
THE ARAMCO MONEY MACHINE: WHERE WILL IT GO?

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11/17/2017

Forget the buzz around Saudi Aramco's initial public offering (IPO), which looks set for 2018. Saudi Crown Prince Mohammad bin Salman (aka MBS) has been on a PR campaign to plant the seeds of a \$2 trillion valuation. Other, more sober estimates put the figure at \$1 trillion. Whatever the number, consider that ExxonMobil's market capitalization is \$353 billion;¹ Saudi Aramco is three to six times that size. The game plan is to sell 5% of Saudi Aramco's equity, most likely in New York or London. This is a big deal.

Time for some "Kremlinology"² on Riyadh. As if there wasn't enough "Riyadhology," MBS shook the tree in November, with billionaire Prince Al-Waleed bin Talal being just one of many arrested on corruption charges. MBS may be wise in his 32 years; throwing the book at the top of the house for corruption is his signal to whomever is going to pony up the \$500 billion for Saudi Vision 2030 that he means business. What's Saudi Vision 2030? That's the massive infrastructure and modernization program that is the Saudi equivalent of China's Silk Road Initiative, complete with Star Trek-like visions of a Saudi Arabian future that is distinctly 21st century.

What's promising about the anti-corruption actions is that the market's reaction is essentially diametrically opposed to ours; we view it as a net positive, as MBS seeks to modernize by crushing opposition, the same opposition that spent decades thrusting radical wahhabism on the populace. The consensus sees this power grab as something that throws the Saudi Arabian status quo into disarray. Quite the contrary; we believe the country desperately needs someone like MBS to make the kingdom a peaceful participant in this century's future, in sharp contrast to its status as a hostile actor in the previous decades.

With President Donald Trump making loving overtures toward the Saudi royal family, maybe New York is the odds-on favorite for the listing, not London. Either way, remember that it is accepted among Middle East followers that Saudi Arabia's harrowing embargoes on Qatar, also a Sunni-ruled monarchy, only came after Trump gave his blessing. Those sanctions came after Saudi Arabia and other gulf nations accused Qatar of funding ISIS, so it is heartening that the regional power broker may be putting its foot down on international terrorism.

Diversifying

Saudi Arabia took a \$3.5 billion stake in Uber in 2016, essentially doing what private banks may do whenever a client has a concentrated investment exposure: put the rest of their capital in something that hopefully is inversely correlated to the concentrated position. And, Saudi Arabia has a concentrated position in oil. In contrast, no business wants the oil price to decline quite like a ride-hailing app that consumes it. It's a [he](#)

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The Uber deal tells us a lot about Saudi Arabia's long game. Compared to the geriatric patriarchy the country traditionally has known, MBS is a spring chicken. Time will tell if he moves Saudi Arabia into the 21st century, because it will take generations for even a true reformer to change decades of Wahhabi indoctrination from the kingdom's madrassas.

Make no mistake; Saudi Arabia is not going to turn into some bastion of liberty anytime soon, but we view the recent decision to allow female driving as at least a baby step in the right direction. It may have been a signal to the west that the direction for Wahhabism is toward marginal moderation. And if there is one thing that Middle Eastern capital would seemingly love, it's moderation.

Deploying \$50 Billion

The [WisdomTree Middle East Dividend Fund \(GULF\)](#), which we launched in 2008, has a quarter of its exposure in Saudi Arabia, a country that may finally be turning the corner culturally, politically and economically. If we're right that Saudi Arabia wants to use the almighty dollar to maintain regional hegemony, the way to do that is by holding equity stakes in companies domiciled elsewhere in the Gulf. To the extent that Saudi Aramco raises more capital in the future, that's just more money seeking a home.

Additionally, we may end up with a double benefit, specifically from the one-quarter presence of Qatar in [GULF's underlying index](#). First, if the Saudi accusations are correct, Qatar will need to put an end to any terrorist financing, forthrightly. That action seemingly would mitigate regional political risk. Second, the very act of doing that might cause Saudi Arabia and the others to lift sanctions, eliminating an overhang over both Qatari and Middle Eastern stocks in general, as the threat of hostilities wanes.

One of the big misconceptions about Middle Eastern stock markets is that they are dominated by energy. In fact, the WisdomTree Middle East Dividend Index has less than 2% in energy stocks;³ the bulk of the sector dominance is in financials and telecom. It is completely consistent with a diversification program for Saudi Arabia to slowly liquefy its Saudi Aramco stake and invest in regional equities.

And with a [market capitalization](#) of \$216 billion,⁴ the WisdomTree Middle East Dividend Index can be moved with sums of money that could easily be digested in the U.S. or Western Europe. For context, the [Russell 3000 Index](#) of U.S. stocks has a market cap of \$28.4 trillion, equal to 131 of our Middle East equity baskets.

The Saudi Aramco money will need to find a home. We believe Riyadhology points to the Middle East taking a chunk of it, in a market that is so tiny that the total value of our 100+ stocks is barely larger than General Electric alone.⁵ The positive policy mojo from MBS is just extra gravy.

¹Source: Bloomberg, as of 11/2/17.

²During the Soviet era, a whole cottage industry of think tanks and academics made careers out of studying the comings and goings of Russian politics and Soviet game theory. They were “Kremlinologists.”

³Source: WisdomTree, as of 11/3/17.

⁴Source: Bloomberg, as of 11/6/17.

⁵Source: Bloomberg, as of 11/6/17.

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Hedge: Making an investment to reduce the risk of adverse price movements in an asset. Normally, a hedge consists of taking an offsetting position in a related security, such as a futures contract.

Market Capitalization: Market cap = share prices x number of shares outstanding. Firms with the highest values receive the highest weights in approaches designed to weight firms by market cap.

Russell 3000 Index: Measures the performance of the 3,000 largest U.S. companies based on total market capitalization.