

LEARNING FROM THE STOCK MARKET

By Mark E. Ripple

IN OUR QUEST FOR VALUE AT the racetrack, it may help if we understand a little bit about the stock market. Utilizing my background as a stockbroker, I will draw some parallels between the stock market and the pari-mutuel "market" or betting pool. When I am done, I hope that you will have gained some new insights on how to discover inefficiencies in the betting pool.

Most of us have heard the anecdote about the chimpanzee that outperformed some of Wall Street's top money managers by throwing darts at the stock pages of a newspaper. The point is to illustrate that at any given moment a stock's price is the best measure of its value and that all the efforts of analysts to discover undervalued stocks are useless. This is the basis for the Efficient Market Hypothesis (EMH).

The EMH explains that all available information that affects the price of a stock is known to, and continuously analyzed by, investors, and that this information is immediately evaluated. So, at any given moment, a stock is efficiently priced, which signifies that its price reflects all the facts, opinions and expectations that have an impact on its value. The EMH contends that undervalued stocks do not exist precisely because so many investors work so hard at discovering them.

The story about the chimpanzee is analogous to the unsophisticated bettor who selects horses based on the name, racing colors, number, etc. While we handicappers spend hours and hours pouring through past performances in order to predict the outcome of a race, it is not at all uncommon at the end of the day to find that this bettor has outperformed us at the track. Thus, we may conclude that our efforts to discover value are futile because at any given moment a horse's odds are efficient. Let's call this the Efficient Pool Hypothesis (EPH).

Using the EMH as a model, a summary of other essential points of the Efficient Pool Hypothesis would look like this:

- 1.) All information that affects the odds is known and continuously analyzed by large numbers of handicappers;
- 2.) All information is evaluated almost immediately;
- 3.) At any given moment a horse's odds are efficient, which means that they reflect all the facts, opinions and expectations that affect its probability of winning;
- 4.) Current odds reflect what is knowable; and
- 5.) There are no undiscovered values because handicappers work so hard at unearthing them.

There is one more common point that both the EMH and EPH must assume in order for them to be true. In order for stocks or horses to be efficiently priced, investors and handicappers alike must make their decisions in a rational manner, that is, they must consistently seek to minimize risk and maximize returns. Therefore, investors would not invest in high-risk stocks unless they offered larger returns than those considered to be less risky. Likewise, a handicapper would not bet on a high-odds horse unless he was convinced it was a solid overlay.

One flaw with these hypotheses is that there are times when the emotions of investors and handicappers alike goes awry and prices/odds become inefficient. Fear is our most primal emotion and can become a dominant influence on odds whenever handicappers abandon rational thinking in favor of crowd psychology.

Take, for example, the last race of the day. By the time it arrives, most bettors are in the red. In a last ditch attempt to break even, many players will discard rational thinking and take a flier on a longshot. The result is two-fold; the longshot will

almost assuredly become an underlay, while more solid horses like the favorite will become overlays. The rational handicapper will recognize that by wagering on one of these more solid horses he will be in a minimum risk/maximum return situation. Conditions for this situation are ideal when longshots have dominated the day's card. It is safe to assume that when this happens, the preponderance of handicappers will have been losing all afternoon. Thusly, they will be trying very hard to compensate for their losses in the last race.

Greed and euphoria are two other tremendous influences on both the stock market and betting pool. In a long and powerful market advance, such as the one we are in now, investors tend to abandon rational thinking because of the temptation of large and instant profits. Understanding this phenomenon will help us identify another type of situation that can offer some spectacular inefficiencies.

In the euphoria generated by a major race such as the Belmont Stakes, when one horse may have a chance at winning all three legs of the Triple Crown, many of the most stalwart professionals abandon rational thinking and join the frenzied betting on the sentimental favorite. We need look no further than Charismatic and Lemon Drop Kid in the 1999 Belmont to see that this is true. Walking around the grounds that day, the euphoria was literally right in front of my face. Thousands of people were adorned with Charismatic shirts and hats. I personally passed the race because my judgment had become clouded, and I was content with cheering for Charismatic. We all know what happened; the odds on Lemon Drop Kid were elevated to 29-1, and he won by a head over Vision and Verse.

Love her or hate her, Julie Krone is the most celebrated female jockey in the his-
(Continued on page 42)

EAST COAST UPDATE

(Continued from page 38)

and Tom Durkin becomes the voice of the Triple Crown.

Along with the last nine Belmont Stakes for NYRA, Durkin called his first Kentucky Derby last year — over the radio. “You don’t really have to build too much excitement into it,” began Durkin about his first Derby experience. “You don’t have to worry about superlatives. ‘So and so wins the Kentucky Derby’ is excitement enough.”

He is not bothered by the size of the Derby field, which routinely numbers 15 or more. “Having seen the horses run all spring, I already know what they look like before the race. The only problem with the big field is it can take so long to get through the field; it can throw off your timing.”

With the Triple Crown knocking on Tom Durkin’s door, so is his contract with NYRA.

“I’m working that out now,” he said in reference to a contract extension and revised work schedule. His current contract expires at the end of the year. Although nothing is ever absolute, there is little if any doubt on either side that Durkin’s tenure at NYRA is far from over.

Safe to assume that Tom Durkin’s reign as The Voice of Racing will not be ending anytime soon either. ♦

RACING THEN AND NOW

(Continued from page 47)

cause of the excessive weight.” Jockey Don Meade told me after the race that his mount (Doublrab) would have won, except for a loose bandage. Actually, the loose bandage caused Apache to take up sharply when Doublrab was eased. At any rate, Boussuet saved the day for Mr. Woodward’s Belair Stud.

One of the three winning trainers, Matt Brady, who saddled Wait A Bit for William Ziegler, displayed his \$26.60 check in the stable’s tack room, saying that in years to come nobody would believe the amount.

All stakes in New York at that time paid a trainers award in stakes that fluctuated between \$70.00 and \$80.00. The Belmont Stakes that year was won by Bounding Home (trained by Matt Brady) and was run just one week before the Carter. Brady did better on that occasion, receiving a check for \$70.00, a measly payoff when you consider the purse for the Belmont was \$55,000 to the winner. ♦



STOCK MARKET

(Continued from page 46)

tory of racing. In his August 25, 1993 New York Post column “Through the Binoculars,” John Swenson described, NYRA’s promotion of Julie as the “Kronization” of the sport. A fair amount of money was to be made during those years by rational handicappers who were aware that the simple presence of Krone in a race was enough to cause odds to become inefficient. While not as severe, the euphoria generated by the meet’s top jockey or trainer is usually enough to cause inefficiencies in the betting pool as well.

A third exception to the EPH lies with horses that show traditionally unfavorable data in their past performance lines. Take, for example, horses coming back after a layoff of more than thirty days. Many systems call for them to be eliminated without exception. However, there is a lot of evidence that shows that when handicapped correctly, these horses can show a very high return on investment.

Finally, the EPH can be contested just by looking at the elite handicappers that are able to consistently “beat the races.” It is a sure bet that these handicappers are constantly seeking new insight into the game. They know that even the simplest of angles may have some success in discovering value among inefficiencies in the pool, however, when use of these methods becomes widespread, the inefficiencies will disappear.

Now, let’s summarize the conditions that are most favorable for creating inefficiencies in the betting pool:

- 1) Races in which fear, greed and euphoria are prominent (last race of the day or major races like the Belmont Stakes);
- 2) Hot jockeys or trainers; and
- 3) Horses with traditionally unfavorable data, such as one coming back after a layoff.

Hopefully, this has given you some new insights into the game. While I believe that the EPH applies to some of the races part of the time, it certainly does not apply to all of the races all of the time. Using these suggestions will help you identify specific races that offer the highest probability of inefficient betting pools. Combine this knowledge with careful handicapping and you will be well on your way to success. ♦

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