

Executive Summary*Polished*

- The RapNet Diamond Index (RAPI™) for 1.00-carat diamonds fell 4.5 percent to 99.57 in September.
- RAPI for 1.00-carat stones dropped 8.6 percent in the third quarter but was still up 22.5 percent for the year.
- Patient Chinese buyers at Hong Kong Jewellery & Gem Fair insisted on lower prices and avoided large inventory purchases.
- The show was slow but was still better than expected.
- Cash-strapped Indian suppliers are willing to discount.

Rough

- Dealer trading is at a standstill as buyers push for deeper discounts.
- De Beers keeps its prices stable even as Diamond Trading Company (DTC) boxes trade at average discounts of 15 percent to 20 percent.
- DTC September sight was estimated at \$500 million.
- Indian manufacturers have sufficient inventory to work through Diwali.

Retail & Economy

- All eyes on China's Golden Week (October 1) and India's Diwali season (October 26) as the industry hopes Far East and Asia-Pacific demand will withstand global economic pressures.
- U.S. consumer confidence remains at weak recessionary levels.
- European debt crisis fuels concerns about the global recovery.
- Financial markets slump to close worst quarter since 2008.

Conclusion: Third Quarter Jitters

The Hong Kong show, which took place in late September, proved an important bellwether for conditions in the diamond market.

Trends that emerged indicate that demand is being driven almost exclusively by retailers buying to fill existing orders, with very little dealer trading taking place. The same is true in the rough market where dealer activity remains unnervingly quiet. Even if traffic in Hong Kong was low, relative to past shows, the underlying Chinese demand continues to drive growth.

Polished prices softened, as reflected in the RapNet Diamond Index (RAPI™). There was a lot of negotiating at the show with some small-to-medium-size Indian suppliers willing to discount more than others. Other sellers appeared intent on holding to their downside limits and there was no real panic selling. Still, consumers are cautious and investors jittery.

The downtrend does not come as a surprise since both rough and polished prices softened in August - in fact, signs of an uncertain market were evident already in July. Weak economic sentiment, propelled by the European and U.S. debt crises, has fueled caution and will continue to do so. As a result, the third quarter was a weak period for the diamond industry, as it was for global markets. Much still hinges on external forces as we enter the all-important fourth quarter.

The Polished Market

Polished diamond prices continued to fall in September as economic uncertainty and tight liquidity in the cutting centers impacted trading.

Business at the long-awaited Hong Kong Jewellery & Gem Fair proved slow but better than expected. Chinese buyers insisted on lower prices and avoided making large-volume purchases as they anticipated further softening in the market. Some cash-strapped Indian suppliers were prepared to discount while other suppliers struggled to hold their prices firm.

The mood at the show reflected concerns for the global economic recovery as buyers and suppliers appeared uncertain about the prospects for fourth-quarter growth given Europe's debt crisis, pending further U.S. debt discussions, and sluggish economic sentiment.

Far East demand for diamonds is stable but retailers in the region are prepared to sit on low inventories, still stocked with goods they aggressively accumulated during the first half of the year, as they wait to assess the extent of the current correction and future price trends.

Buying for most of the month was focused on filling existing retail orders with very little dealer trading taking place.

The RapNet Diamond Index (RAPI) for 1.00-carat polished diamonds fell 4.5 percent to 99.57 in September (see Figure 1), while RAPI for 0.50-carat stones declined by 4.5 percent to 36.47, and RAPI for 3.00-carat diamonds dropped 0.9 percent to 168.04.

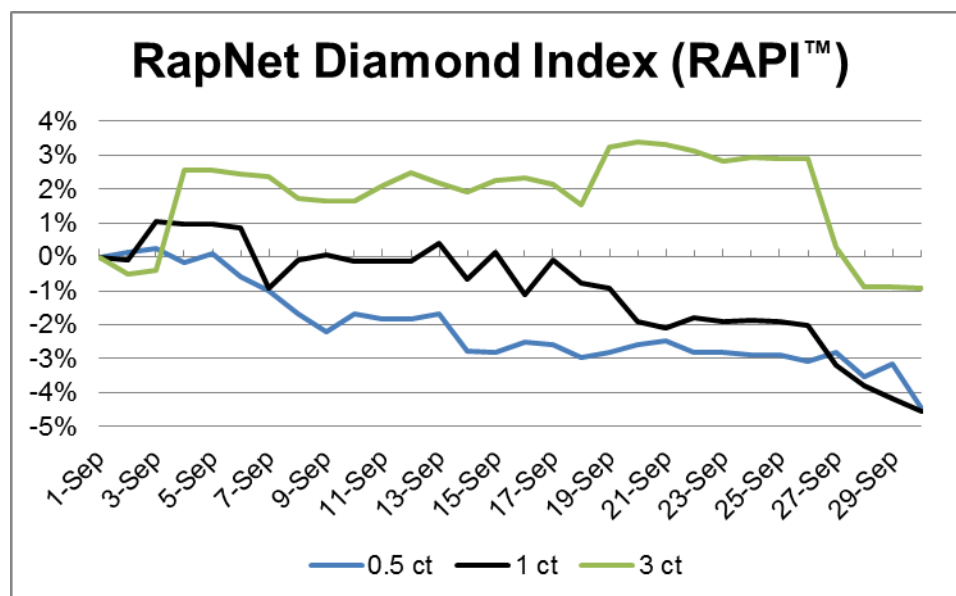


Figure 1

The RAPI is based on the best asking price in hundred \$/ct. for the top 25 quality round diamonds (D-H, IF-VS2, RapSpec-2 and better) offered for sale on RapNet – Rapaport Diamond Trading Network.

The trend followed similar declines that were seen in August as polished prices closed the third quarter in negative territory. RAPI for 1.00-carat diamonds fell 8.6 percent during the three months that ended on September 30, 2011 (see Figure 2, Column 2).

For the year to date, prices were still up significantly as RAPI for 1.00-carat stones increased 22.5 percent through the nine month period (see Figure 2, Column 3) and ended September 23.7 percent above the level of one year ago (see Figure 2, Column 4).

RapNet Diamond Index (RAPI™)				
	Column 1	Column 2	Column 3	Column 4
	September	3Q 2011	Jan - Sep 2011	Y2Y Changes at Sep 30
RAPI (1 Cts)	-4.5%	-8.6%	22.5%	23.7%
0.5 cts	-4.5%	-7.5%	26.9%	29.3%
3 cts	-0.9%	-5.8%	23.8%	20.7%

Figure 2

The RAPI is based on the best asking price in hundred \$/ct. for the top 25 quality round diamonds (D-H, IF-VS2, RapSpec-2 and better) offered for sale on RapNet – Rapaport Diamond Trading Network.

The Rough Market

Dealer trading in the rough market came to a near standstill as buyers are asking deep discounts of around 15 percent to 20 percent on Diamond Trading Company (DTC) boxes, which sellers were reluctant to accept. In addition, rough inventories among Indian manufacturers are sufficient to last through the Diwali season, which begins on October 26, during which Indian factories close. They are hesitant to lay out additional capital for rough purchases, especially given the low liquidity available and as they remain cautious about the market in the near-term.

On the other hand, large dealers with strong liquidity are expected to start buying up goods at current discounted rates. Rough availability is expected to rise as speculation in the dealer market diminishes and as cutters seek to ramp up production.

Firestone Diamonds reported weak demand for small stones at its September tender at the beginning of the month, and Petra Diamonds noted that prices at its most recent tender were below the June 2011 highs.

DTC's September sight, which took place the week after the Hong Kong show, had an estimated value of \$500 million. De Beers kept its prices stable and did not make any changes to assortments. The company has pledged to maintain that policy at least until the end of the year in an effort to buoy up market sentiment. ALROSA has made a similar commitment.

The sight value was slightly above the September-October sights of the previous two years (see Figure 3) but the volume of supply has been stable, if not slightly down, as growth has been driven largely by the price increases experienced in the first half of 2011.

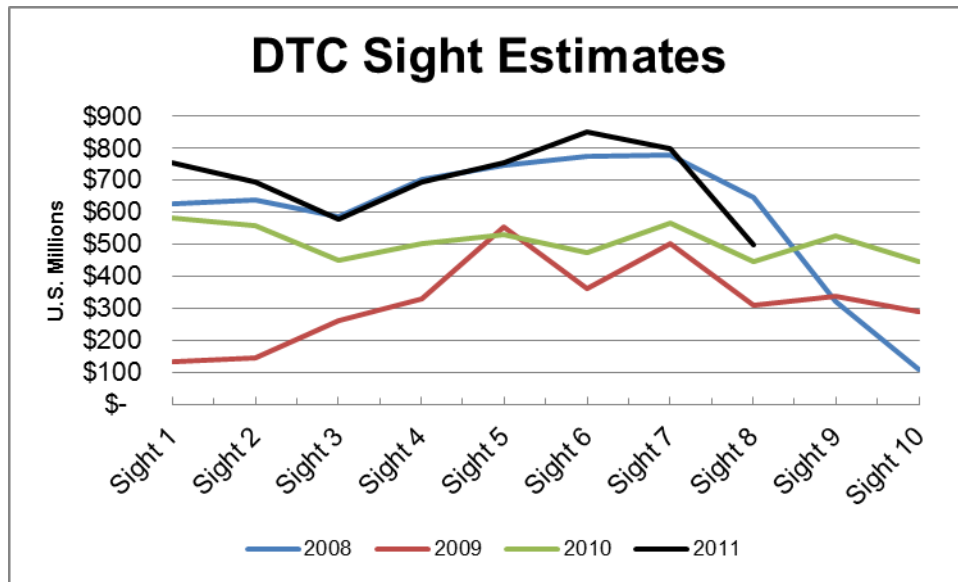


Figure 3

Data is based on Rapaport estimates with those for 2008 to 1H 2011 adjusted to reflect DTC sales as reported by De Beers in its financial statements.

Average prices are estimated to be approximately 40 percent above levels of one year ago having declined by about 15 percent to 20 percent since the beginning of August (see Figure 4).



Figure 4

Rapaport Estimates.

Retail & the Economy

Jewelry retailers have avoided building their diamond inventory and have focused instead on buying to fill existing orders. The focus of industry growth continues to shift to the east as expectations rose for China's National Day Golden Week, a major retail period which began on October 1, and as the outlook remains positive for India's Diwali season.

The outlook for the U.S. fourth-quarter season remains subdued as consumer confidence has fallen to lows last seen during the recession. The Conference Board's Consumer Confidence Index was basically unchanged in September but remained at a 30-month low following the sharp decline in August (see Figure 5).

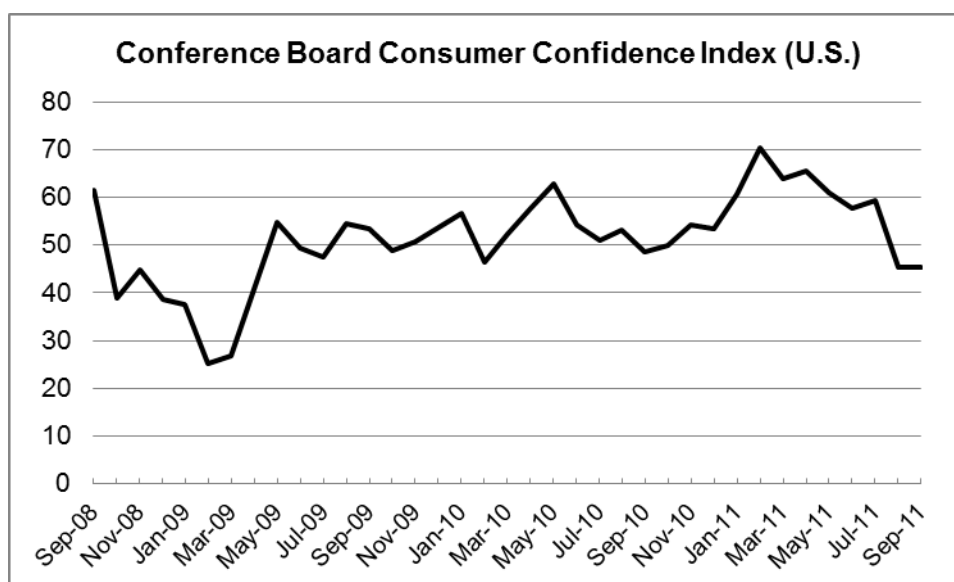


Figure 5

Based on data collected from the Conference Board.

Weak consumer sentiment in the U.S. is attributed to the persistently high unemployment numbers, pegged at around 9 percent since April 2009, as well as to declining personal income, Europe's debt crisis and U.S. political wrangling over its national debt, and has kept consumers cautious and investors jittery.

Their nerves have been evident in the volatile financial markets in the third quarter, which experienced their worst quarter since the crash of September 2008, wiping out gains made in the first half of the year. The Dow Jones Industrial Average lost 12 percent during the quarter; while Hong Kong's Hang Sang Index fell 23 percent and London's FTSE 100 declined by 14 percent (see Figure 6).

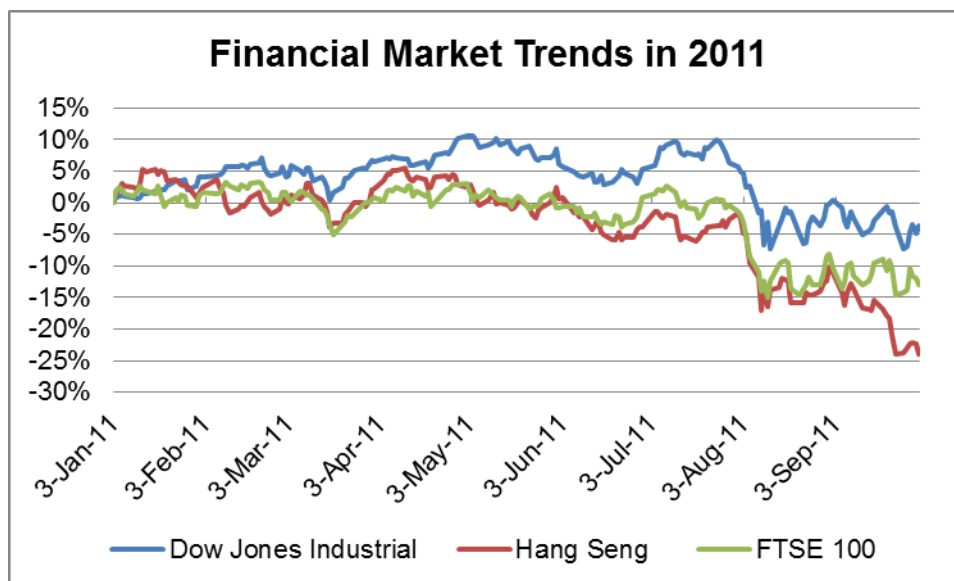


Figure 6

While long-term supply-demand fundamentals remain in place for the diamond industry, these economic trends are uppermost in the minds of many in the near term. The industry anxiously watches developments in Europe and the U.S., as well its own liquidity levels, as the fourth quarter gets underway.

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