

# Market Report

## October 2009

## Rough

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A small DTC sight, still somewhat expensive Russian and a lack of Angola goods have combined to produce an unexpected firmness in the Indian-driven rough market.

The dip and the resistance we felt coming in the rough market last month hasn't come through. Prices of rough, first hand and second hand, remain high. At the last BHP spot sale, prices of + 2cts were up 2.2%, medium sizes 2.4%, and smalls only 1%. The main thing is that they haven't come down. The reason for this is the relative scarcity of goods.

What hasn't changed compared to last month is that manufacturers of medium and large goods are still quite picky about what they need. They are prepared to pay 1-3% more for what they want, but nothing like the premiums we see in some of the Indian goods.

Premiums on DTC boxes were higher than last month, but we question whether many transactions actually took place in medium and large goods. There was good demand for 4-8grs, crystals, and some of the Indian boxes.

The strong Indian demand for rough has several drivers:

- Additional last minute orders from USA and speculation that US retail will pick up
- Dwindling inventories
- Anticipation that there is going to be a shortage of rough
- Buying rough to create work in progress for polishers
- Speculation
- Increased liquidity and good feeling created by the rising Indian stock market

The disconnect between rough and polished prices continues to fuel fears of a market that is increasingly becoming unstable. It is also causing people to move away from rough manufacturing into polished trading.

Diamond banks continue to look for the appropriate balance in serving their clients.

### Botswana

There are a number of companies showing interest in "the parallel trading channel" and the Diamond Hub has put several conditions into the process. Four issues that need to be resolved before issuing the licences are:

- Completion of the tax regime and related fiscal aspects
- Procedures for tracing origins of rough traded
- Putting in place due diligence procedures
- What to do with existing dealer licences held by current sightholders (which are apparently not acceptable at the moment for anything other than buying from DTCB).

The deadline for having all of the above resolved and to start issuing trading licences is currently end of 2009 / beginning of 2010.

The government is working to establish a turnover tax while sightholders are mostly asking to remain with the original corporate tax structure. It seems now government will no longer consult a large forum for tax matters, but will impose their preferred tax system and ask for 'public' comments before final implementation.

There are also plans to establish a diamond exchange in Gabarone modelled after Tel-Aviv and Antwerp.

## ■ Polished

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The Hong Kong show drew a wide range of verdicts, but the issue that stood out was the continuing commoditization of pointers and 4grs, where demand is healthy. Elsewhere, the US market remains slack and mostly disappointing.

**Antwerp:** Despite an upbeat rough market, polished demand in Antwerp showed virtually no change from the previous month. Some traders even reported a further weakening of sales in the last 2 weeks. Demand for pointer dossiers (20pts+) in the middle and top end of the market seems to be the only bright spot today, though a lack of availability and stiff price competition are limiting business. Buyers today choose to order small quantities more regularly rather than large amounts occasionally.

The situation in the better end of smalls has become worrisome since most luxury brands have gone quiet. As a result, traders are forced to go after new customers and have to make price concessions if they want to avoid credit risk. Despite pressure from the rough suppliers, the value of polished in this area is eroding with the disappearance of the premium segment.

Demand for 50 – 69pts has been described as very hot, especially in IF – VS2 quality, D-I colour. Prices have firmed 2 to 3%. Sales in 30 – 49pts remain stable.

**Tel-Aviv:** The main event in September was the Hong Kong show where much of the industry's polished went on display. Reports on the results of the show were mostly negative, and the following is commonly said:

- Buyers came armed with pre-prepared shopping lists for specific items. They went from booth to booth looking for the lowest prices and were not willing to deviate from what they came to buy.
- Buyers were looking for certified goods.
- Many said they were able to add a few new clients this year.
- The sellers from India out-competed the Israelis with lower prices.
- Some said sales were pretty good and some said dismal. All said profitability was low to non-existent as buyers were extremely price resistant.

Demand from America for the season has been tepid so far. Manufacturers say there are fewer retailers to sell to: some of the majors have downsized or gone bankrupt while many of the independents are deemed a credit risk. There are orders still coming in but at the moment they are for specific, missing items needed for stock. One hopes that buyers are simply waiting for the last possible minute to buy although we are fast approaching the 'now or never point' for the season. Short-term prospects are not good as America is still mired in the recession and unemployment continues to rise.

Round 4 and 6 grs continue to move well from VVS-I2, D-J. 2 cts are moving slowly. Princess cuts are moving slowly again after a relatively good summer. Round-edge fancies are moving very slowly under 2 cts but there is slightly better demand in the 3-5 ct range for higher colours and clarities with good makes.

**Mumbai:** Loose buyers at the Hong Kong Jewellery Fair were primarily Indian, with large numbers of GIA dossiers exchanging hands this month. To give an idea of volumes of dossiers being traded, GIA turnaround of stones was at an all-time high, with polished being sent to Karlsbad for certification as the Indian laboratory could not deal with the volumes.

Polished prices increased last month with strong demand for 0.50-1ct GIA certificates. Also moving well were 0.18-0.22 ct pique and naats.

**New York:** The market remains quiet and it is this, at a stage in the season when sales start peaking, which is causing some concern amongst diamantaires in New York. That said, a few have reported recent sizeable late orders, but their timing may mean that they are difficult to fulfill.

Many had been pinning their hopes of a surge in business at the Hong Kong show to lay the foundations for the season. Some reported healthy sales, however, some were disappointed. But all were concerned about the commoditization of polished and the squeeze on margins.

The 5+ct range continues to be slow except for stones sold at a better-than-market discount. 1-1.50 ct continues to be the strongest range although stiff price resistance was felt at the HK show.

**Hong Kong:** The September Hong Kong Watch and Jewellery Fair attracted record members of participants and goods. People didn't like the split locations since it increased costs and diverted buyers' attention. As for loose diamonds, people were relatively happy about levels of sales although these were well below last year.

People gave the show an average score. Everyone complained about price competition though, especially from day three when the Wanchai Jewellery show started; distress sales were a common feature. One might wonder what the point is of having trade shows for loose diamonds where everyone comes with the same product, to the same place and fights for the same customer, it reduces the business to its lowest common denominator: price.

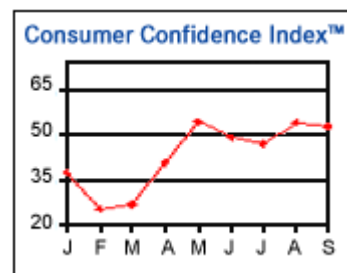
The main article for many Asian markets, 0.30-0.90pts GIA dossiers, has been totally commoditized. It has become a totally transparent certificate business in which there are no more secrets and the only differentiation is price.

Apart from the Trade Fair, it seems that business in Hong Kong has picked up a bit since mid August, although the jewellery manufacturing and export business is still very sick. Most of them had to renegotiate their debt and extend to anything between 6 months and 2 years.

On October 7th Sotheby's Hong Kong held an important auction for Magnificent Jewels & Jadeite. The total amount auctioned was US \$33m, the flagship being an important Fancy intense blue emerald-cut diamond, weighing 8.74 carats flanked by two emerald-cut diamonds together weighing 1.00 carat in a white gold ring. The ring was estimated between \$4.50m and \$5.80m, and was sold for \$5.65m.

## ■ Retail

The **Conference Board Consumer Confidence Index™**, which had improved in August, dipped in September. The Index now stands at 53.1, down from 54.5 in August. "Consumer Confidence, which had improved in August, retreated slightly in September. Consumers viewed both current business conditions and the labor market less favorably than last month. While not as pessimistic as earlier this year, consumers remain quite apprehensive about the short-term outlook and their incomes. With the holiday season quickly approaching, this is not very encouraging news." (According to the Conference Board)



## EUROPE

With the entire European market being in a recessionary environment, downstream demand has not materialized. Retail demand remains soft across all markets. Retailers have cut back on reorders in an effort to clean up existing inventories and conserve cash.

The biggest market in Europe, Italy, has been described as 'totally dead', though a few people are still working well (as in every market). The recent Vicenza show was reported to be busier than the previous one in May and decent activity took place. Payment terms remain problematic in this market. France and UK are slow, demand from Spain is non-existent with plenty of stocks sitting with wholesalers. In Germany, independents perform better than department stores thanks to their flexibility. Sales of chains are equally sluggish.

Good activity in Turkey. Most of the Swiss brands refrained from buying fresh goods in September and while being known for not questioning price, they have now become very price conscious buyers. On average, YTD orders are down between 15 and 50%.

Richemont reported that the first 5 months of this year overall sales fell by 16% compared to 2008. US region was the worst performer, as expected in the circumstances, with a decline of 36%. Sales in the Asia-Pacific region, including China, grew by 5% per cent although sales in Japan were down 7%. European sales were 22% lower, including the Middle East, which is still growing. The Group's retail business, through its own stores, has fared reasonably well, being only 7% below last year's level; wholesale business on the other hand is down by 21%, which largely reflects de-stocking by retailers.

## **USA**

Finlay Enterprises has filed the necessary paperwork to delay reporting its second-quarter fiscal results. Finlay Enterprises is also closing all of its speciality jewellery store nameplates, which include Bailey Banks & Biddle, Congress Jewelers, Carlyle & Co., J.E. Caldwell, Park Promenade and Zell Bros. Jewelers. After twice delaying the reporting of its financial results, Zale Corp. now expects to report results by Oct. 29, "although this date may change if unforeseen circumstances arise".

Bulgari is shifting locations of several of its US stores in an effort to shore up lagging growth. The company has closed stores in Palm Beach, Aspen and on New York's Madison Avenue and plans to open units in San Francisco, Las Vegas and Dallas this year. Bulgari has 15 directly-held boutiques in the US including stores.

Bridal diamond sales in the independent guild stores are stable and increasing very slightly. However, it is the price point that will be considered the key to this season. The Everlon sterling silver pieces in the \$199-\$399 may well prove to be winners, particularly with gold over \$1000. That said, the market is expecting sales to be at the same level as last year. Unemployment still has a long way to go until its peak, and the threat of increasing interest rates will undoubtedly hold many back from big spending.

U.S. holiday retail sales are expected to decline 1% this year to \$437.6 billion, according to a National Retail Federation (NRF) forecast released on Tuesday.

These sales include retail industry sales in November and December at traditional retail categories such as discount stores, department stores, supermarkets and speciality stores, but exclude sales at car dealers, petrol stations and restaurants.

## **HONG KONG AND CHINA**

Chinese retail business indeed picked up in September as was expected. For the year to date we see a high single digit growth, fuelled by growth in the 'smaller' cities, because big cities are often down. Also, retail growth is mainly because of distribution network expansion and not organic. The next six months will show us whether this is sustainable and whether there is enough flow-through to the consumer.

The range of goods being sold in China is definitely expanding with more SI and I1 goods and lower colours (JKL) as well. Triple Excellent goods are often desired, even in the lower qualities, and Hearts & Arrows for the moment seems to be a gimmick and not all that important. Forevermark is having discussions with NGTC, China regarding Chinese certificates.

## **INDIA**

With Diwali just around the corner and retailers stocking up for the marriage season, polished in all ranges is moving very well. Pique is moving faster than quality goods but with smaller margins.

Several retailers and wholesalers to tier 1 and tier 2 cities have posted considerable sales growth in September, some up to 10%. Moreover, with the rupee firming against the dollar, gold prices are likely to get capped, thereby further boosting further demand for jewellery. After the low key activity of the past few months, the retail industry is looking forward to a good season.