

Top Ten Crude Oil Exporters
as a Percent of Total World
Exports, for the year 2016

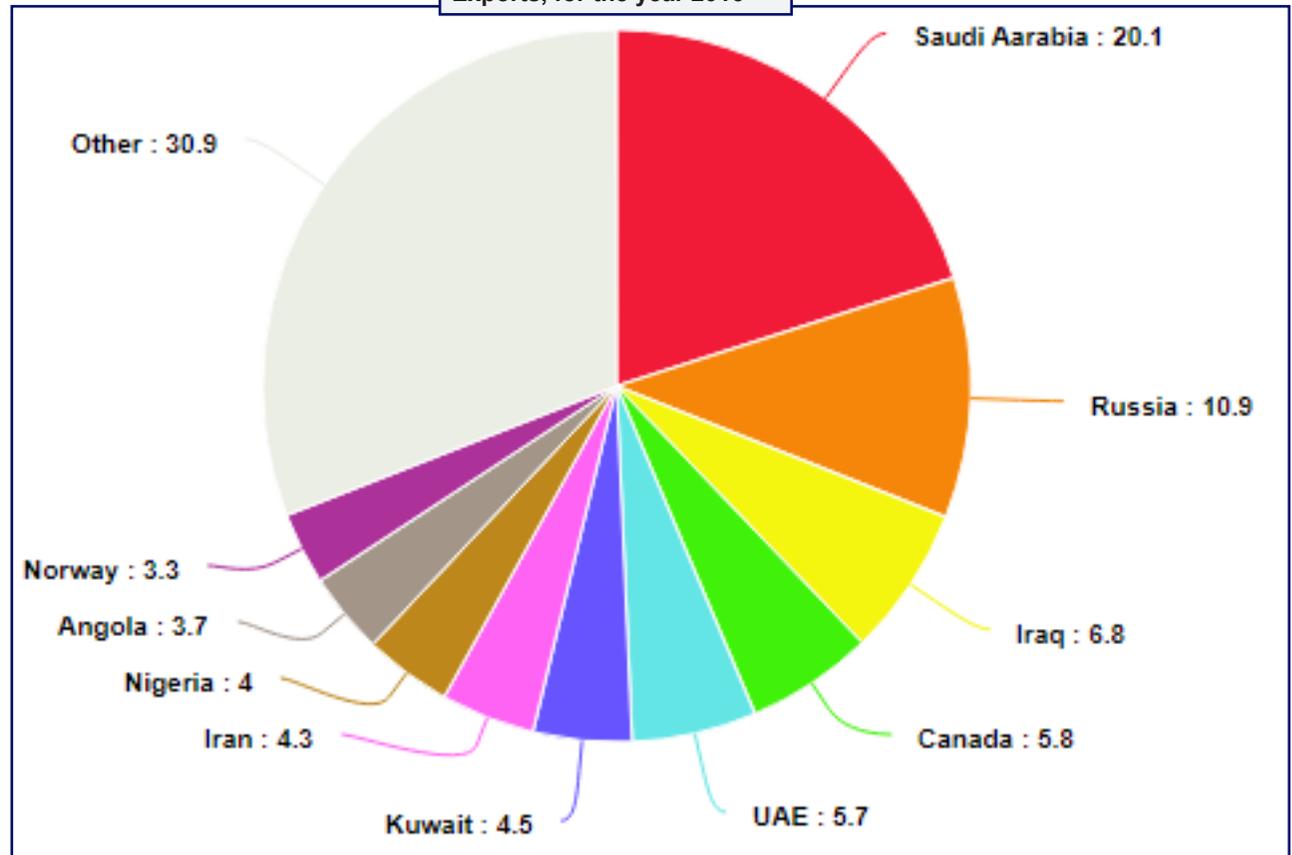
12 Nov 2017

Saudi Arabia:

Employing behavioral economics
and technical analysis
to help decipher current events

Walter J. Zimmermann Jr.

ICAP Technical Analysis



The economic or market commentary contained in this presentation is based on information that ICAP Technical Analysis, a division of ICAP Corporates, LLC ("ICAP") believes to be reliable, but has not been audited or verified by ICAP for accuracy or completeness. This commentary is provided to you for informational and educational purposes only, and is subject to change without notice. Principals and employees of ICAP and its affiliates may trade, for themselves, for ICAP or for customers, in the financial instruments or financial markets discussed in this presentation, taking positions similar to, or opposite to, the positions or market movements discussed in the presentation. Nothing in this presentation is intended to constitute a trade recommendation. The recipient of this presentation should take into account the recipient's individual objectives, financial resources and needs in deciding whether to use any of the information in the commentary. Futures, options and other derivatives trading involves substantial risk and is not suitable for all persons.

Perception versus Reality

All the great spiritual traditions share one common theme. That theme is the difference between perception and reality. And this theme can be summarized with one proverb: the world is as we are. Our perception of the world is colored, influenced, and skewed by what is inside us. Furthermore it is not an easy task to vanquish the various subjective biases and see the world clearly and objectively. There is no easy fix. It is a long term project.

Behavioral Economics

The modern science of behavioral economics has extensively and carefully documented the various expressions of the subjective bias long ago brought to light by the ancient spiritual traditions. And it should be emphasized that behavioral economics is not some spurious theory like the efficient market hypothesis. Behavioral economics is a complete and vigorous science based on careful observation and testing. We can use the findings of this science to evaluate how current events and news items reveal the collective mood - the dominant, collective, subjective bias.

The Collective Mood is Cyclical

The collective mood of the markets are deeply cyclical. The collective consciousness cycles from bullish extremes of hope and optimism to bearish extremes of fear and pessimism. And it is this collective mood that determines what is relevant and newsworthy

The “We are All the Same Fallacy”

One of the great themes of a bull mood is inclusiveness. The positive aspect here is that greater equality is typically legislated. But there is a dangerous downside when this fallacy is taken to extremes. Deep and powerful cultural differences are ignored. When US policy makers fall into this trap foreign policy disasters ensue. And history shows that US policy makers have no monopoly on this vulnerability.

The Optimism Bias

Another dominant and deeply related theme of bull market excess are extremes of optimism. Deep and fatal flaws are overlooked and ignored. Things that would otherwise be instantly recognized as impossible pipe dreams are planned for and expected. This report examines current events from Saudi Arabia in this light.

Saudi Arabia Demographics

As of July 2017

- 22,707,576 Saudi Nationals and 8,429.401 foreign workers
- 51% of Saudi nationals under age of 25 (as of Feb 2012)
- Median age 27.5 years, 70% of population under 30
- Among Saudi Nationals, 90% Sunni, 10% Shia
- Urban population 83.5%

Foreign Workers in Saudi Arabia

- Saudi Arabia has the the world's 4th largest immigrant population after the Unites States, Germany, and Russia.
- A 2015 UN report pegs foreign workers at 31.4% of the total population, placing Saudi Arabia in the top ten.
- Human Rights Watch has documented the exploitation of foreign workers as forced labor, trafficking, and slavery-like conditions.
- Over 72% of the prison population are foreign workers (WPB)

Foreign Workers Current Events

- By 2020 all 70,000 of foreign workers in public sector jobs are to be fired and replaced by Saudi Nationals.
- In January 2017 hundreds of foreign construction workers protested six months of unpaid wages by burning a few buses belonging to their employer, the Binladen group.
- Many of those protestors were sentenced to 300 lashes and four months in prison.

Saudi Arabia Country Rankings

- A 2017 report from the 'US Commission on International Religious Freedom' measuring the world's blasphemy laws ranked Saudi Arabia in the top ten worst countries.
- "Saudi Arabia continues to use criminal charges of apostasy and blasphemy to suppress debate and silence dissidents."
- A 2017 Freedom House report 'Freedom in the World' rated Saudi Arabia as the 10th worst of 195 ranked countries.
- The 2017 World Bank rating of 'The Ease of Starting a Business' placed Saudi Arabia at 147 of 190 countries.
- The 2017 World Bank rating of 'The Ease of Doing Business' placed Saudi Arabia at 94 of 190 countries.
- The 2017 'World Press Freedom Index' by Reporters Without Borders ranked Saudi Arabia 168 of 180 countries
- The 2016/2017 Amnesty International Report cited Saudi Arabia for severely curtailed rights and the common use of torture.
- The 2016 'Human Freedoms Index' from the Cato Institute places Saudi Arabia at #144 of the 159 ranked countries
- A 2015 annual report from the US State Department placed Saudi Arabia in the top ten of the worst countries for religious freedom
- A 2013 report from the Pew Research center entitled 'Government Restrictions on Religious Freedom' placed Saudi Arabia in the top ten worst countries.

Saudi Royal Family

Size of the Royal Family

- Over 15,000 Princes and Princesses in the Saudi the royal family
- Over 2,000 elite members of the royal family

History of the Royal Family

- Ibn Saud, founder of modern Saudi Arabia had a total of 22 wives (only 4 at a time), 115 children, 45 sons, 1,000 grandsons

Mohammed bin Salman (aka MbS)

- Reportedly worth \$17 billion *before* seizing power.
- Allegedly personally controls 2 million b/d of oil production
- In 2016, while cutting Saudi Arabia's capital spending by 71% he quickly bought a 440 ft yacht from Yuri Shefler for \$548 million

Royal Family Wealth Distribution: Income Inequality Saudi Style

Government Stipends (from leaked American diplomatic cables)

- \$800 per month for lowliest family members
- \$8,000 per month for great-great-grandsons
- \$13,000 per month for great grandchildren
- \$27,000 per month for grandchildren
- \$200,000 to \$270,000 per month for elite princes and princesses
- Bonuses of \$1 to \$3 million for wedding gifts and building palaces
- Meanwhile foreign workers go six months without being paid
- This is income inequality Saudi style.
- And income inequality is never a stabilizing influence.

Sources of Royal Family Income

- Of roughly \$40 billion annual SA budget \$2.7 billion per year is allocated to government stipends for the royal family (2016)
- Plus an unknown amount from taken from Saudi Aramco profits. This is very likely not a nominal amount.
- Plus royals skimming from \$10 billion in annual off-budget spending controlled by a few key princes.
- Plus massive borrowing from Saudi commercial banks - loans that are never repaid.
- Plus royals expropriating land from commoners. The land is then resold at huge mark-ups for government projects.
- This includes tracts as large as 30 square miles.
- Plus payments from residency permits. Each prince typically sponsors 100 or more foreigners.
- Plus free cell phones and usage, free hotel suites, and unlimited travel on Saudi Airlines.
- Plus unpaid overseas shopping sprees. In one infamous case a Princess rang up \$20 million in a 2009 unpaid spree in Paris.
- Plus one time special payments. Like \$130 billion during the Arab spring and \$32 billion from MbS in 2015

Comparison to Cost of British Royal Family

- \$368 million per year from Crown Estate income, of which \$48 million comes from the British government.

Summary

- Saudi Arabia is a closed, feudal, even medieval society
- It is one of the last places on the planet where citizens are lashed for blasphemy and beheaded for sorcery.
- It is a place where extreme clerics still move and speak freely.
- And the recent summary arrests of a few princes barely scratches the surface of corruption. And it hardly increases transparency.
- From the founding of modern Saudi Arabia it has been a country run and held together by patronage of epic proportions.
- In any society one can expect forces that favor the status quo.
- And the richer the benefits to maintaining the status quo, the more powerful the resistance to change.
- My hypothesis is that it is this powerful resistance to change that has inspired MbS to propose NEOM
- And that brings us to the second half of this report.

NEOM

- MbS has recently proposed sinking \$500 billion into the creation of a country within a country.
- Neom is an abbreviation for Neo-Mustabal, a Latin - Arabic portmanteau for 'New Future'
- At 10,000 square miles, or 33 times the area of New York City, this is no city.
- It is a country. From the website for this enterprise: "an idyllic lifestyle...founded on modern architecture, lush green spaces, quality of life, safety, and quality in service of humanity paired with excellent economic opportunities." Everything that the old Saudi Arabia is not.
- It will be an independent zone with it's own regulations, social norms, government, taxation, customs, and labor laws.
- Presumably, everything that Saudi Arabia is not.



Precedent for NEOM

- There is no precedent in the historical record anywhere on this planet for building a separate country within a country.
- There is no precedent in fiction either.
- And to my knowledge there is no precedent in science fiction.

Previous “let’s start fresh attempts” in Saudi Arabia

- Ten years ago plans for the ‘King Abdullah Economic City’ were laid out. It was to be a major metropolis of two million people just south of the proposed Neom site
- Ten years on and only 10,000 people live there.
- Also ten years ago plans for the ‘King Abdullah Financial District’ just north of Riyadh were laid out.
- It was to be a major economic hub to rival and then dwarf Dubai.
- An initial \$200 million was set aside for this project.
- Ten years on not one single financial institution has any plans to move into any of the 73 buildings in this district.

A Grand Delusion, or 3rd Times the Charm, or Something Else?

- So is Mohammed Bin Salman Al Saud completely delusional?
- Or can the third and most grandiose attempt to restart Saudi Arabia succeed where two much smaller scale and much more practical attempts fell completely flat?
- Or is there something else entirely at work here?

Quotations from the Neom Promotional Video

- “Nothing to hold you back.”
- “No set ways of thinking”
- “No restrictions”
- “No divisions.”
- “No excuses, just endless potential.”
- “A part of the world set aside for those who want to change the world.”
- “A place where pioneers and thinkers and doers can exchange ideas and get things done.”
- “A start up the size of a country.”
- A truly global culture from every place and background you can imagine that can show the rest of the planet how it is done.”

Summary

- Everything that Saudi Arabia is absolutely not and never has been.

An Ultimatum to the Status Quo?

Does MbS really want to build a separate country, or would he prefer to transform Saudi Arabia itself? Might the Neom promotion be an ultimatum to all those that want to keep Saudi Arabia a closed, feudal, and medieval dead end? Might MbS be telling the status quo ‘change or be left behind.’ In other words, could Neom be an ultimatum instead of an intended utopia?



3,500 World Economic Leaders Who are Hoping for a \$500 Billion Feed Trough

A Kumbaya Fantasy of Extreme Optimism?

- That \$500 Billion is real money. Especially when the corporate world has resigned itself to stock buy-backs to boost bonuses.
- The hope for a massive Saudi project is genuine.
- But is it realistic?



Background

- Neom is part of Vision 2030.
- The purpose of Vision 2030 is to free the Saudi economy from its complete dependence on the price of crude oil.
- An IPO for 5% of Saudi Aramco is the chief part of Vision 2030
- Proceeds from the Aramco IPO are to go to the Saudi Public Investment Fund (PIF)
- This PIF will function as the Saudi sovereign wealth fund.
- Ownership of the other 95% of Aramco are to eventually be transferred to the PIF

Unknowns

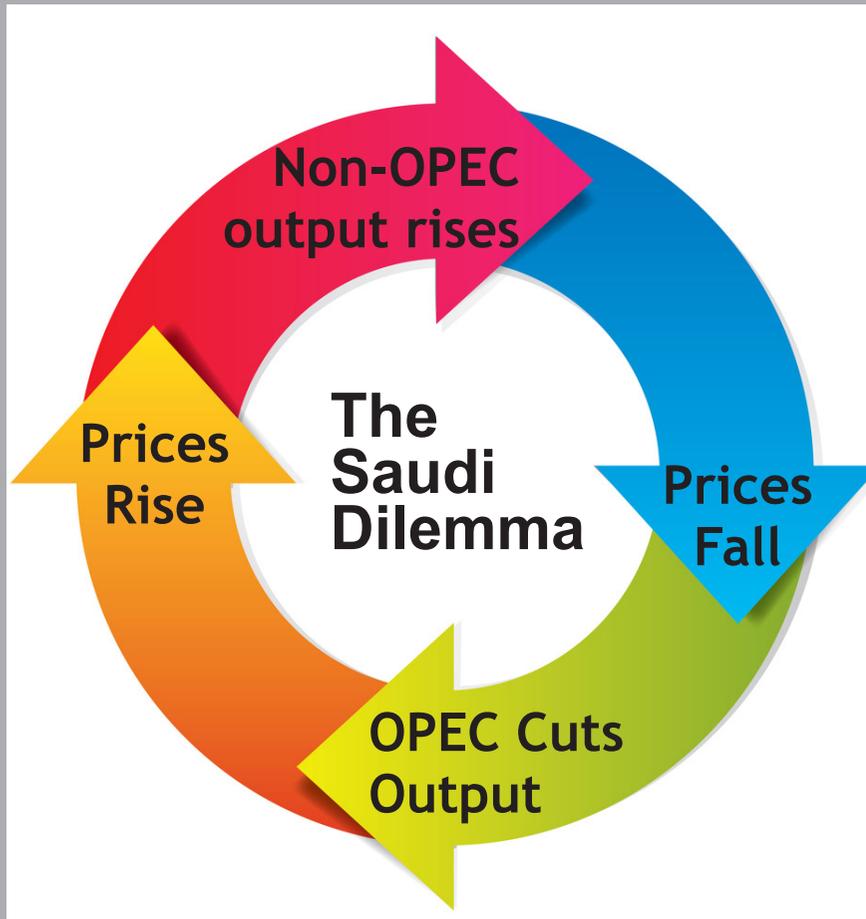
- What is the true market value of Aramco?
- What are the actual crude oil reserves of Aramco?
- Are the claims of 260 billion barrels of oil inflated?
- Remember that the allocation of OPEC crude oil quotas has long been based on crude oil reserves. So there has been a long standing incentive to inflate crude oil reserves.
- How much of Aramco income is currently being siphoned off to the Saudi royal family?
- How quickly will the rise of electric vehicles decimate world oil demand?
- Such demand destruction will crush crude oil prices.

IPO Related Unknowns

- Selling off shares in Aramco will not make Aramco a true public company in the usual sense of the word.
- Aramco decisions will still be controlled by the Saudi government, and will still be subject to OPEC policies.
- Other instances of public shares in national oil companies have been impacted by political turmoil and corruption scandals.
- Shareholder value thereby suffers. So the markets typically discount share values in national oil companies.
- How severe might such share value discounts be for a regime as completely insulated from transparency as Saudi Arabia?
- Also, Aramco is not 'all oil all the time.' Aramco also funds big social projects. So there is a 'PDVSA flavor' to Aramco.
- What degree of share value discount might the market give to that aspect of the Aramco business?

The Biggest Unknowns

- How exactly will funds from the Aramco IPO liberate Saudi Arabia from complete dependence on the price of crude oil?
- Is it in fact already too late to bring on this Aramco IPO?
- I have noted before that what the Saudi's really need is a time machine so they can issue this IPO back in 2008 and catch the peak of the thirty year commodity cycle high.



Three other facets of all this must be covered

1. Crude Oil Market Share versus Price

- The Saudi's are likely quite fed up with the long standing inability of OPEC to get both the market share of Crude Oil demand that they want and the Crude Oil price that they want.
- The reality is that they cannot have both.
- They cannot have both high prices and high market share.
- Free markets to not work that way. See the next page.
- And now the advent of an electric car future threatens to slash global crude demand by one-third into 2025 - 2030

2. High Tech versus Crude Oil

- The apparent Saudi solution is to sell a stake in the world's largest reserves of crude oil and invest the proceeds in high tech.
- Think this is a very fair one sentence summary of Neom.
- Saudi Arabia will stop living off crude oil prices and start living off high tech inventions and investments.
- Perhaps "dream on" is the best response to this dream.

3. What does it take to succeed in high tech?

- The entrepreneurial spirit.
- Flexible and creative thinking.
- Maximum freedoms.
- The completely unrestricted flow of new ideas.
- Everything that Saudi Arabia is *not*.

