

January 11, 2016

## **The Saudi Executions**

*(Due to Martin Luther King, Jr. Day, our next issue will be published Jan. 25, 2016.)*

On January 2, Saudi Arabia executed 47 people accused of various crimes against the state. Of this unfortunate group, 46 were Sunni jihadist radicals and one was a Shiite cleric, Sheik Nimr al-Nimr. Al-Nimr's execution set off protests in Iran and the Saudi Embassy in Tehran was sacked. In response, the Saudis broke off diplomatic relations with Iran for the first time since 1980. Several other Sunni nations have either followed Saudi lead in breaking off relations or have recalled ambassadors in protest.

These executions are the result of several important trends and factors that are affecting Saudi Arabia, specifically, and the Middle East, in general. In this report, we will discuss the executions and the signals they send. We will also analyze the transformation occurring in the Middle East and the Saudi response. As always, we will conclude with market ramifications.

### **The Executions**

Saudi Arabia faces threats from both Shiite powers and Sunni jihadists. The latter believe the kingdom's leadership is corrupt. There are a number of reasons some Sunnis hold this position. First, there are elements of the royal family that behave in an impious fashion. Some religious leaders believe this worldly behavior disqualifies them for leadership of Saudi Arabia. Second, the fact that the kingdom has relied on the U.S. for

protection is thought by some to be scandalous. When King Fahd felt threatened by Saddam Hussein after Hussein's invasion of Kuwait in 1990, the king invited the U.S. to base troops in northern Saudi Arabia for protection. Eventually, the Bush administration formed a large coalition, mostly of non-Islamic states, to oust Iraqi forces from Kuwait. Osama bin Laden wanted the king to rely on mujahedeen fighters instead and believed that inviting heathens to protect Islam's most holy places was blasphemy. Osama bin Laden went on to form al Qaeda, which had as one of its express aims to foment revolution to oust the royal family.

At the founding of Saudi Arabia, Ibn bin Saud partnered with Wahhabi<sup>1</sup> Islamic leaders to give the royal family religious credibility. Maintaining this relationship is considered important to the legitimacy of the regime. Thus, criticism from Sunnis is a serious threat to the kingdom. The Sunni jihadist radical executions indicate that Saudi authorities will not tolerate threats from Sunni deviants such as al Qaeda or Islamic State (IS).

The decision to execute al-Nimr is also significant. The sheik was trained in Iran and was an outspoken critic of the kingdom's treatment of Shiites. The eastern regions of Saudi Arabia have a high concentration of Shiites and Saudi security forces are always concerned about unrest developing in these regions. The fact that the oil industry is concentrated in this part of the country exacerbates these concerns.

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<sup>1</sup> Wahhabism is a strict form of Sunni Islam.

Although al-Nimr was accused of participating in a gun battle with Saudi security forces, the primary charges he faced were outspoken opposition to the government and the defense of Shiite civil rights. He was arrested in 2012 and sentenced to death in October 2014. Saudi authorities waited nearly 15 months to carry out the death sentence on al-Nimr.

There are three messages the Saudis are sending with these executions.

**The kingdom believes it is facing significant threats from both deviant Sunni jihadists and Shiites, and considers these threats to be equivalent.** In other words, Iran and IS are nearly identical risks to Saudi security. The mass execution was bound to make headlines and the royal family wanted them to be noticed. It tells Iran, IS and other Sunni jihadists that neither position will be tolerated. At the same time, it also suggests that Saudi authorities are quite worried about internal stability and are using the executions to address this worry. The victims suggest that Sunni deviant jihadism won't be tolerated and non-compliant Shiites won't be allowed either.

**It is clear the Saudis knew executing al-Nimr would infuriate Iran.** The attacks on their embassy in Tehran could not have come as a surprise. In effect, the kingdom is indicating that it's willing to live with Iranian displeasure with its actions.

**The executions suggest to other Sunni states that Saudi Arabia is the primary defender of mainstream Sunnis in the region.** In other words, the kingdom plans to protect its allies from Sunni jihadists and Iranian-backed Shiite threats. To some extent, the executions were designed to rally support from other Sunni states in the region.

### **The Regional Transformation**

The Middle East is in turmoil. The fundamental geopolitical problem in the region is that Iran and Saudi Arabia are both vying to be the dominant power in the area. This issue has been in place for a millennia. Over the past few centuries, outside powers have thwarted this goal and have kept this potential conflict frozen. Initially, the Ottomans dominated the region and kept the two sides from going to war. The British and, to a lesser extent, the French, replaced the Ottomans. After WWII, the U.S. became the regional guarantor of stability. The recent tensions between Iran and the Arab states is a sign of a frozen conflict that is starting to thaw.

The unraveling of America's security guarantee for the region began with the ill-advised decision by the Bush administration to attack Iraq in 2003 and oust Saddam Hussein. From 1945 until 2003, the U.S. mostly managed the region by having an armed presence and by balance of power geopolitics. In fact, one of the most tumultuous periods, from 1972 to 1980, was when the U.S. was perceived as weak. The Nixon administration's decision to leave the gold standard and overtly support Israel in 1973 led to the Arab Oil Embargo, and President Carter's mismanagement of the Shah led to the Iranian Revolution. Under President Reagan, order was restored by supporting both sides of the Iran-Iraq War.

However, when President Bush removed Hussein from power in Iraq, he set off a series of problems by creating a power vacuum in the region that only the U.S. could adequately fill. Saudi Arabia and the other Gulf states had been protected by a Sunni Iraq, which acted as a buffer state against Iran. When President Obama withdrew American troops from Iraq, from a

Saudi perspective, Iraq became a *de facto* Shiite state.

Former Iraqi PM al-Malaki's sectarian policies led to strong Iraqi Sunni opposition and fostered the creation of IS. The Bush administration's "surge" in 2007 effectively split Sunni tribes from radical jihadists, but al-Malaki's policies led them to unify again against Shiites from both Iran and Iraq. Although Saudi Arabia does feel threatened by IS, it supports other Sunni insurgent groups in Syria and Iraq to thwart Iranian ambitions.

The Obama administration has made a deliberate decision to reduce American influence in the region. It withdrew American troops from Iraq, negotiated a nuclear deal with Iran that is likely the precursor to normalized relations between Iran and the West, and failed to attack Syria after it violated one of the president's "red lines" by using chemical weapons against the Syrian insurgency. The administration's decision to support various democratic movements spawned by the Arab Spring disturbed the royal family, and when President Obama forced the ouster of Hosni Mubarak from Egypt the Saudi leadership wondered if it was next.

The Obama administration's decisions led the Saudis to conclude they can no longer rely on America to be the guarantor of security in the region and therefore they will be forced to protect themselves. That transition has been evolving over the past two years.

### **The Saudi Transition**

The Saudis previously used three security strategies.

**Support for Sunni militant groups:** The Saudis supported various mujahedeen

groups during the Soviet-Afghan War. After the conflict, these groups dispersed around the Middle East and North Africa and formed radical Sunni jihadist groups. Al Qaeda is an example of one of these groups. Unfortunately, the kingdom has suffered significant blowback from this policy as various Sunni groups have attacked the royal family and caused security problems.

**Relying on the U.S.:** Beginning with President Roosevelt's visit with Ibn Saud in 1945, the U.S. and Saudi Arabia have been allies. Although the relationship hasn't always been smooth, American interests of keeping the Soviets out of the Middle East and protecting regional oil flows made Saudi Arabia a key ally. Saudi oil policy in the mid-1980s was instrumental in bringing down the Soviet Union. However, as the U.S. began to back away from its global hegemon role and developed shale oil, the need for this special relationship waned. Simply put, the U.S. concluded it no longer needed to offer extensive support to Saudi Arabia.

**Money to allies:** Being the world's largest oil exporter and, for many years, the largest producer, has given the kingdom enormous financial power. The Saudis have used this to buy influence. Unfortunately, Saudi spending has failed to foster reliable allies. Egypt and Pakistan have been beneficiaries of Saudi largess, but both nations have offered only token support for the Saudi war in Yemen.

The failures of these earlier strategies have fostered a new set of policies.

**Capture oil market share:** The Saudis decided to capture oil market share and drive down the price of oil beginning in the summer of 2014. That policy has continued.

The goal is to harm its Shia rivals, Iraq and Iran. Low oil prices blunt the benefits of Iran's détente with the West and reduce Iraq's ability to attack Sunnis in Iraq. Since Russia supports Assad in Syria, low oil prices are partially aimed at them as well. We have serious doubts that the U.S. oil industry was a major target of this policy.

**Military action:** Former defense secretary Robert Gates famously quipped once that Saudi Arabia would fight its enemies to the last American soldier. That isn't the case anymore. Saudi Arabia has shouldered the military burden of attacking the Houthis in Yemen, and some analysts believe this is preparation for broader military activity in the region. In other words, Yemen is a training ground for the Saudi military.<sup>2</sup>

**Fomenting Saudi-Shia tensions:** King Salman's administration appears to be using sectarian unrest to project power and build allies. By triggering hostile actions from Iran and Shiite Iraq, Saudi Arabia wants to build a coalition of Sunni powers in the region. Already, the kingdom announced a Sunni military coalition consisting of 34 nations.

How will the Saudis execute this strategy and what will constrain it? To gain market share in oil and handle its own military action, the Saudis will need money. Gaining market share will drive oil prices lower and decrease revenues, while military action will lift government spending. The IMF estimates that the kingdom will drain its foreign reserves in about five years if it continues its current pace of spending.

Already, Deputy Crown Prince (DCP) Salman has made changes to shore up Saudi finances. The young deputy crown prince is

responsible for economic policy within the Saudi government. He has cut subsidies and is looking to implement a value added tax. Recently, he floated the idea of an initial public offering for Saudi Aramco. If the Saudis take the company public, it would be the world's largest public company. The kingdom has made some global bond sales and rumors abound that it may depreciate its currency. The latter would be profoundly bearish for oil because the Saudis pay their workers in local currency but sell their oil in dollars; thus, devaluing the riyal would effectively boost margins and support expanding production.

There are two primary constraints. The first is that DCP Salman's policies put the Saudi social contract at risk. Saudi citizens (perhaps subjects is a better term) live in a rentier state; the government provides basic necessities and, in return, the people allow the royal family to rule without public input. Cutting subsidies and implementing taxes could lead Saudi citizens to demand representation in government. The royal family isn't prepared for such changes.

The second constraint is within the royal family. When Crown Prince Salman became king after King Abdullah died, he demoted the previous deputy crown prince, Muqrin, and appointed Prince Mohammed bin Nayef as crown prince. He also named his favorite son, Prince Mohammed bin Salman, as deputy crown prince.<sup>3</sup> King Salman purposely skipped to the next generation of princes, putting younger men in line for the throne. The appointment of his son to deputy crown prince was, and remains, controversial. He is very young (30 years old) and has been given great responsibility. He is not only in charge of the economy but is also in charge of military operations in Yemen.

<sup>2</sup> It could be argued that the Spanish Civil War played the same role for Nazi Germany.

<sup>3</sup> See WGR, 5/11/2015, [The Next Generation](#).

There are reports of grumbling among some of the older princes. For the most part, the royal family has avoided controversy in succession; the family has relied on age and consensus on competence to appoint each king. King Salman's decision to put his young son in line for the throne is seen as a power grab. His actions on the economy and in Yemen have been considered by some to be impetuous. If the changes he is trying to implement fail, a palace coup isn't out of the question.<sup>4</sup>

### Ramifications

Oil prices initially rallied on news of the executions, but since then worries about global growth and oversupply have pushed prices to new lows. If one looks at Saudi Arabia's new strategy, two of the three policies are bullish for oil. Fostering

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<sup>4</sup> See WGR, 1/20/2015, [Saudi Succession](#). Note the discussion of King Saud, who succeeded the nation's founder, Ibn Saud. King Saud was ousted by his brothers and cousins due to profligate spending, military adventurism and the lack of consensus-building among the royal family. One could argue that King Salman is flirting with similar conditions.

sectarian tensions and the willingness to go to war could easily lead to a supply disruption. On the other hand, the market share policy will do nothing but press prices lower.

In the near term, we believe the market share goal will trump the other two strategies. Thus, we remain bearish on oil prices into the spring. However, the potential is rising for a geopolitical event that would reduce oil supply. Furthermore, the lower oil prices decline, the greater the likelihood that Iran or Russia will trigger some sort of event to lift prices. For example, in late December, Iran conducted military exercises in the Persian Gulf and missiles landed 1,500 yards from the U.S.S. *Harry S. Truman*. The power vacuum created by U.S. policy and the attempts by Saudi Arabia and Iran to fill that empty space are increasing the odds that an oil supply event could occur later this year.

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