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Ahead of the Tape

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November Surprises

Many Washington pundits see a Democratic takeover of the House of Representatives as a done deal. Wall Street is still waking up to it.

Polls show voters increasingly favor a changing of the guard in Congress. An election-prediction market run by the University of Iowa, in which investors bet on what party they see winning the Nov. 7 election, puts the chances of Republican's losing control of the House at 65%, up from 39% a month ago. The Iowa market puts the chances of Republicans losing the Senate at 30%, from 17% a month ago.

This matters for markets. A paper by Stanford economists Erick Snowberg and Eric Zitzewitz and Wharton economist Justin Wolfers found a connection between election odds as measured by these prediction markets and stock and bond market-price movements. They found that in the past investors have seen the election of a Republican president as good for stocks but bad for bonds. This time, the Dow Jones Industrial Average has been rising as the odds of victories in Congress by Democrats have increased. Prices of long-term bonds, meantime, have fallen since September after rising in the summer.

At an individual level, some politically sensitive stocks have moved. Shares of SLM Corporation, the student-loan provider known as Sallie Mae, have fallen 9% this month. Democrats want to cut the costs associated with student loans, which could squeeze Sallie. Meantime, shares of Fannie Mae and Freddie Mac, both unloved in some Republican circles, have risen. With Democrats in power, the two government-sponsored mortgage-finance companies would be safer from legislation aimed at reducing their portfolios.

Yet shares of many other politically sensitive companies haven't responded, says Andy Laperriere, an analyst at research firm ISI Group. Investors are thrilled by Wal-Mart's cost-cutting plan, which has pushed up its shares. But have investors considered that Wal-Mart is a target of labor unions, allies of potentially empowered Democrats? Nor have investors hit the shares of energy companies, which could be targets of "windfall" tax plans by Democrats.

Some November surprises, in other words, could still hit Wall Street.