

Selling securities as a way to predict hurricane landfall

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If nothing else, University of Miami economics professor David Kelly's new project will give South Florida residents something to do as they while away the hours of yet another

seemingly endless hurricane watch.

Kelly, along with UM hurricane expert Dr. David Nolan and fellow UM economist Dr. David Letson, created a research project aptly titled MAYHEM, which creates a securities market to predict where hurricanes will make

landfall.

Kelly introduced the project at a May 24 "Preparing for Hurricane Season" media seminar at UM's Rosenstiel School of Marine and Atmospheric Science. "I'm an economist, what do I know about hurricanes?"

Absolutely nothing," Kelly said. "But securities markets are a way of collecting information, and researchers have created securities markets to predict everything from presidential elections to Nobel prize winners."

Kelly offered an example of how it works:

The National Hurricane Center spots Hurricane Dave — named in honor of the three academics behind MAYHEM, naturally — and the storm begins spiraling across the Atlantic. Kelly, Nolan and Letson set up an events mar-

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ket — basically a securities market geared to one specific event — on their website, www.bus.miami.edu/~dkelly.

They sell 12 securities, each one representing a different spot where the hurricane could make it's first hit — Miami-Dade County, the Florida Keys, North Carolina, Maine, etc. They also offer the possibility of the storm missing land altogether.

Then, it's up to the public — by now bored silly enough by constant media prognostication to try something new — to log on and start voting with the good old American dollar.

In Kelly's example, a meteorologist uses her scientific expertise to decide there's a 20 percent chance of landfall in Miami-Dade, so she pays up to 20 cents for a Miami-Dade security. In the Keys, a seasoned bar owner recalls past experiences and gives The Magic City a 50-50 shot of taking a direct hit. He pays up to 50 cents.

As they buy and sell, the bar owner realizes someone thinks his price for the Miami-Dade security is too high and lowers his prediction to a 30 percent chance of hitting the County, while the meteorologist holds steady at 20 percent.

If the meteorologist and bar owner keep trading — joined by thousands of others — Kelly's theory holds that the eventual securities prices will indicate where the hurricane will hit.

"With lots of traders, the price reflects all the information people have and how strongly people feel about the information," he explained. "At the end of the day,

everyone is going to settle on a certain probability of it landing in Miami-Dade."

The sheer number of participants can make up for the lack of expertise some traders have, Kelly said: "We have at least a fighting chance of doing as well as the scientific forecasts."

It has worked before, he noted.

A University of Iowa market accurately predicted George W. Bush would beat John Kerry in the 2004 presidential election. The system, in fact, consistently outperforms polling data.

Markets have also predicted Nobel Prize winners, and new programs ask everything from which flu strain will emerge to whether Michael Jackson will be acquitted of child molestation.

Kelly said the project is fun and practical, and answered several concerns it raised.

First off, he noted, UM and the professors involved will not profit off MAYHEM in any way. People who buy securities do stand to make money, Kelly said, but he doesn't see that as an unseemly example of profiting off other people's misfortune.

"I find that kind of puzzling, to be honest," he said. "Every time you buy stock in IBM, you basically hope someone at Dell becomes unemployed. Every time you buy oil futures, you hope people have to pay more for gas. Every time you buy securities, you're betting on someone's misfortune. We're trying to predict landfall, and that has a benefit to society."

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