ZANETTI FINANCIAL, LLC

Zanetti Monday Missive 2022.10.31
Et Tu Saudi Arabia

Happy Monday, Everyone!

It's Walt Benson here, your friendly neighborhood Financial Advisor. Last week, I wrote about oil, Saudi Arabia, the Petrodollar, and the new BRICS negotiations. There's so much to unpack there that Greg is continuing with the subject today.

So, without further ado, here's Round TWO!

"You can avoid reality, but you cannot avoid the consequences of avoiding reality."
~ Ayn Rand

“Sooner or later everyone sits down to a banquet of consequences.”

~ Robert Louis Stevenson

Hello Everyone,

Some of you are receiving the “Monday Missive” for the first time. Many of you should have been receiving it for a long time. My apologies.

The missive is meant to be read in under two minutes.

It is also meant to give you a different view of the world of money and politics.

As you can guess from the opening quotes, today’s theme is consequences have consequences…have consequences. :>)

Fed Chair Jerome Powell and Saudi Prince Mohammed bin Salman are not usually mentioned in the same sentence, but here is where today’s “consequences have consequences” theme meet.

So, let’s get to it.

I am not a Mixed Martial Arts fan. But I know enough to know the Ultimate Fighting Championships are held in the Octagon.

There is no escape from the Octagon. Fighters can’t jump out of the ring through the ropes. And the fights can be brutal.

The US and Saudi Arabia are in the Octagon.

We all know the Saudi’s body-slammed the Biden Administration when they recently cut oil production by 2 million barrels per day.

That immediately led to a quick spike in oil prices just before the mid-term elections.

As you might guess, the Democrats were not pleased.

What can we read from Saudi Arabia’s actions? And what does it mean for us going forward?

For those of you who don’t want to read the whole missive here is the BLUF---Bottom Line Up Front:

The most important issues of 2023 will be energy and

food costs.

Not interest rates. Not the border. Not gender identity.

<u>Food</u> and <u>Energy</u> costs.

Here is my take:

- Strategically, the Saudis have flipped. The Kingdom is no longer with the US.
- The Saudis are instead siding with Russia, China, & India.
- As an aside, if the Saudis believed the Russians were losing the war in Ukraine, they would not have cut oil production.
- If (when?) the Chinese invade Taiwan, don't expect the Saudis to cut oil flows to Xi.
- Ultimately, the petro-dollar deal is dead. The authorities just haven't officially pronounced the time of death. (For new readers, the dollar has effectively been backed by oil since Henry Kissinger cut the oil-for-dollars agreement with the Saudis—in exchange for US military protection---back in the early 1970's.)
- And, since food and energy are inextricably linked, rising energy prices = higher food prices.

OK. So, now let's add a twist.

Fed Chair, Jerome Powell, is partially responsible for the US-Saudi split.

"But wait!" you say. *"Jerome Powell? How can that be!? The Federal Reserve has nothing to do with Saudi Arabia.*

Powell has never met Saudi leadership. He is not responsible for energy policy. He is not depleting the Strategic Petroleum Reserve. This is all politically driven. Not interest rate driven."

If you said or thought that, you are correct. There is no direct link between rising US interest rates and the Saudi split.

But, indirectly, the Saudis see rising rates as an attack on the Kingdom's economy.

Here's how:

- As the US Fed raises rates, it not only slows down the US economy, it also slows down the world economy.
- As the global economy slows, energy demand falls.
- As energy demand falls, prices fall.
- Falling energy prices hurt the Saudis.
- The Saudis (Sunni Muslims) need high oil prices to:
  - Keep Iran (Shia Muslims) at bay.
  - Prevent Yemen from rising up against them.
  - Placate (read: bribe) rival Sunni tribes who resent Saudi monopolistic power
  - Provide needed capital to diversify the Saudi economy away from total oil (a depleting asset) dependence to a more information/technology economy.

Thus, the Saudis have cut oil production and basically said, *"Look America, we can cut supply much faster than you can slow the economy. And by cutting supply we can keep oil prices elevated. Oh, and Russia and China have our back on this."*

And they are right.

So, look what is happening.

Global inflation is not slowing down despite the slowing economies. And elevated energy prices are part of the reason.

Next, energy is being diverted from west to east. (Russia and OPEC are sending oil to Asia vs. US and Europe.) **And we are now looking at critically low diesel shortages occurring in the US.**

And since everything in the food chain----from fertilizer, to harvesting, to packaging, to trucking---- is dependent on energy prices, it is not hard to predict that food and energy will take center stage in 2023.

Couple this with drought (anyone looked at Mississippi River water levels lately?) and persistent supply chain issues (Covid + War in Ukraine + China Trade Sanctions) and food/energy inflation is not hard to predict.

As consumers, none of us like rising food and energy costs. And price hikes here disproportionately hurt the poor and middle class. Ugh.

As an investor though, you want the price of your products rising…and products for which there are no substitutes.

Thus, we are staying committed to the hard-asset-commodity-heavy investment strategy….even though we do not like its societal effects.

Strange days indeed.

Signed, Your Elon-Musk-Brought-Halloween-Early-To-Many-Twitter-Employees Financial Advisor,
Greg

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Our mailing address is:

5120 San Francisco Rd NE
Suite A

Albuquerque, NM 87109

505-858-3303