

Markets and Models

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Why predict elections?

- ▶ Resource allocation
- ▶ Strategy adjustment
- ▶ Quantitative journalism
- ▶ Uncertainty is scary

How to Predict Elections

1. Opinion Polls
2. Poll Aggregation
3. Forecast Models
4. Prediction Markets

Onion Polling

Ex: *Washington Post/ABC*

- ▶ Simple random sampling
- ▶ Response rates
- ▶ Sample size
- ▶ Statistical bias
- ▶ Partisanship

In 1824, *The Harrisburg Pennsylvanian* had Jackson over Adams, 335 to 169.

Literary Digest starting polling nationally in 1916. Infamously “sampled” 2.3 million readers in 1936 and bias caused them to predict Landon over over Roosevelt.

Polling Aggregation

Ex: *RealClearPolitics.com*

- ▶ 21st century invention
- ▶ Average out all polls
- ▶ Law of large numbers
- ▶ Minimize errors and reduce bias

Forecasting Models

(Forecasting models) take lots of polls, perform various types of adjustments to them, and then blend them with other kinds of empirically useful indicators. . . to forecast each race. Then they account for the uncertainty in the forecast and simulate the election thousands of times.

Forecasting Models

Most election models (including [FiveThirtyEight's]) work in something like the following way: First, they calculate the most likely outcome in a particular state ("The Republican wins by 1 point") and then they determine the degree of uncertainty around that estimate. Most models do this by means of a normal distribution or something similar to it.

Historic indicators of *greater* uncertainty:

1. The election is further away in time
2. There are fewer polls
3. Those polls disagree more with one another
4. The polling average disagrees more with the state fundamentals
5. There are more undecideds or third-party voters in the polls
6. The race is more lopsided

Model Inputs

1. **Polling:** District level polling. FiveThirtyEight rates pollsters to adjust their findings. Further adjusted for recency and other factors.
2. **CANTOR:** A proprietary k-nearest neighbors algorithm to identify similar congressional districts to infer results for polling-sparse districts.
3. **Fundamentals:** Non-polling factors that historically help in predicting congressional races:
 - ▶ Incumbency
 - ▶ Partisanship
 - ▶ Previous margin
 - ▶ Generic ballot
 - ▶ Fundraising
 - ▶ Scandals
4. **Expert forecasts:** Ratings published by the historically accurate experts.

Model Outputs

Table 1: 10 of 299,760 observations with 7 of 12 variables

Date	State	District	Party	Incumbent	Prob	Share
2018-08-01	AK	1	R	TRUE	0.72	49.35
2018-08-01	AK	1	D	FALSE	0.28	44.11
2018-08-01	AL	1	R	TRUE	1.00	64.90
2018-08-01	AL	1	D	FALSE	0.00	35.10
2018-08-01	AL	2	R	TRUE	0.97	58.23
2018-08-01	AL	2	D	FALSE	0.03	41.77
2018-08-01	AL	3	R	TRUE	1.00	62.27
2018-08-01	AL	3	D	FALSE	0.00	37.73
2018-08-01	AL	4	R	TRUE	1.00	76.32
2018-08-01	AL	4	D	FALSE	0.00	23.68

Prediction Markets

- ▶ Exchange-traded binary options markets
- ▶ Contract price reflects probability
- ▶ Crowd-sourcing information
- ▶ Efficient market hypothesis
- ▶ Price discovery through equilibrium
- ▶ Risk aversion overcomes bias
- ▶ Dubious legality in the United States

In 1503, traders bet on Papal successor.

Iowa Election Market founded in 1988.

PredictIt

PredictIt is a unique and exciting real money site that tests your knowledge of political events by letting you trade shares on everything from the outcome of an election to a Supreme Court decision to major world events. . . PredictIt is run by Victoria University of Wellington, New Zealand, a not-for-profit university, for educational purposes

PredictIt Contracts

- ▶ Real money, \$850 limit imposed by CFTC
- ▶ Elections, Justice, Administration, World
- ▶ Futures contracts, executes at time or condition
- ▶ Two buyers on either side
- ▶ Execute for \$1 or \$0 based on outcome
- ▶ Traders can sell at any time, price change reflects information

PredictIt Markets

- ▶ Who will win the 2020 Democratic presidential nomination?
- ▶ Will Donald Trump be impeached in his first term?
- ▶ Will Congress ratify the USMCA by year-end 2019?
- ▶ Will Facebook's Mark Zuckerberg run for president in 2020?
- ▶ How many tweets will @realDonaldTrump post from noon Mar. 22 to noon Mar. 29?
- ▶ Will Theresa May be prime minister of the United Kingdom on 6/30?

Who will win the 2020 Democratic presidential nomination?






Contract	Latest Yes Price	Best Offer	Best Offer
 Joe Biden	22¢ 2¢↓	22¢	Buy Yes Buy No 79¢
 Bernie Sanders	21¢ NC	21¢	Buy Yes Buy No 80¢
 Kamala Harris	15¢ 1¢↓	16¢	Buy Yes Buy No 85¢
 Beto O'Rourke	14¢ NC	14¢	Buy Yes Buy No 87¢
 Pete Buttigieg	12¢ 2¢↓	13¢	Buy Yes Buy No 88¢
 Andrew Yang	10¢ 1¢↓	11¢	Buy Yes Buy No 90¢
 Elizabeth Warren	7¢ NC	7¢	Buy Yes Buy No 94¢
 Cory Booker	6¢ NC	6¢	Buy Yes Buy No 95¢
17 More Contracts ▼			

Figure 1: Democratic Primary Market

Predict Data

Table 2: 10 of 44,711 observations with 6 of 11 variables

Ticker	Date	Price	Volume
CRUZ.TXSENATE.2018	2017-03-31	0.70	1166
TNSEN18	2017-10-18	0.88	968
STAB.MISENATE.2018	2017-12-23	0.80	0
WARREN.MASENATE.2018	2018-03-10	0.91	3
MN03.2018	2018-04-22	0.26	9
SPEC.MSSEN.18	2018-05-13	0.80	0
NY19.2018	2018-05-31	0.45	0
SPEC.MSSEN.18	2018-07-01	0.88	50
BRAT.VA07.2018	2018-09-01	0.57	0
ISSA.CA49.2018	2018-10-26	0.01	558

Messy Data

Table 3: 9,200 observations of 4 variables

Date	Race	Market Price	Model Probability
2018-08-01	AZ-S1	0.66	0.738
2018-08-01	CA-10	0.58	0.705
2018-08-01	CA-12	0.91	1.000
2018-08-01	CA-22	0.30	0.049
2018-08-01	CA-25	0.61	0.745
2018-08-01	CA-39	0.61	0.377
2018-08-01	CA-48	0.72	0.666
2018-08-01	CA-49	0.98	0.795
2018-08-01	CA-49	0.77	0.795
2018-08-01	CA-S1	0.94	1.000