

Market Forces Drive Political Horses

Once upon a time scientists were members of the gentry who chose a life not based on either wretched excess or vapid indolence. Both Isaac Newton and Thomas Jefferson fit this mold. While both men, Jefferson in particular, had a strong practical streak, both were satisfied with the pursuit of knowledge for knowledge's sake alone.

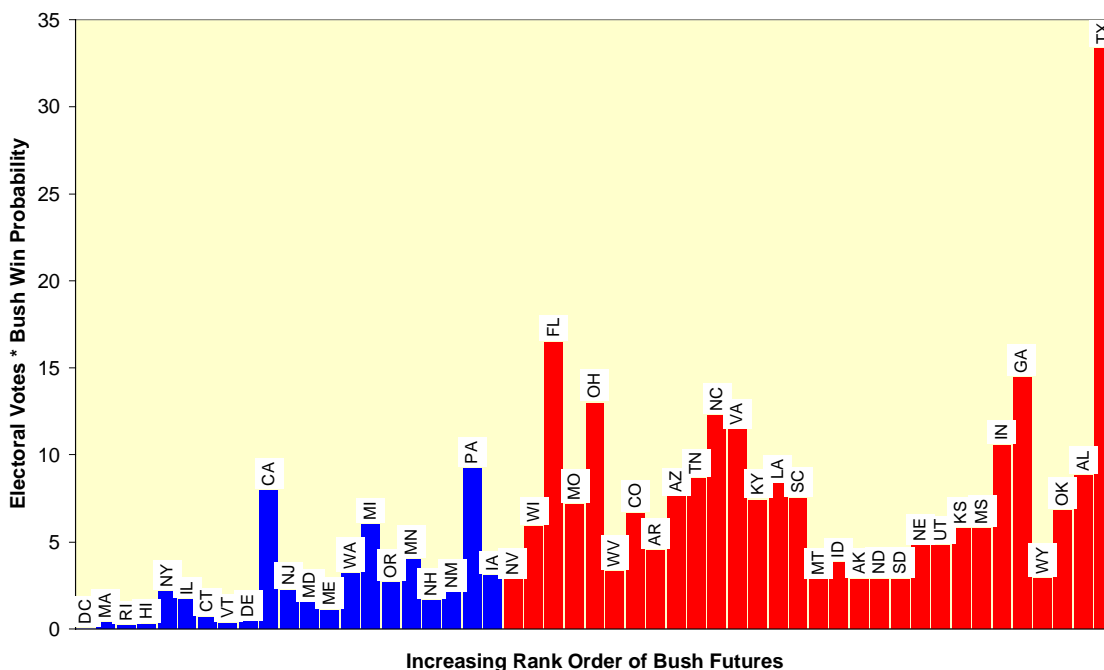
It may surprise you to learn many political pollsters think similarly. For every cynic and spinmeister, there are those whose true enjoyment derives not from producing an answer from each focus group but from the insights into human nature derived therefrom. It is a shame the profession as a whole has gained a reputation for amoral expedience, especially now that they are being called upon to divine what appears to be, once again, a particularly tight presidential race.

Sports Of All Sorts

Quoth the market: "Bunk!" Once upon a different time, opinion polls were all we had to assess various sentiments. We now have organized electronic futures markets such as Tradesports.com wherein the only participants are the willing. The opinions expressed are backed by an actual bet, which as all traders and investors recognize, helps focus the mind. Before we continue, please be aware of my deeply held opinion that markets are not forecasting mechanisms but rather measuring devices; we cannot pool our ignorance and somehow achieve wisdom about the future.

The Tradesports.com site allows participants to bet not only on the aggregate outcome of the election, and on various over/under electoral vote totals, but also on the outcome in each state and the District of Columbia. If we take the most recent bid-ask spread on each electoral unit (and this is assuming that Colorado will continue to vote as a winner-take-all rather than as a set of Congressional districts this fall) we arrive at a probability-adjusted bid-ask range of 278-292 electoral votes for George Bush's re-election.

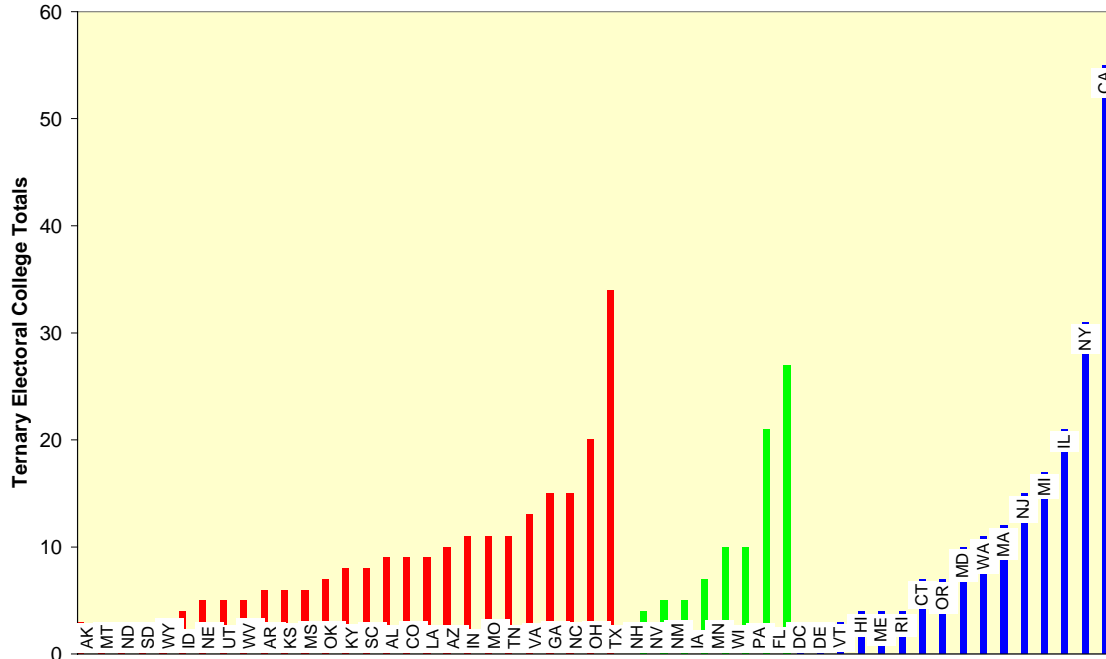
Bush Gains The Ayes of Texas



Of course, we do not have a system where votes are counted by probability, depth of feeling or any other measure than a binary yes or no. As we learned in Florida in 2000, close does not count. So let's eliminate the close votes and assign a winner-take-all, above caveat about Colorado still applying, to the Tradesport.com vote assessment. And, this being a financial Website, let's define close as anything inside the Fibonacci retracement levels of 38.2% - 61.8%. Anything under a 38.2% level will be considered a "safe" state for Kerry and anything over 61.8% a "safe"

state for Bush. At these breakpoints, the Electoral College totals are 242 for Bush, 207 for Kerry and 89 undecided. The undecided states and their electoral votes, depicted in green below, are New Hampshire (4), Nevada (5), New Mexico (5), Iowa (7), Minnesota (10), Wisconsin (10), Pennsylvania (21) and Florida (27). States such as Missouri and Ohio, often mentioned as battlegrounds, both measure as easy Bush victories according to Tradesports.com.

Deciding On The Undecided



Market Movers

We Americans are simple people to please: Just give us cheap oil and bulging portfolios and you can have your way with us. How can I make such a crass statement? By looking at the facts: If we overlay the history of the Tradesports.com Bush re-election futures onto those of the S&P 500 and the cash price of West Texas Intermediate crude oil, we cannot avoid noticing the correlation.

The President's re-election futures peaked in the Tradesports.com market on January 9, 2004 with a value of 74.8%. The S&P 500 kept moving higher into early March, which coincidentally was the climax of the political primary season; it also was the start of a string of negative news coming from Iraq. The two markets have paralleled each other - no causality is attributed - ever since. The correlation between closing values of the S&P 500 and Bush re-election futures since January 2004 has been 64.18%.

The Index Fund On Pennsylvania Avenue



The connection between presidential fortunes and crude oil exceeds that of stocks. Here the relationship has been inverse with higher crude oil prices eroding Bush's re-election odds and vice-versa. Since January, the correlation has been a very strong -81.54%.

A Crude Look At The Big Picture



For those of you still devoted to the transitive property of equality and all it stands for, yes, the S&P and crude oil have been correlated negatively over this period at -77.55%.

Taxation Without Representation

We Americans have an odd relationship with taxation. On one level, it was the British attempt to enforce stamp taxes in the mid-eighteenth century that led to our Revolution. On another level, our system of more-or-less voluntary compliance with the tax collector is the marvel of other countries who had to go to value-added taxes in the hope of ever collecting anything.

The second part of this column, which will appear next week, will deal with the municipal bond market and its spread to Treasuries as a barometer of political fortunes. The top marginal tax rate on high-income individuals is one of the few distinct differences between Bush and Kerry this election season, so it would stand to reason that municipal bonds would be more attractive relative to Treasuries when Kerry's prospects are rising.