



THE WISDOM AND MADNESS OF CROWDS: POLITICAL MARKETS AS A CASE STUDY

Beyond polling...

Not a political post...

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- The focus of this blog has always been on markets and companies, more micro than macro, and I am sure that you will find my spouting off about my political views off-putting, much as I do, when celebrities and sports stars tell me their voting plans.
- This post, though, does have a political angle, with a market twist. During the just-concluded presidential election, we saw election markets (about almost every aspect of the election) not only open up but insert themselves into the political discourse.
- I would like to use this post to expand the discussion to cover what markets do well, what they do badly and the consequences, i.e., revisit an age-old divide between those who believe in the wisdom of crowds and and those that point to their madness.

Election Forecasts: History

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- As in the movie “Conclave”, I am sure that the actual conclaves that have characterized papal succession for centuries have used informal polling as a way of forecasting who will win election for centuries.
- In fact, going back in time to the very first democracies in [Greek](#) and [Roman](#) times, where notwithstanding the restrictions on who could vote, there were attempts to assess election winners and losers, ahead of the event.
- The first reported example of formal polling occurred ahead of the 1824 presidential election, when the Raleigh Star and North Carolina Gazette polled 504 votes to determine that Andrew Jackson would beat John Quincy Adams.
 - Starting in 1916, The Literary Digest started a political survey, asking its readers, and after correctly predicting the next four elections, failed badly in 1936 (predicting that Alf Landon would beat FDR in the election that year).
 - In 1948, polling had one of its early dark moments, when predictions that Thomas Dewey would beat Harry Truman were upended on Election Day, leading to one of the most famous headlines of all time (in the Chicago Tribune).
- In the decades after, polling did learn valuable lessons about sampling bias and with an assist from technological advancements, and the number of pollsters has proliferated.

Poll Aggregators

2024 National: Trump vs. Harris

Multi-Candidate Polls | Trump vs. Biden Polls | Presidential Betting Odds

Battleground States: Arizona | Nevada | Wisconsin | Michigan | Pennsylvania | North Carolina | Georgia | RCP Electoral Map

This Day In History - 1 Day to Election: 2020: Biden +6.9 | 2016: Clinton +3.2

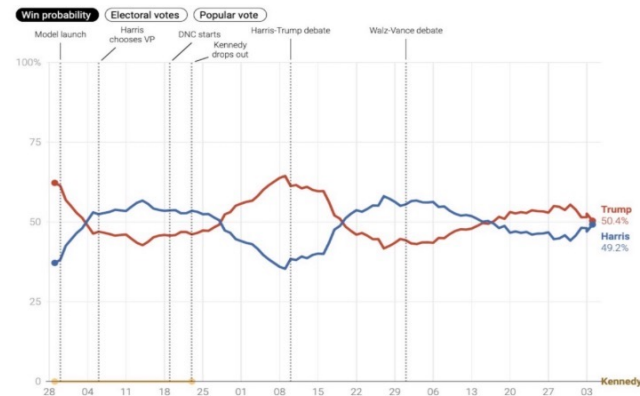
POLLSTER	DATE	SAMPLE	MOE	TRUMP (R)	HARRIS (D)	SPREAD
RCP Average	10/10 - 11/4	—	—	48.5	48.5	Tie
Atlas Intel	11/3 - 11/4	2703 LV	2.0	50	49	Trump +1
TIPP	11/1 - 11/3	1411 LV	2.7	48	48	Tie
New York Post	10/31 - 11/3	886 LV	3.0	49	49	Tie
NPR/PBS/Marist	10/31 - 11/2	1297 LV	3.5	47	51	Harris +4
NBC News	10/30 - 11/2	1000 RV	3.0	49	49	Tie
Emerson	10/30 - 11/2	1000 LV	3.0	49	49	Tie
Forbes/HarrisX	10/30 - 11/2	3759 LV	1.6	49	51	Harris +2
Yahoo News	10/29 - 10/31	1074 LV	—	48	49	Harris +1
Morning Consult	10/29 - 10/31	8919 LV	1.0	47	49	Harris +2
Reuters/Ipsos	10/25 - 10/27	LV	—	46	47	Harris +1
Rasmussen Reports	10/10 - 10/29	12546 LV	2.0	49	46	Trump +3
CBS News	10/23 - 10/25	2161 LV	2.6	49	50	Harris +1
NY Times/Siena	10/20 - 10/23	2516 LV	2.2	48	48	Tie
Wall Street Journal	10/19 - 10/22	1500 RV	2.5	49	46	Trump +3
CNBC	10/15 - 10/19	1000 RV	3.1	48	46	Trump +2
USA Today/Suffolk	10/14 - 10/18	1000 LV	3.1	49	50	Harris +1
FOX News	10/11 - 10/14	870 LV	3.0	50	48	Trump +2

Poll Judgments

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How each candidate's chance of winning has changed

We update our forecast often. Click the buttons to see the ways each candidate's outlook has changed over time



Nate Silver's forecast for 2024 Presidential Election

Who Is Favored To Win The 2024 Presidential Election?

538 uses polling, economic and demographic data to explore likely election outcomes.

Trump wins 52 times out of 100
in our simulations of the 2024 presidential election.
Harris wins 48 times out of 100.

There is a less than 1-in-100 chance of no Electoral College winner.



538's forecast for 2024 Presidential Election

Polymarket: Political Market

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Kalshi: An alternative...

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Kalshi



Election

Markets ▾

Ideas

API



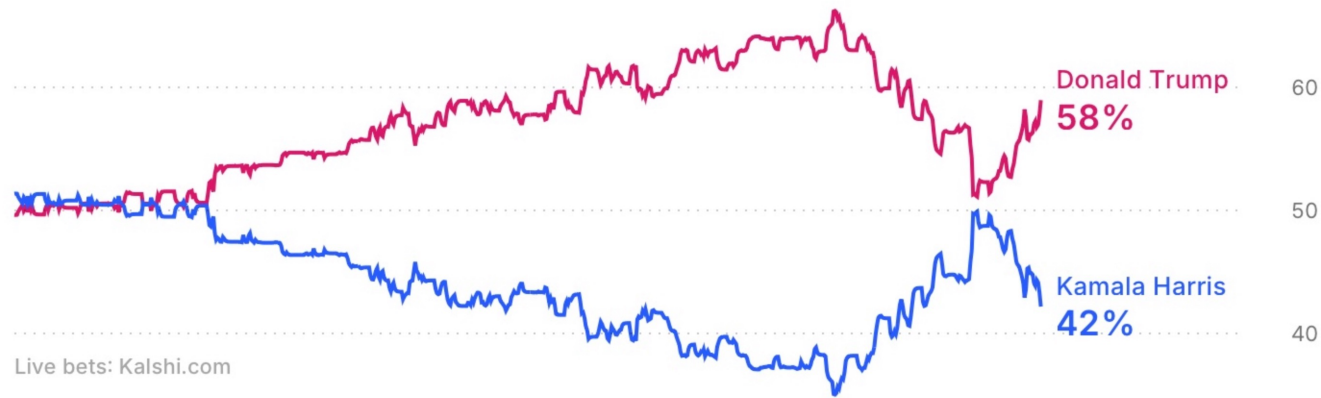
Search markets or people



Who will win the Presidential Election?



Kalshi



Live bets: [Kalshi.com](https://kalshi.com)

Oct 4

Oct 20

Nov 4

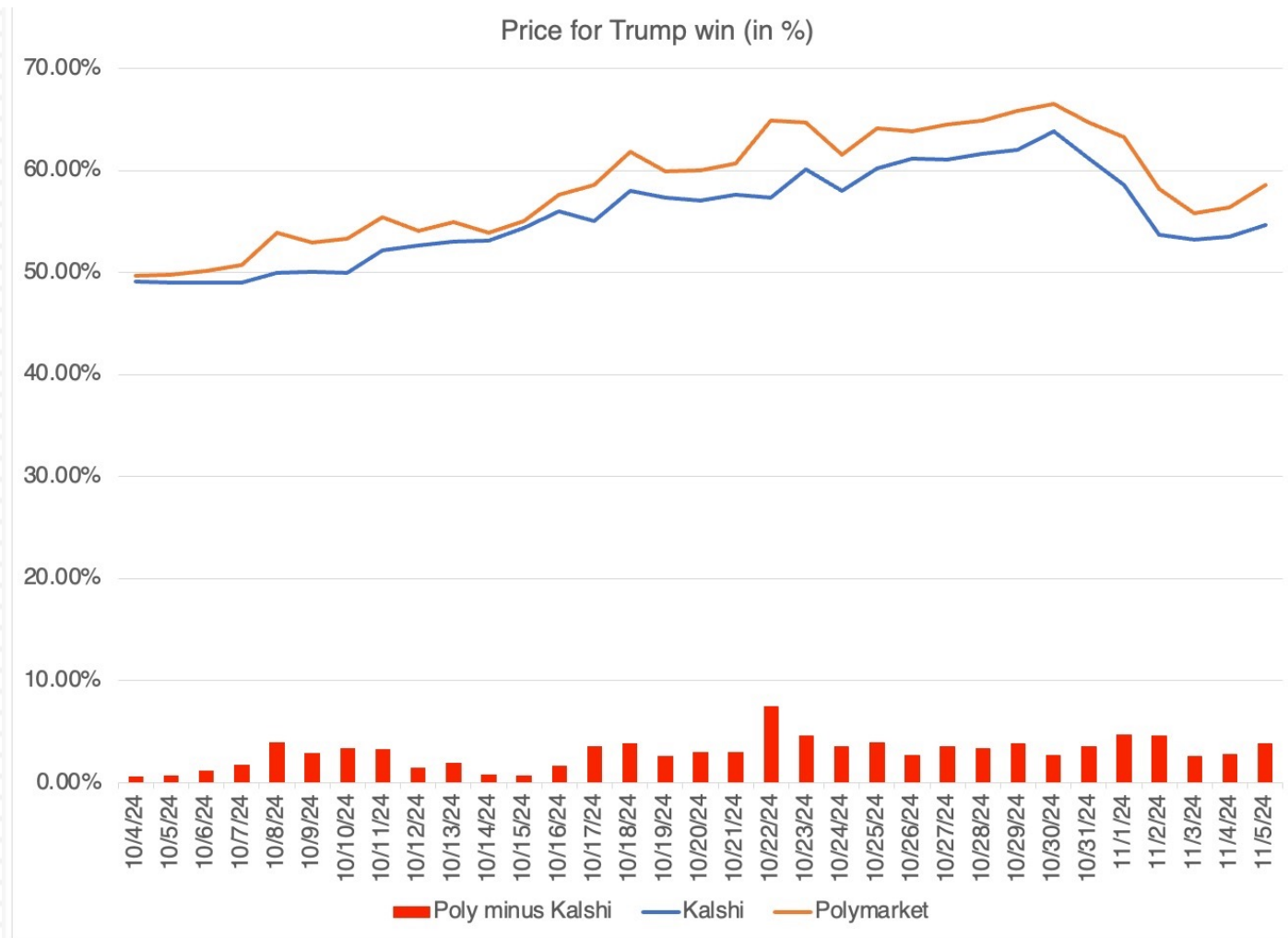
1W

1M

All

Poly vs Kalshi

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Vindication?

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- At least on this election, the answer is yes, since unlike most of the pollster and poll aggregators, the political markets led into Election Day, expecting a decisive victory for Trump in the electoral college.
- However, political markets did not expect Trump to win the popular vote, which he did, and that can be taken as evidence that markets are surprised sometimes, as well.
- In the weeks leading into the election, there were two dimensions on which political markets varied from the polls and aggregators.
 - On the plus side, the political markets were more dynamic, reflecting in real time, responses to events like the debates, interviews and endorsements; Polymarket's odds of a Trump win dropped by almost 10% after the debate.
 - On the minus side, political markets were volatile, with swings driven sometimes by large trades; the Wall Street Journal highlight one trader who put almost \$30 million into the market on the Trump win, pushing up the price.

The Wisdom of Crowds

- In an earlier part of this post, I talked about going to the movies, and it is indicative of the times we live in that my movie choice was made, not by reading movie reviews on the newspaper, but by [movie ratings on Rotten Tomatoes](#)
- . Once the movie was done, the restaurant choice I made was determined by Yelp reviews, and without boring you further, you can see this pattern unfold as you think about how you choose the products you buy on Amazon or even the services (plumbing, electrical, landscaping) that you go with, as a consumer.
- On a less personal and larger scale, I have described the block chains that underlie Bitcoin transactions as crowd sourcing the checking process (performed by fiats and banks, with conventional currency), and you can argue that trusting social media to deliver you information is essentially crowd-sourcing your news.

Markets: Crowds, with restricted entry...

- With all of these examples, you can see one of the dangers of crowd judgments, and that is that in all the crowds described above (Rotten Tomatoes, Yelp, Amazon product reviews and social media), there is no cost to entry, or to offer an opinion, and that can dilute the power of the judgments.
- With markets, we introduce an entry fee to those who want to join the crowd in the form of price, and demand more to amplify those views. In the words of Nassim Taleb, opinionated people with no skin in the game can make outlandish predictions, often with no accountability.
- No matter what you think about the experience or motivations of traders on a market, they have to put money behind their views, and more money, if they want the views to have more weight.

Three reasons why markets are wise...

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1. Information aggregation: One of the magical aspects of well-functioning markets is how pieces of information possessed by individual traders about whatever is being traded get aggregated, delivering a composite price that is effectively a reflection of all of the information.
2. Real time adjustments to news: While experts (rightfully) take their time to absorb new information and reflect that information in their assessments, markets do not have the luxury of waiting. Consequently, markets react in real time, often in the moment, to events as they unfold. That allows market prices to always be more updated than any expert forecast or assessment.
3. Law of large numbers: It is true that individual traders in a markets can not only mistakes, often big ones, in their assessments of value, but can sometimes also let their preconceptions and biases drive their trading. To the extent that the mistakes can lie on both sides, they will average out, allowing the "right" price to emerge from several wrong judgments.

Fox versus Hedgehog!

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- Phil Tetlock, co-author of the [book on super forecasting](#), chronicles the dismal record of expert forecasts, and argues that the best forecasts come from foxes (knows many things, but not in depth) and not hedgehogs (with deep expertise in the discipline).
- In short, his argument is that the deep knowledge that experts have in their subject matter skews their thinking and traps them into forecasts that do not reflect reality.

The Madness of Crowds

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- It is worth remembering that well before we had any of these resources existed , we had financial markets, and in those markets, prices are crowd judgments on the value of the traded instruments.
- Our experience in financial markets is that while markets allow for information aggregation and consensus judgments that are almost magical in their promptness and power, they are also capable of making mistakes, sometimes monumental ones.
- One of my favorite books remains [*Extraordinary Popular Delusions and the Madness of Markets*](#), published in 1841, and chronicling how market mistakes form and grow, using the South Sea Bubble and the Tulip Bulb Craze as illustrative examples.
- To those who believe that markets have somehow evolved since then to avoid these mistakes, behavioral finance provides the counter, which is that markets reflect behavioral quirks that are part of the human make-up, and thus always be part of markets.

And what creates the madness...

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1. Noise drowns out information: While noise exists in even the best-functioning markets, there is enough information in those markets to offset the noise effect, and bring prices back into sync with value. However, if noise is the dominant force in a market, it can drown out information, causing prices to delink from information.
2. Momentum versus Fundamentals: On a related note, it is worth remembering that the strongest force in markets is momentum, where price movements in a period are driven more by price movements in past periods, than by fundamentals.
3. Participant bias: While markets require skin in the game from traders, that requires money, and that biases markets against people with little or no money.
4. Market Manipulation: The history of financial markets also includes clear cases where markets have been manipulated, to deliver profits to the manipulators. That problem becomes worse in markets with limited liquidity, where big trades can move prices, and where market insiders have access to data that outsiders do not.
5. Feedback loop: There are times where market prices can affect the fundamentals, and through them, the value of what is being traded. With the political markets, this feedback loop manifested itself in my social media feeds, where I often saw the Polymarket or Kashi charts being used by candidates to convince potential voters that they were winning (to get them to jump on the bandwagon) or losing (to get people to give them money).

To “crowd” or “not to crowd”

- I am convinced that in making our choices as consumers and citizens, we will be facing the choice between market-based assessments and expert assessment on more and more dimension. As we face these choices, there will be two camps about whether market prices should be trusted. One, rooted in the wisdom of markets, will push us to accept more crowd-sourcing and crowd-judgments, and the other, building on market madness, will point to all the things that markets can get wrong.
- While I do believe that, in balance, the wisdom will offset the madness in most markets, there are places where I will stay wary, as a user of market prices. If you are planning to trade on these markets
- There is another use for these political market securities that you may want to consider. To the extent that you feel emotionally invested in one candidate winning, and you don't have much faith in your probability assessments, you may want to consider buying shares in the other candidate.