Peering into the Black Box: Trader Strategies in the Iowa Electronic Markets

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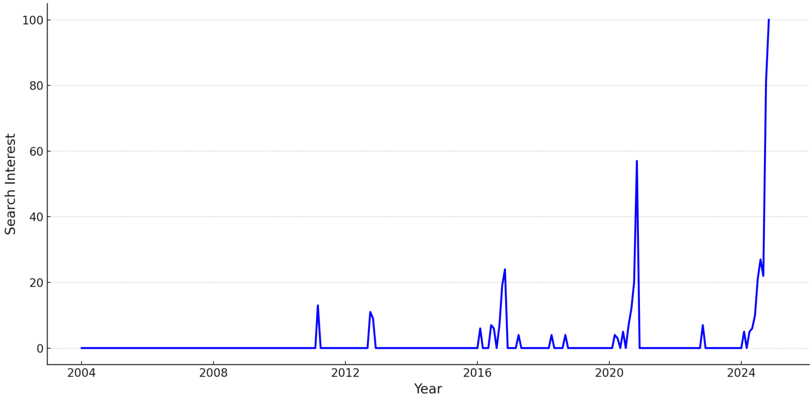
Google Search Volume for "Election Betting Markets"



Election-Betting Site Polymarket Says Trump Whale Identified as French Trader

- User hasn’t attempted to manipulate the market, probe shows
- Betting platform shows higher chance of Trump win than rivals

The French Whale

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Broader lessons?

Why Study Betting Markets?

To circumvent the joint hypothesis problem, in this paper, I analyze an alternative asset pricing laboratory—sports betting markets. The idea is simple. Two key features of sports betting markets provide a direct test of behavioral asset pricing that is distinct from, and not confounded by, any rational asset pricing framework: (i) ***sports bets are idiosyncratic and have no relation to risk premia*** *in the economy and (ii)* ***sports contracts reveal a terminal value that is (largely) independent from betting activity and preferences****, where uncertainty is resolved, which allows mispricing to be detected.*

– Moskowitz (2021)

What this paper does

- Iowa Electronic Markets (IEM)
  - bid, ask and transaction data
- Two contracts
  1. REP20_WTA – pays \$1 if R candidate wins popular vote
  2. DEM20_WTA – pays \$1 if D candidate wins popular vote
- Pricing
  - Contract price reflects probability of R/D winning popular vote
- Arbitrage
  - Can buy or sell “bundle” of contracts for \$1 from exchange
  - Sum of market prices $\neq \$1 \rightarrow$ arbitrage

What this paper does

Three sets of results:

- Suboptimal trading
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$\rightarrow$ consistent with limited attention

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- Classic behavioral biases
  - disposition effect
  - endowment effect
- Trading activity
  - more active traders do better

  $\rightarrow$ goes against Barber and Odean (2000)

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- **But** cost to traders is small
  - Total profits to (single) arbitrageur is \$186.52
- **Alternative interpretation:** traders are remarkably careful to transact at optimal or near-optimal prices

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  - Barber and Odean (2000) – households
  - This paper: households and (semi-?)professional traders

Partisan Beliefs

What differentiates politics and finance?

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Large deviations of reported beliefs from rational expectations

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Some questions

- How is political news priced into markets?
- How might political beliefs impede or amplify this transmission?
- To what extent are the findings within IEM generalizable?

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Result 16: *More transactions established long Trump positions that were held to liquidation than long Biden positions.*

Partisan Beliefs

- What political news generates trading activity?
  - Are there some events that apparently should generate trading activity, but do not?
  - Do some “price setters” only price set for Trump news and some only for Biden news?
  - Does good news for either candidate generate activity for buy-and-hold investors?
- Substantial activity from buy-and-hold investors vs. active traders at particular times?

Conclusion

- Interesting and timely paper!
- Already many interesting results
- My suggestion: use your setting to understand how partisanship affects the transmission of political news
  - Could be future work
- Good luck!

Small Comments

- Confused by language: seem to imply that you replicate the "false consensus" and "wishful thinking" results in the conclusion and introduction. I don't see these directly referenced in the text.
- Page 36: "to not trade" instead of "do not trade"
- Footnote seven: grammatical error.
- Page 19: side instead of size.
- Helpful to describe at the beginning of Section II exactly what you observe.