$3 million on election day.

Traders can place bets of up to \$1 million and check the odds of all the Senate races at the click of a button.

Trading volumes in political betting markets are still dwarfed by their activity in the pre-war era, when wagering on U.S. presidential elections sometimes even exceeded turnover in stocks and bonds, historians say.

The volume of betting on elections in the U.S. dried up after 1940 as regulations limiting betting on horse races were freed up, and newspapers and research companies came up with their own political opinion polls.

But the advent of online betting markets may herald a return to the golden days of election punting. Online betting platforms could even become a hedging tool for investors looking to insure their portfolios against political risk.

"The liquidity of these markets right now looks like its enough for these markets to be darn good at prediction," says Justin **Wolfers**, an assistant professor at the University of Pennsylvania's Wharton school who has done extensive research in prediction markets. "It's not enough yet to offset risks through hedging, but that's the next step."

"We've already got a history that these markets can grow to be humungously large," says Bianco. "I can only imagine that trading on the presidential election in two years time is going to be many times larger."

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