Trade Financial Markets Like The Pros

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The Ghosts In The Machine

There are a number of major factors that individually could continue to twist financial markets into trading patterns that swing exceptionally quickly into wildly contradictory modes, if they are not thoroughly understood in terms of accurate historical precedent, correlations and geopolitical dynamics. These 'ghosts in the machine' are questions of growth in the US, Eurozone, China and Japan, with corollary concerns over the global hydrocarbons market and the risk/reward balance in emerging and frontier markets, in addition to fears over global security pressure points. **At any one moment, one or more of these take precedence in dealing terms over the others, but the order can change in a split second, so thoroughly understanding these 'ghost' factors is vital to ensuring correct portfolio positioning in order to skew the risk/reward balance in a trader's favour, and this is what this section is about.**

Oil

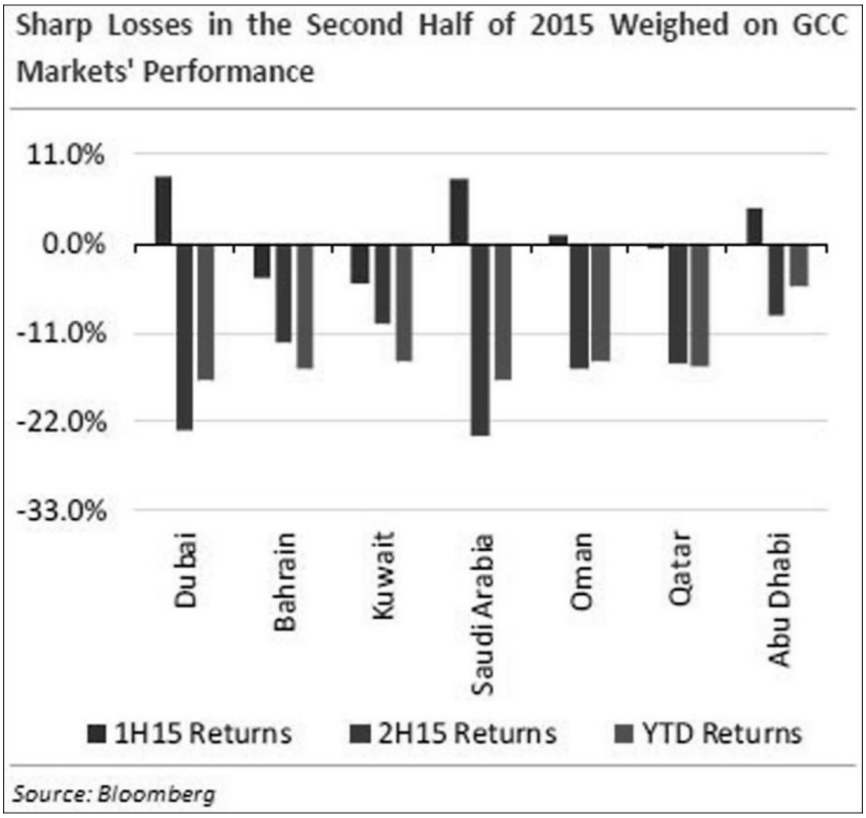
Global energy concerns, both feeding from the price of oil and from geopolitical factors relating to the commodity, will continue to play a huge part in the overall trading dynamics of all asset markets for the foreseeable future. This book has already gone into great depth looking at this problem (and opportunity) from a number of key angles, but the primary takeaway from all of the facts, figures and announcements relating to this sector is that **the Saudi shale-stymieing strategy is not working, that it is threatening to irreparably damage the economies both of Saudi Arabia and all other hydrocarbons-centric countries, that it is unlikely to work ever, and that, in this context, virtually every announcement that Saudi makes is damaging to the oil price, to all related assets and the global economic growth profile taken as a whole.**

A telling example of the way in which global traders regard Saudi Arabia came with the reaction to the announcement in the first half of 2016 that the Kingdom was to attempt to address budgetary pressures (inflicted on itself, of course) by beginning a 'megafund' that would eventually substitute for oil revenues in its revenues mix.

'Moronic', 'barely even half-baked' and 'the sort of thing that you'd expect from a 15 year old doing a basic course in economics' were comments from senior oil traders at serious trading banks to whom I spoke following the announcement, principally on the basis that there was quite obviously a lot less than met the eye to the idea outlined by Saudi Arabia's Deputy Crown Prince Mohammed bin Salman. As far as market players were concerned, in fact, even what was visible was profoundly flawed, reinforcing the market view that **the Saudi heir apparent has no meaningful idea of how to extricate his country from the hole it has dug for itself since it embarked on its strategy to stymie the growth of the nascent shale oil industry two years ago.**

Looking at the latest idea first, the headline news that Saudi Arabia was to create a sovereign wealth fund (SWF) with enormous global market purchasing power – at least USD2 trillion was the figure mentioned by Salman – was, in itself, at the most basic level, extremely misleading. In fact, what was envisioned was that the existing Public Investment Fund (PIF) would have the proceeds of the planned initial public offering of Aramco put into it – itself a hugely dubious prospect – and that the remaining shares in Aramco would also be transferred into the PIF. **However, the net result was likely to be negligible for Saudi Arabia as a whole, as the vast bulk of the fund would, in fact, just be an ownership interest in Aramco and other domestic firms which the Saudis already own. In practical terms, then, it would be just a shift on balance sheets, rather than any new assets or investable funds.**

As for the portion of the fund that did constitute liquid money, available for investment around the globe, in a similar manner to the neighbouring Qatar Investment Authority SWF, it was highly unlikely to amount to anything approaching a significant amount for a top-flight global SWF. **Initially the idea mooted was that all of Aramco was to be floated, then just its downstream operations, and then the indications were that it would just be a relatively small part of its downstream operations, amounting to no more than five percent of the firm at most. Even this, though, is not assured of success.** On the one hand, the usual buyers of such an offering – the SWFs of neighbouring countries – are going to be reluctant to participate in helping Saudi out, given what the Kingdom's shale strategy has done to their economies (at least USD300 billion in lost government revenues for GCC countries in the past two years, according to the IMF), not to mention that they would regard any possible investment monies in Aramco as being better invested by themselves in Western enterprises and/or market assets. On the other hand, Western investors would demand an international level of transparency in Aramco's accounts and operations as a pre-requisite for any investment, which Saudi will never provide.

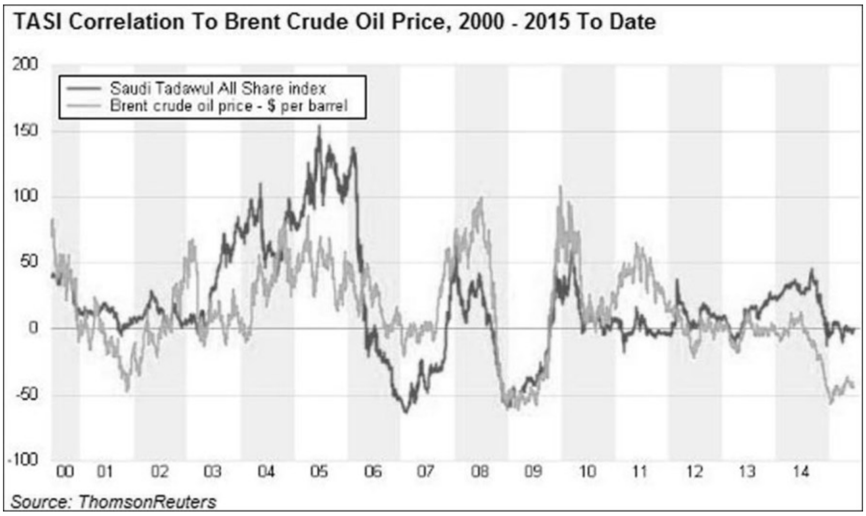


Feeding into this negative investment scenario is the way in which the Tadawul All Share Index (TASI) has performed and operated since it was opened up to direct foreign non-Gulf investment participation in June 2015. Over and above the fact that it was the second worst performer of all MidEast stock markets in 2015 (after Egypt's Hermes Index), the worst in 2016 and has seen its market capitalisation fall from around USD530 billion in June 2015 to about USD377 billion by the end of the first quarter of 2016, the assurances of the Exchange's chief executive officer, Adel al-Ghamdi, in Riyadh, that the market would move quickly towards Western levels of compliance and ease of trading have proved hollow thus far.

Severe limitations on Qualified Foreign Investors (QFIs) still remain in place (including the ownership cap of 10% of a firm by value, which raises serious questions about forced liquidations of existing holdings at that 10% mark when the value of the market falls), concerns over minority shareholders persist and, on even the most basic level, only around 45% of company announcements in the Saudi market are in English as well as Arabic. **Meaningful announcements, either of the accounting or operational variety, in whatever language, are also few and far between.** A very large proportion of the emails sent out every day from the TASI say that X or Y company has failed to provide any accounts for the month or the quarter, even some of the bigger names.

This lack of a coherent strategy to build out its benchmark stock exchange as promised only confirms the financial markets' general view that Saudi Arabia's overall vision is profoundly confused. **The way the market sees it is that Saudi started out with the absolute objective to push the oil price down to whatever level was necessary to destroy as much of the shale industry as possible – Saudi Oil Minister, Ali Al-Naimi, in December 2014 said whether it goes down to twenty dollars is irrelevant – but, having ruined the finances of its neighbours and its own to a degree, it suddenly turns around and announces an**

output freeze, with the aim of boosting the oil price, even though the shale industry is still going strong.



If that did not look incompetent enough to dealers, who essentially make their living sussing out and exploiting stupidity, even the tactic was ill-judged, in that it involved freezing output at record high levels and did not take into account that some of the biggest producers, like Iran and Iraq, would obviously not take part. The Saudis shot themselves in the foot from every direction, and now the markets think that it does not know what it is doing at all. Attesting to Saudi Arabia's increasing lack of investability is the dramatic decline in both capital flows and foreign direct investment (FDI) into the Kingdom, much more than has been seen in neighbouring Middle East hydrocarbons producers over the ongoing oil price downturn.

In this respect, net capital flows to the Kingdom averaged just under USD8 billion from 1961 (when records began) to the beginning of 2015, but went into negative territory in the first quarter of 2015 (negative USD14.787 billion in that quarter alone), where they have remained ever since, whilst FDI has similarly plummeted from an average of just over USD5.1 billion from 2006 until the beginning of 2015, to a record low of just under USD2 billion in the first quarter of that year, around which level it remains.

Finally, having inveigled a number of its neighbouring hydrocarbons-producing neighbours into an oil output freeze, even after its over-production strategy had caused such profound economic damage to them, Saudi Arabia then (in April 2016) decided to abandon its own notion of extending the freeze once more. **'Betting on the stupidity and lack of market savvy of Saudi is a one hundred per cent winning trade, whichever method you use to do it', was the judgment of perhaps the most successful oil trader still active.**

At some point, oil will see its fortunes turn around in a significant way, as the global supply and demand mix rebalances, and when this has clearly manifested itself into an upwards oil price trend then obviously the positions to be taken would be the opposite of those outlined above.

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