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A Coup in Riyadh

On June 20th, King Salman of Saudi Arabia announced that his son, Prince Mohammed bin Salman (MbS, as he is affectionately known), would be the new crown prince, replacing Prince Mohammed bin Nayef. Although the move was momentous, it was not necessarily unexpected. MbS's stature in the kingdom had been rising since he was appointed as deputy crown prince in 2015, while Prince Nayef, who had been appointed as crown prince at the same time, held a lower profile and was generally overshadowed by his younger cousin.

However, over the past two weeks, details of the change emerged in the major U.S. media.¹ Although the initial reports suggested the change was consensual, recent articles, referenced below, make it clear that Prince Nayef was ousted.

In this report, we will discuss the history of the succession of Saudi kings to highlight how the eventual ascension of MbS will represent a major break with history. We will then examine the details of the ouster and the potential for opposition to MbS taking power. We will analyze what the eventual kingship of MbS might mean for

¹ <http://www.reuters.com/article/us-saudi-palace-coup-idUSKBN1A41IS>
https://www.nytimes.com/2017/07/18/world/middleeast/saudi-arabia-mohammed-bin-nayef-mohammed-bin-salman.html?mcubz=0&_r=0
<https://www.wsj.com/articles/how-a-saudi-prince-unseated-his-cousin-to-become-the-kingdoms-heir-apparent-1500473999>

the region. As always, we will conclude with market ramifications.

Historical Context

Saudi Arabia was founded by Ibn Saud, a charismatic sheik who created the modern kingdom. Through military campaigns and intermarriage, Ibn Saud gradually unified the territory on the Arabian Peninsula to create the modern Saudi state. During this process, he had at least 22 wives and 45 sons, 36 who survived to adulthood. He ruled Saudi Arabia from its founding in 1932 to 1953.

Due to the large number of sons, Ibn Saud created a succession plan that would shift from brother to brother rather than from the eldest brother to his eldest son, a process known as primogeniture. This succession plan did manage to maintain peace among the founder's sons but it also held the potential for an eventual crisis as the generation of the sons of Ibn Saud aged out.

Even the process of kingly succession from brother to brother did not occur without tensions. The first, King Saud, the eldest son of the founder, ended his rule in abdication. King Saud was erratic and a spendthrift; he attempted to assassinate Egyptian President Gamal Nasser and engaged in a proxy war against Egypt in the Yemen civil war in the early 1960s. However, the key concern about King Saud was that he had 30 sons and was steadily putting them in positions of power, undermining the authority of King Saud's brothers. The clergy and Saud's powerful brothers (Princes Khalid, Fahd and Abdallah, all three future kings) conspired to force Saud's ouster. In 1964, Saud was

deposed in favor of his brother, Faisal, Ibn Saud's third son. King Faisal was the prime minister during the Saud administration.

Faisal was a sober, thrifty, religious man who introduced public education for both men and women to the kingdom, but opposed the Arab nationalist movement of Nassar and Hafez Assad in Syria. At the same time, he supported unity among Shiites and Sunnis, a position opposed by the Saudi clergy. He opposed communism and Zionism as well, and ordered the Arab Oil Embargo in response to U.S. support for Israel during the Yom Kippur War in 1973. King Faisal was assassinated by a half-nephew in 1975.

The next king, Khalid, was essentially a caretaker monarch. His brother, Prince Fahd, managed the kingdom's day-to-day operations. Khalid suffered from heart disease and died in 1982; he was succeeded by Fahd. King Fahd was the eldest son of Hassa al-Sudairi,² one of the founder's favorite wives.

Fahd had a long and eventful reign. Fearing the Iranian Revolution, he actively supported Saddam Hussein's Iraq during the Iran-Iraq War. His oil minister, Zaki Yamani, abandoned the kingdom's OPEC role of swing producer in 1986; this led to a collapse in oil prices and was partly responsible for the downfall of the Soviet Union. Fahd was not a fan of the influential Yamani, and eventually he unceremoniously fired him.³ King Fahd also invited the U.S.

² Hassa al-Sudairi bore seven sons who survived to adulthood. They are considered perhaps the most influential of Ibn Saud's sons and are nicknamed the "Sudairi Seven."

³ According to Daniel Yergin, Yamani learned of his sacking by hearing it on television. Yergin, D. (1991). *The Prize: The Epic Quest for Oil, Money, and Power* (p. 763). New York: Simon & Schuster.

military to Saudi Arabia in the autumn of 1990 after Saddam Hussein invaded and annexed Kuwait. President George H.W. Bush and Secretary of State Jim Baker built a large coalition to oust Iraq from Kuwait, using Saudi Arabia as a base of operations. Although the execution of the war was impressive, anger at the king for allowing "infidels" to operate in the land of Mecca and Medina spawned al Qaeda, led by Osama bin Laden.

Fahd anticipated the end of his generation of kings and began the process of a more formal system of succession, allowing the current king to name his successor instead of relying on informal decisions by the sons of Ibn Saud. The edict allowed the sitting king to select using his own criteria and permitted him to pass over those with seniority, setting the stage to move to the grandsons of Ibn Saud.

Although Fahd was the longest reigning Saudi king, he suffered a series of strokes, the first in 1995. Crown Prince Abdullah increasingly ran the operations of the kingdom from 1995 until Fahd's passing in 2005. Abdullah became king in 2005.

Unlike the worldly Fahd, Abdullah was, like Faisal, a man of personal piety. He did implement some important economic reforms, including joining the WTO. Abdullah died in 2015 and was replaced by Crown Prince Salman.

King Salman opted to demote Deputy Crown Prince Muqrin, the last "king eligible" son of Ibn Saud. He appointed Prince Nayef to crown prince and his son, MbS, to deputy crown prince.

The Ouster

On Tuesday, June 20th, Crown Prince Nayef was summoned to an evening meeting with

King Salman at the royal palace in Mecca. According to Reuters,⁴ the king accused his nephew of unchecked dependence on narcotics that was affecting his judgement. Nayef had been the target of an al Qaeda assassination attempt⁵ and the resulting injuries had led him to use painkillers. The king wanted Nayef to sign a declaration that he was willingly stepping down from his position as crown prince. Nayef initially declined and so the king left him alone, effectively under arrest, while he convened the Allegiance Council, the 34-member board that consults with the king on succession matters. The council voted 31-3 to approve MbS as crown prince.

By morning, Nayef realized his position was untenable. There are inconsistent reports as to whether Nayef signed his abdication, but the final result is that he is out of power. Since then, the former crown prince has been confined to his palace under guards loyal to MbS. Nayef's two daughters are also said to be effectively under house arrest. Although we doubt Nayef would stage a counter-coup, it does appear King Salman is taking no chances. We also note that neither the king nor his new crown prince attended the G-20 meetings in Germany earlier this month, suggesting they don't feel confident enough to leave the country.

Since the ouster, further power has been given to the young crown prince. He already has control of the energy portfolio and the military. The state security agency was added after the ouster; this body includes Special Forces and counter-terrorism. The new crown prince also controls the interior ministry. The only

major area of government that is outside of MbS's control is the National Guard, a tribal military with the task of internal security. The National Guard is under the control of Prince Mutaib bin Abdullah, the son of the former king. One of the three members of the Allegiance Council who voted against approving MbS to crown prince was the son of the late King Abdullah, Abdulaziz bin Abdullah. If strong opposition is going to develop against Crown Prince Salman, the first place to look will be elements of the Royal Family aligned with King Abdullah.

The Key Points

Here are the key points from this event:

The consolidation of power to MbS is unusual and will likely raise opposition.

The succession shift from the sons of Ibn Saud to the grandsons of the founder king was always fraught with risk because of the change it represents. The Saudi Royal Family managed the potential tensions among the sons of Ibn Saud in two ways. First, it transferred power from brother to brother in order to avoid the conflict that would have developed if the next king was the son of the sitting king. Preventing all those brothers from being king someday would have almost certainly led to civil war. Second, responsibility for running the kingdom was spread among various princes to give the various family factions some share of power.

This is a consolidation of power in the hands of one member of the family that is unprecedented since the founding of the modern kingdom.

- Gregory Gause, professor at Texas A&M⁶

⁴ Op cit.

⁵ <http://www.washingtonpost.com/wp-dyn/content/article/2009/10/06/AR2009100603711.html>

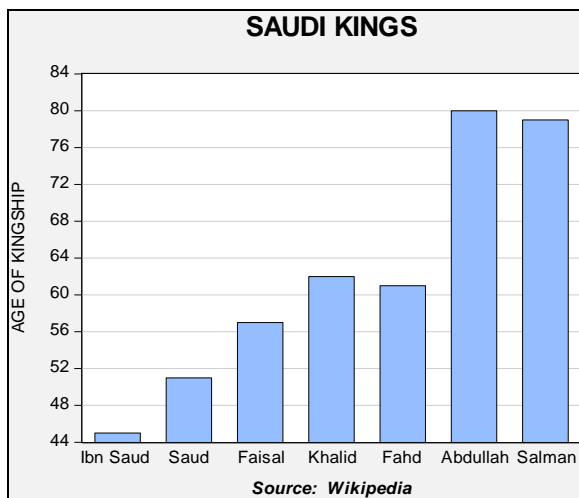
⁶ <https://www.ft.com/content/c8f084b6-5685-11e7-9fed-c19e2700005f>. Gause is one of our favorite sources of information about the Saudi Royal Family.

This aggressive consolidation of power is bound to raise tensions within the House of Saud. How those tensions are managed will be critically important.

The crown prince may be king soon.

Again, according to Reuters,⁷ King Salman has reportedly recorded a video indicating that his son is now ready to be king. Although this video could smooth the transition after the king’s demise, it is also possible that King Salman may abdicate, citing poor health, and put his son in charge. It is less likely that the opposition within the Royal Family would attack the new king if the elder king is alive. There are rumors that King Salman may abdicate in the fall.

The crown prince would be the youngest king in modern Saudi history. The youngest king was Ibn Saud, who took power at age 45. The oldest was Abdullah at 80. Although the average age is 62, because of the process of selecting kings from the first generation of Ibn Saud, the age of kingship has been rising.



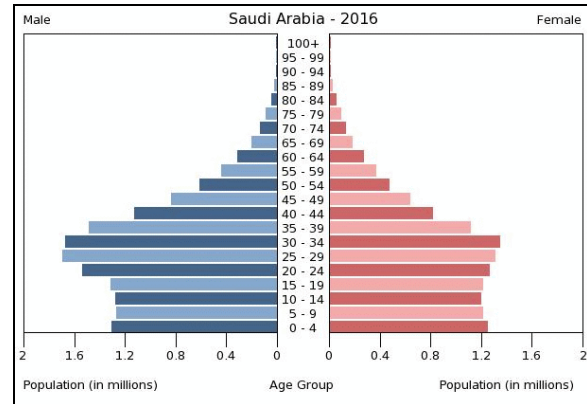
MbS is 31 years old. If he takes power this year, a 40- to 50-year reign is possible, which would likely outlast most of the

⁷ Op cit.

grandsons of Ibn Saud and perhaps lay the groundwork for primogeniture. As we have shown, that would be a major departure from how the kingdom has operated and raise the odds of a crisis.

There are advantages to a young king.

The kingdom has a young population.



(Source: IndexMundi)

Only about 4.9% of the population is 55-64 years old, which ranks 162nd out of 208 nations (the U.S., by comparison, ranks 41st with 12.9% of its population within this age range). The crown prince has reduced the power of the religious police who enforce social codes and has planned a series of concerts and events with Western stars that appear to be quite popular. Although the Royal Family may grumble, the bulk of the population may be supportive of a young king.

Crown Prince Salman seems to like risk.

MbS has been in charge of the war in Yemen. It also appears that he strongly supports the current hardline stance toward Qatar. The Saudi Aramco IPO is the handiwork of MbS; in fact the swings in Saudi oil policy, which moved from flooding the market with oil to cutting production to bolster output, appear to have originated with the crown prince. He has

unveiled a program to wean the Saudi economy off oil with his Vision 2030⁸ plan.

Although there is ample evidence that the kingdom has become more risk averse in the past two decades, it should be noted that King Saud supported a war in Yemen and plotted to assassinate Nasser.⁹ Faisal introduced public education and took modest steps toward liberalization. He also conducted the Arab Oil Embargo.¹⁰ Fahd allowed Western forces to base in the kingdom to oust Saddam Hussein from Iraq.¹¹ However, since then, change and aggressive actions have become less common.

Simply put, younger kings seem to have been prone to aggressive actions. There is clear evidence that MbS intends to undermine the established order. Although strong policy moves are not unheard of in Saudi history, the world has become accustomed to a less aggressive kingdom. It would be historically consistent to expect MbS to act more aggressively than the last two kings, who were around 80 when they took office.

MbS as king wants to lead the Sunnis against Shiite Iran. The Saudis have viewed themselves as the leading Arab Sunni nation. Clearly, other countries would beg to differ; Egypt has been a perennial power in the region and Turkey once colonized much of the region. Thus, these nations may be reluctant to accept Saudi dominance. On the other hand, if MbS becomes king soon, we would expect him to

⁸ <http://vision2030.gov.sa/en>

⁹ It should also be remembered that Saud was deposed.

¹⁰ Of course, Faisal was assassinated.

¹¹ This action led Osama bin Laden to form al Qaeda.

become more assertive in the region; how this will affect the area remains to be seen.

What does concern us is that relations between the Trump administration and the kingdom appear much stronger than with the previous American government. We worry that MbS may overestimate the degree of American support and could expect the U.S. to back his moves when the Trump administration may be reluctant to get directly involved.

Ramifications

We believe investors should be prepared for a new, young Saudi king who may take power before year's end. If he does, we expect him to be much more aggressive than his most recent predecessors. We also fear that he may struggle to maintain order, especially if his foreign adventures fail or if he moves too quickly to liberalize the Saudi economy and society. A religious backlash could develop.

The market impact is that the chances of an oil event in the Middle East would increase. Thus, we could see an unexpected jump in oil prices. The Saudis deliberately "sheathed" the oil weapon after the 1973 Arab Oil Embargo, realizing that it's impossible to single out a few nations for oil "punishment." However, that may not stop a new king who doesn't have that experience nor would not have the institutional memory that comes from a brother instead of an uncle. In other words, there were always risks when shifting to a new generation of the House of Saud. These risks have increased due to the young age of the new crown prince who could become king sooner rather than later.

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