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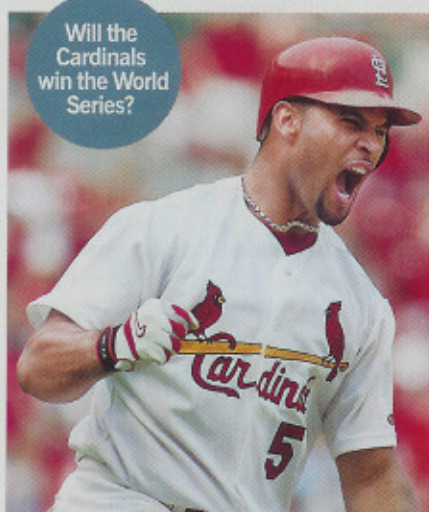
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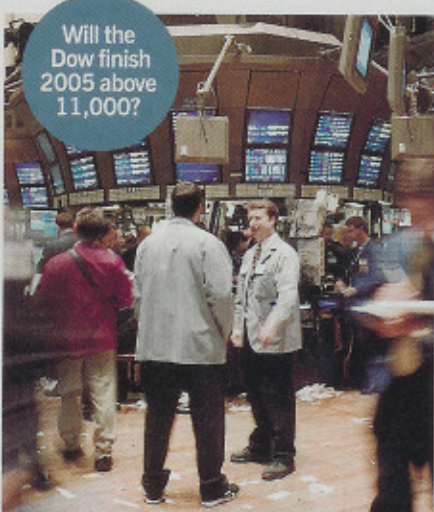
Making a market in (almost) anything

A fledgling website with some big-name backers, Intrade allows regular people to invest—not bet—on the current events they know best. **By Andy Serwer**



Will the Cardinals win the World Series?

The market gives them a 20% chance.



Will the Dow finish 2005 above 11,000?

Investors believe there's a 35% probability.



Will Hillary get the 2008 nomination?

At 48%, she's the favorite among traders.

FROM LEFT: TOM GANNAM—AP; STEVEN AHGREN; SETH WENG—REUTERS/CORBIS

AT THE BEGINNING OF DECEMBER 2003, THE U.S. MILITARY'S search for Saddam Hussein appeared to be going nowhere. Eight months after the deposed dictator escaped from Baghdad, the trail, at least to the outside world, seemed to have gone cold. But a small group of unidentified investors suspected that Saddam was about to be trapped—and made money on their hunch.

How? They were members of Intrade, a fledgling web-based market where you can buy or sell a contract on everything from the likelihood that Hillary Clinton will be the next Democratic presidential nominee, to whether the Nasdaq 100 will close higher today than yesterday, to how much the new summer blockbuster will gross on its opening weekend.

The traders in this case invested in a contract saying that Saddam Hussein would be "captured or neutralized" by the end of December 2003. That contract had bobbed along at a price of 9 (more

later on how pricing works) for weeks. But on Thursday, Dec. 11, volume suddenly spiked, and the value of the contract leaped to 30, on no (public) news. Then, on Saturday night, Dec. 13, Hussein was captured in his spider hole near Tikrit. The announcement was made the following day—and the contract settled at 100. A piece of inside info about the progress of U.S. forces (or a bit of inspired guesswork) made those investors a bundle.

At FORTUNE we often write about the latest hot company, but it's rare that we get a chance to introduce you to an entirely new market. And yet that's what Intrade appears to be. Just a few years old, Intrade is beginning to attract a good deal of attention from market prognosticators, political strategists, statisticians, professional traders, and increasingly, ordinary investors. Some heavy-hitter backers have bought stakes in the company, and it recently began negotiations to become a regulated exchange in the U.S.

Update



What we said

In "Is This Discount Broker Oversold?" (March 7, 2005) we noted that Ameritrade's stock had fallen by more than a third over the previous year despite record profits and operating margins. With its shares trading at just 14 times projected 2005 earnings, we concluded that Ameritrade was too cheap.

What happened

The market for **Ameritrade (AMTD, \$20)** heated up: The stock has spiked almost 80% since our story ran—but much of that gain is temporary. In May the company fended off a takeover bid by rival E*Trade. Then, in June, Ameritrade said it was buying the TD Waterhouse USA brokerage business from Toronto-Dominion Bank for \$3.3 billion. Under the terms of the deal, Ameritrade stockholders (as of a yet-to-be-announced date) will get a one-time \$6 per share dividend. That payout is now priced into the stock. But subtract the dividend and the stock still trades at just 18 times 2005 earnings. Meanwhile, in July the broker reported another quarter of record net income. And Ameritrade CEO Joe Moglia, who will run the new TD Ameritrade, says that he expects to wring out \$378 million in cost synergies, and that increased trading could boost revenues by up to \$200 million annually starting in 2007. The stock is no longer a steal, but it's probably still a long-term buy. — **Julia Boorstin**

LAURENCE DUTTON—GETTY IMAGES

There are a handful of other quirky exchanges that take bets on future events. The Iowa Electronic Markets, for instance, has been run by the University of Iowa since 1988 as a forum for predicting economic and political outcomes, with an emphasis on elections. And HedgeStreet, which opened for business in 2004, is a private exchange that allows investors to use options it calls Event Derivatives to hedge against various economic outcomes. But Intrade is the only efficient market system around for investing in, well, almost anything.

Intrade.com and its sister website Tradesports.com, which carries mostly (you guessed it) sports contracts, are run by a company called Trade Exchange Network. The firm was founded in Dublin almost six years ago by a group of bankers led by John Delaney, 36. Trading began in 2002, and the sites now have 46,000 members who trade some 200,000 contracts a day. That's not much—the NYSE, for example, trades an average of 1.6 billion shares daily—but volume is growing 165% a year. Roughly 50% of total volume is sports related.

Intrade works much like a stock exchange, except that you're investing in events, not companies. Generally, the contracts are designed so that a buyer is betting that the act will occur, while a seller is betting it won't. Prices are quoted between 0 and 100. The higher the number, the greater the probability of its happening, according to the market. If you go long and you're wrong, the seller of the contract gets your money. Likewise, you get the short-seller's money if the event, such as Saddam's capture, happens. If the scenario doesn't play out by the specified deadline, a contract settles at zero; if it does, it settles at 100.

Getting started is pretty easy. You can open an account on the site in about five minutes by using your credit card or a wire transfer. There's no minimum investment. And Intrade charges a flat commission of 4 cents per contract for each transaction. Let's say you want to bet on the confirmation of John Roberts, President Bush's Supreme Court nominee. The day after Roberts was announced, the "ask" price for a Roberts confirmation contract opened at 81. That means you could buy,

for example, ten contracts for \$81 (plus 40 cents commission). If Roberts is confirmed, the contract's price will rise to 100, and you'll make \$19 (minus the 40-cent commission for selling). If it appears more likely that Roberts will be confirmed over the coming days or weeks, the contract might rise to, say, 95, in which case you could sell and lock in a profit. If Roberts makes some sort of gaffe, the contract will likely drop below 81 and you'll be in the red. If Roberts is voted down by the Senate, the contract goes to zero and you lose all your dough, but of course you could try to sell at any time on the way down.

Notice that we used the word "bet" above. Because it involves putting money on everyday events (like sports), trading contracts on Intrade may seem a little like gambling. But Intrade executives say it's not: For one thing, Intrade takes only a commission and does not act as "the house" like a Las Vegas casino. Also, investors on Intrade can, at least in theory, use skill to hedge their risk, as they do in the equity market. Intrade says it is in the process of seeking regulatory oversight by the Commodities Futures Trading Commission, the federal agency that regulates futures and options. (Citing the lack of a formal application, the CFTC had no comment.)

Whether or not you want to invest in current events, Intrade is a fascinating exercise in the power of the marketplace to anticipate the future. Its trading data have proven to be remarkably accurate. For instance, Intrade never wavered in predicting that George W.

The market as crystal ball

The more volume, the more accurate the market should be. Here's how Intrade's investors predicted some recent events.

Event	VOLUME*	Comment
 The 2004 election	3.5 MILLION	Even when polls showed Kerry pulling ahead in October, the market didn't waver. Contracts for a Bush victory never settled lower than 50.
 The 2012 Olympic bid	58,300	Contracts for odds-on favorite Paris sold for 75 to 80 until the end. But two days before the news broke, London's bid spiked from 12 to 28.
 The Michael Jackson trial	31,000	Traders hedged: The contract for guilty of intoxicating a minor rose to 75 while the price of a molestation conviction never got above 52.
 The new Pope	19,700	Early trading pointed to an Italian. But in the week before the white smoke rose, Cardinal Ratzinger's price doubled, from 10 to 20.

*Total contracts traded.

FROM TOP: JASON HEDD—REUTERS; NAASIRAN—GETTY IMAGES; JIM RUMMEN—UPI/LANDOV; CESO JUNIOR—ITS PRESSGAMMA

Bush would be reelected in 2004, and it called 33 out of 34 Senate races as well (it failed in Alaska, where contract volume was minimal). It also correctly signaled that Cardinal Ratzinger would be chosen as the new Pope, arguably the most secret vote on the planet. "Unlike a poll which asks, 'Who would you vote for?' we are essentially asking, 'Who do you think will win?' and then, 'Who will you put money on to win?'" says Delaney. "Markets have an incredible ability to suck out information. They can be wrong—but not as much as opinion polls."

Intrade says that some hedge-fund managers have begun scrutinizing contract pricing to aid them in their investing. Before the presidential election last fall, one manager with a hefty "Bush portfolio" (energy and defense stocks) closely monitored the line on a Bush victory for reassurance that his political take was on target. (Of course, he could have also hedged his Bush portfolio by buying Kerry contracts.)

One way Intrade hopes to grow is as a hedging device. For example, it has introduced hurricane contracts, which allow traders to bet on where a given storm will make landfall. Intrade execs say this could

prove extremely useful to insurers that wish to hedge their coverage risk. (For now, volume here is minuscule.)

Dean LeBaron, one of the pioneers of index investing and the former head of Battery Capital (which he sold to Legg Mason several years ago), has invested in Intrade. According to Intrade, so too have hedge-fund heavies Stan Druckenmiller and Paul Tudor Jones (both declined to comment). "New markets are where we learn things," says LeBaron. "I look at this as like getting in on the beginnings of indexing." Much like indexing, LeBaron says, Intrade requires counterintuitive thinking. (*The Wisdom of Crowds*, indeed!) LeBaron points out that as Intrade expands and liquidity increases, the value of its predictive information and the accuracy of the pricing will grow.

John Murray sees value already. He used to commute every day from his house in suburban Morris Plains, N.J., to trade foreign

exchange and stock futures on the New Board of Trade in Manhattan. He began noodling around on Intrade some two years ago, and soon after, a light bulb went on:

"I was trading with it on a hobby level, when suddenly I said, 'This is great. This is exactly what I do for a living. Why go to New York every day?'" So now, Murray says, he makes a living at home by investing through Intrade and Tradesports. "I trade a lot of sports, where I do a lot of modeling, and some politics too," he says. "My work these days is generally 5 P.M. until

One investor started on Intrade as a hobby. Now he trades baseball and politics contracts full-time and makes \$500 to \$1,000 in profits a day.

midnight." Wait, let's get this straight. Murray, who has four kids, has his days free, then watches a couple of baseball games each night to make a living? Actually, yes. "I'll trade about 1,000 to 2,000 lots," he says. "Right now I'm averaging between \$500 and \$1,000 in profits a day." While it's hard to say that Murray is making money the old-fashioned way, who's to say he's not earning it?

REPORTER ASSOCIATE Corey Hajim

Nuptials

Take the plunge: It's time to buy the Knot

The small-cap wedding specialist is registering big gains in online-ad sales.

Ah, to be young, in love, betrothed—and in a state of panic over where to find the reception hall, the bridesmaids' dresses, and the DJ. That's where wedding specialist the **Knot (KNOT, \$7)** comes in. Founded in the dot-com froth of 1996, the Knot not only survived the bubble but has emerged as the web's go-to spot for nuptials-related content and services. With more than 2.1 million visitors a month, its flagship site (theknot.com) is attracting a passel of advertisers eager to grab their share of the \$70 billion that's spent annually on weddings in this country.

That huge web presence gives this small fry (market value: \$155 million) great growth potential. The Knot's online-ad revenue increased 41% in 2004 and is growing even faster this year. To broaden its appeal, the company recently added sites designed to target newlyweds (thenest.com) and singles (greatboyfriends.com). It also cut a deal with Target's gift registry—the largest in the U.S., according to NPD Houseworld—to shore up a glaring weak spot in its retail business.



KNOT is currently trading at nearly 100 times its previous 12 months' earnings. But JMP Securities' Bill Morrison, the lone analyst who covers the Knot, expects profits to jump from 11 cents a share this year to 31 cents in 2006. Based on those projections, KNOT is now trading at a forward P/E of 26. "We think online media is a growth area, and the Knot is the dominant media asset in its niche," says Henry Ellenbogen, co-manager of T. Rowe Price's highly rated Media & Telecommunications fund, which owns around 200,000 shares of KNOT.

As with any union, though, saying "I do" to the Knot has its risks: Investors should keep a

close eye on what occurs once retail giant Federated completes its acquisition of May Co., which has a 16% stake in the Knot. (Federated is a shareholder and partner of WeddingChannel.com, the Knot's main rival.) Should Federated sell May's shares on the open market, it could put a damper on KNOT for several months. Still, we think this wedding party is worth crashing. — **Matthew Boyle**