Executive Summary

Polished: Uncertainty Prevails

- The RapNet Diamond Index (RAPI™) for 1.00-carat diamonds fell 4 percent to 103.91 in August.
- The RAPI increased 27.9 percent in the first eight months of the year.
- Buyers demanded lower prices at the India International Jewellery Show (IIJS) due to financial uncertainties.
- Lack of liquidity surfaces in India.
- Polished dealers seeking price stability ahead of Hong Kong show.
- Manufacturing expected to increase as polished inventories are low and rough inventories high ahead of the fourth-quarter holiday season.
- U.S trade buoyed by high prices as import and export volume stays low.
- Hong Kong 2Q data signals continued shift toward the Far East.

Rough: Trading Slows as Prices Drop

- Trading slowed in the dealer market as premiums fell to near zero, with some goods selling at a discount.
- Liquidity issues in India put a strain on rough buying.
- BHP Billiton's tender prices fell 15 percent to 20 percent in August.
- De Beers Diamond Trading Company (DTC) held prices steady, increasing some items by low-single-digit percentages.
- DTC August sight valued at an estimated $800 million.
- More than $2.5 billion worth of rough released to the market in July and August despite market slump.
- Exports from Zimbabwe's Marange fields continue amidst new reports of human rights abuses in the area.

Retail: Slow Growth Persists

- Major retailers post strong second-quarter sales growth.
- Overall U.S. jewelry store sales basically flat in second quarter.
- Jewelry prices continue to rise.
- Bridal sector drives sales but survey by XO group indicates average spending on engagement rings has fallen.
- Consumer confidence in U.S. falls to lowest level since April 2009.

Conclusion: Activity in the diamond market slowed in August as the slump in consumer and investor confidence filtered down to the trade. While bourses in Belgium and Israel were closed for the summer months, Indian polished buyers held back due to tight liquidity and global economic uncertainties. Rough prices in the dealer market fell while mining companies released large volumes of goods to the market. Dealers are hoping for polished price stability before the Hong Kong Jewellery & Gem Fair, which starts on September 19, which would fuel some confidence for the fourth-quarter buying seasons in China, India and the U.S. Rising luxury and investment demand in Hong Kong and other wealthy markets are expected to stabilize polished diamond prices.

The Polished Market

Diamond trading slowed in August as the market grew cautious about prospects for the global economic recovery. Traders in Belgium and Israel took their summer breaks as the bourses in those countries were closed, while dealers in India faced new liquidity challenges.

Trading of loose diamonds at the India International Jewellery Show (IIJS), which took place in Mumbai at the beginning of the month, fell below expectations as buyers demanded lower prices due to financial uncertainties. The show coincided with the announcement by Standard & Poor's (S&P) that it had lowered its rating on U.S. debt, which triggered further nervousness about the global economic recovery. General jewelry sales were satisfactory at the show as Indian consumers continued to focus on gold as a safe-haven asset.

The RapNet Diamond Index (RAPI™) for 1.00-carat polished diamonds fell 4 percent to 103.91 in August (see Figure 1), while the RAPI for 0.50-carat stones declined by 2.2 percent to 38.24, and the RAPI for 3.00-carat diamonds dropped 5.4 percent to 371.58. The RapNet Composite Index fell 4.9 percent to 171.25.

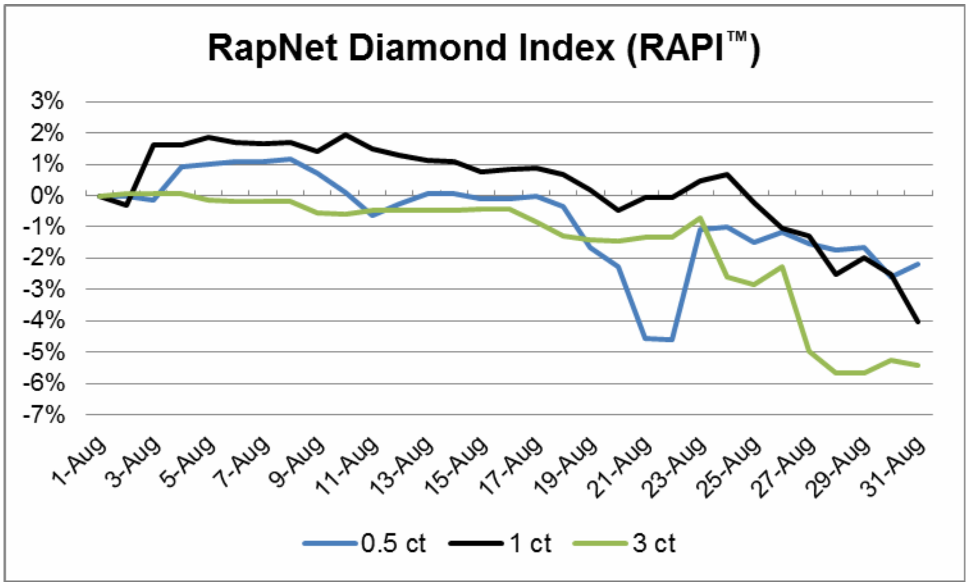

Figure 1

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 downturn was largely seen as a correction in the market after prices rose significantly in the first half of the year, but were basically stable through July. The RAPI for 1.00-carat diamonds rose 27.9 percent in the first eight months of the year (see Figure 2, column titled 'Jan – Aug 2011') and was up 29.7 percent from one year ago (see Figure 2, column titled 'Y2Y Changes at Aug 31').

RapNet Diamond Index (RAPI™)			
	August	**Jan-Aug 2011**	**Y2Y Changes at Aug 31**
RAPI (1 cts)	-4.0%	27.9%	29.7%
0.5 cts	-2.2%	33.1%	35.6%
3 cts	-5.4%	25.0%	24.4%

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.

Polished dealers continue to seek price stability and are hoping to achieve this before the September Hong Kong show, which they are anticipating will signal renewed confidence for the fourth-quarter buying season – which includes China's National Day Golden Week celebration (October 1), India's Diwali festival (October 26), and the Christmas holiday period.

Polished inventories are said to be low and rough inventories high, which may work in the industry's favor in the fourth quarter. Manufacturing is expected to increase in the coming months to satisfy demand for the respective holidays. While there are few reports of polished shortages, dealers are looking for the right goods at the right price and appear to have delayed making large purchases to fill inventories for the season until they sense some price stability.

U.S. Polished Trade

The polished trade through the U.S. is expected to continue its uptrend when compared to last year, as higher prices buoy the value of imports and exports. However, volumes are likely to remain low, as they were during the first half of 2011.

While the value of U.S. polished imports and exports have exceeded pre-recession 2008 levels (see Figure 3), the volume of imports have remained basically steady through the past four years, while export volumes have dropped (see Figure 4).

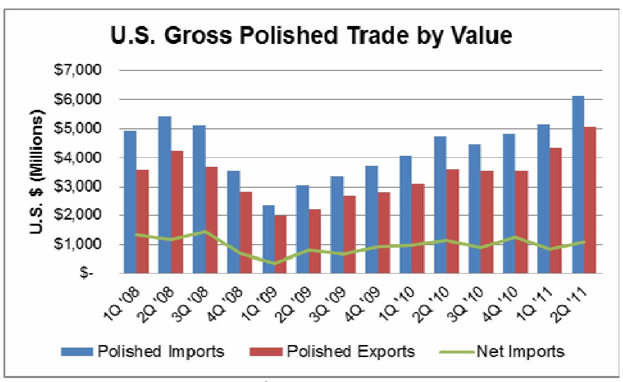

Figure 3

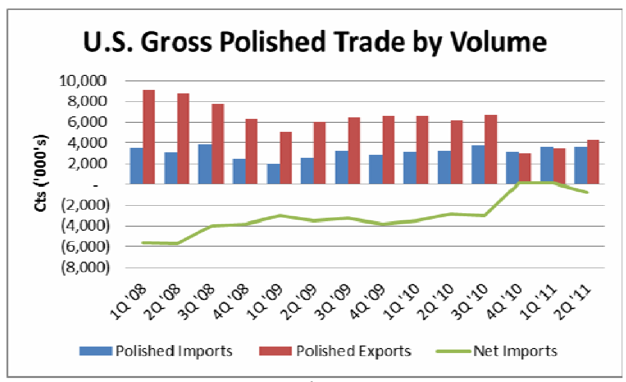

Figure 4

Source: Based on monthly data published by the U.S. Commerce Department.

During the second quarter, polished imports to the U.S. rose 30 percent year on year to $6.14 billion with imports by volume up 9 percent to 3.61 million carats. Polished exports rose 41 percent to $5.06 billion but exports by volume decreased by 30 percent to 4.327 million carats.

As a result of rising exports, the net polished imports – representing imports less exports to indicate the amount of goods that remained in the U.S. for consumption – fell 5 percent to $1.08 billion (see green trend line in Figure 3 above). Net polished imports by volume, which have historically shown a deficit, improved by 75 percent to negative 716,629 carats in the second quarter of 2011 (see green trend line in Figure 4 above).

It appears that the characteristics of the U.S. trade are changing as the country has raised its exports of higher-value goods. While the average price of imports grew 19 percent to $1,700 per carat, the average price of polished exports doubled to $1,168 per carat (see Figure 5).

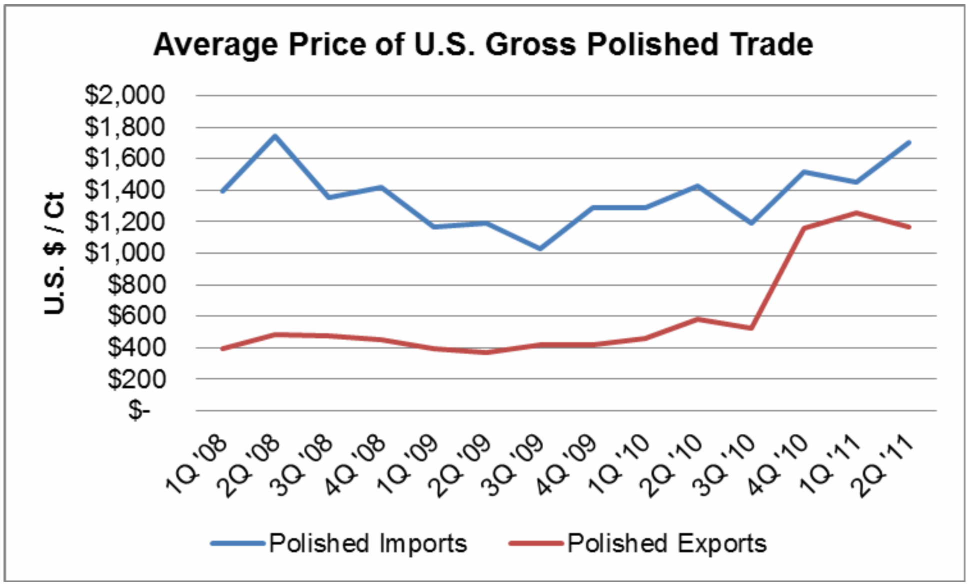

Figure 5

Source: Based on monthly data published by the U.S. Commerce Department.

<u>Hong Kong Polished Trade</u>

The polished trade through Hong Kong has been on a steady uptrend since the downturn of 2008-09. Polished imports rose 37 percent year on year to $4.53 billion in the second quarter of 2011 while polished exports grew 44 percent to $3.3 billion (see Figure 6). Volumes held basically steady while the average price of the imports rose 36 percent and the average price of exports increased 38 percent.

While net polished imports rose 21 percent to $1.23 billion during the quarter, indicating the amount of goods absorbed in the local Hong Kong market, it is assumed that large amounts leave the municipality undeclared, largely to other countries in the region, and mostly to Mainland China.

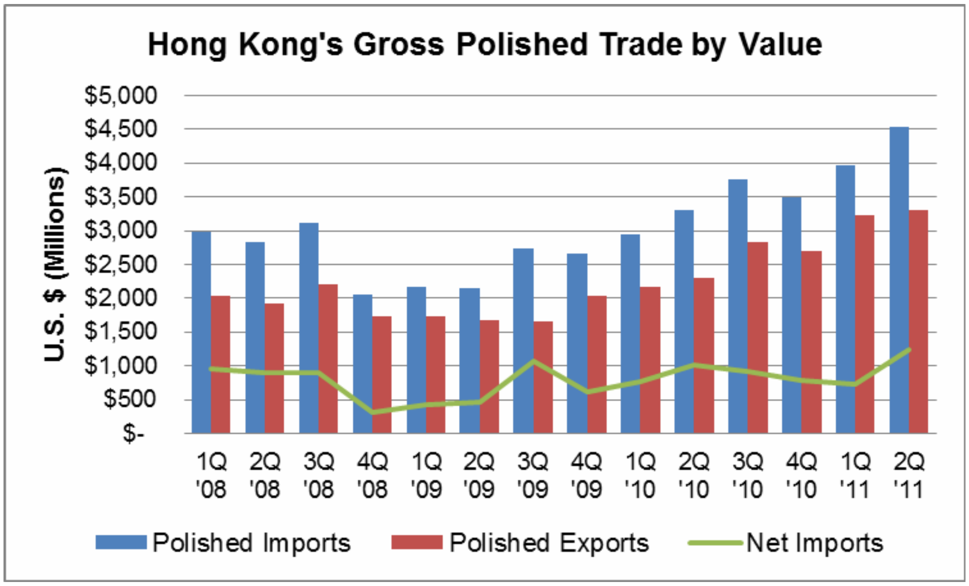

Figure 6

Source: Based on data published by the Diamond Federation of Hong Kong, China Ltd.

The Rough Market

Trading in the rough dealer market slowed significantly in August, after a period of unsustainably high premiums which were prevalent in the first seven months of the year.

Rough dealers lost some of their previously held confidence to buy rough as equity markets fell and remained volatile through August. In addition, manufacturers in India are burdened with low liquidity as they have had to keep their factories churning with the same volume of rough that cost about 40 percent more than it did a year ago. Banks there have also tightened their lending to the industry.

As a result, premiums on De Beers Diamond Trading Company (DTC) goods, which were almost consistently at double-digit levels through the first half of the year, fell to near zero and in some cases were selling at a discount.

DTC held its prices firm with slight low-single-digit increases implemented on some goods. The sight was valued at an estimated $800 million (see Figure 7). De Beers appears on track to achieve record rough sales for the year, well in excess of $6 billion, even as production has remained below 2010 levels.

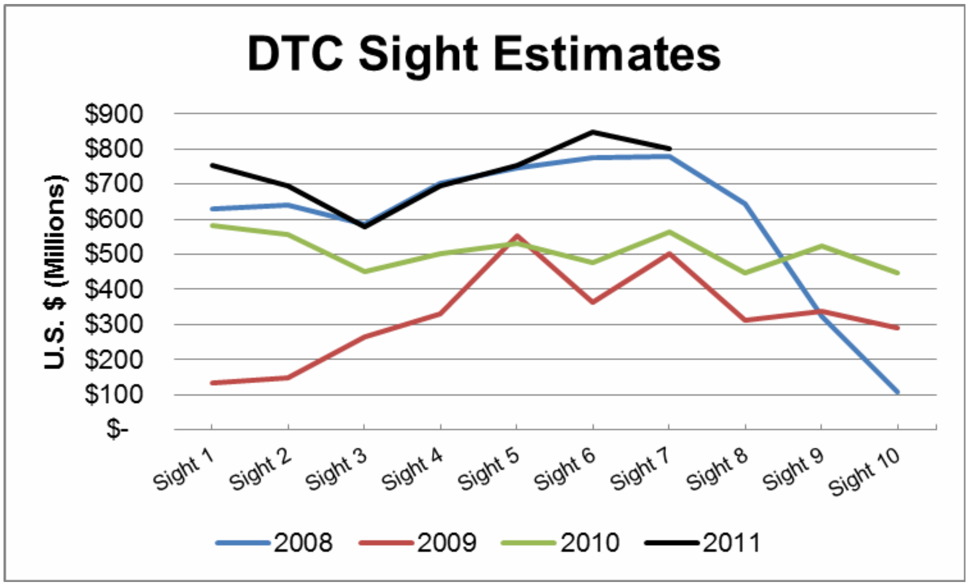

Figure 7

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.

Prices at BHP Billiton's August spot tenders fell by 15 percent to 20 percent. The company's tender prices were considered overpriced through much of the year, which enabled it to post record sales in the six months that ended on June 30, 2011 (see green trend line in Figure 8). Sales rose 13 percent year on year to $583 million during the six months, despite the 25 percent decline in production to 1.127 million carats (see bar lines in Figure 8) at its 80 percent owned Ekati mine – BHP Billiton's only diamond asset. Rapaport estimates that the average prices of BHP Billiton goods were up about 51 percent in the half year from the same period in 2010.

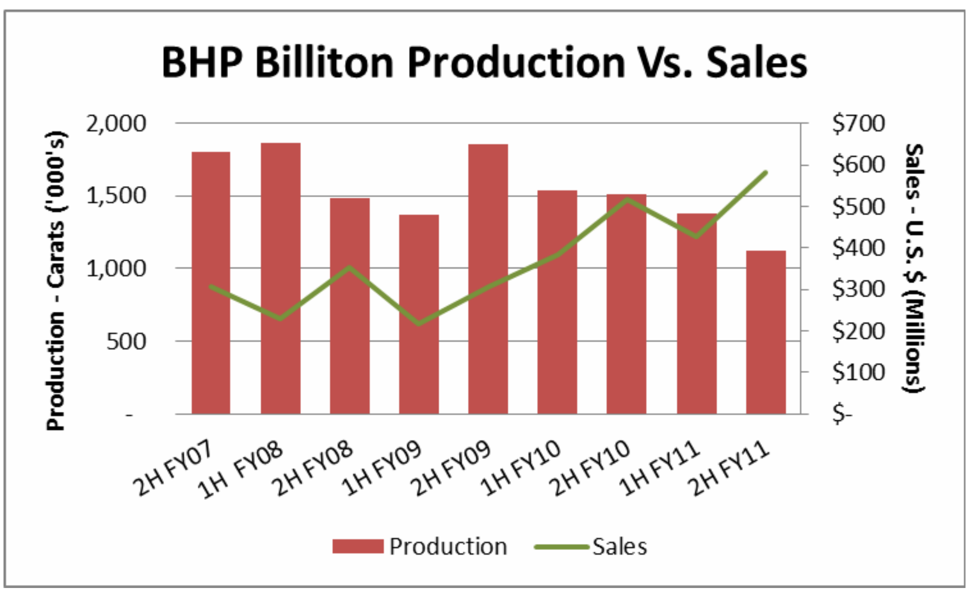

Figure 8

Data based on production and diamond sales reported by BHP Billiton. BHP Billiton's financial year ends on June 30.

Despite the slump in dealer demand, more than $2.5 billion worth of rough is estimated to have entered the market in July and August.

Among these, more than $150 million worth of rough from Zimbabwe's Marange fields were cleared to be released into India, pertaining to a special parcel of goods that were certified by the Kimberley Process (KP). South Africa continues to import Marange goods, even as the KP position on these diamonds remains unclear, and as Human Rights Watch reported ongoing abuses being carried out in the fields.

The Retail Market

The major retail companies continued to post strong growth in the quarter that ended on July 30, 2011, driven by higher price points (see Figure 9). Tiffany & Co. sales rose 30 percent to $873 million and posted growth in all regions. Signet Jewelers sales grew 10 percent to $798 million and Zale Corporation sales increased 9 percent to $377 million.

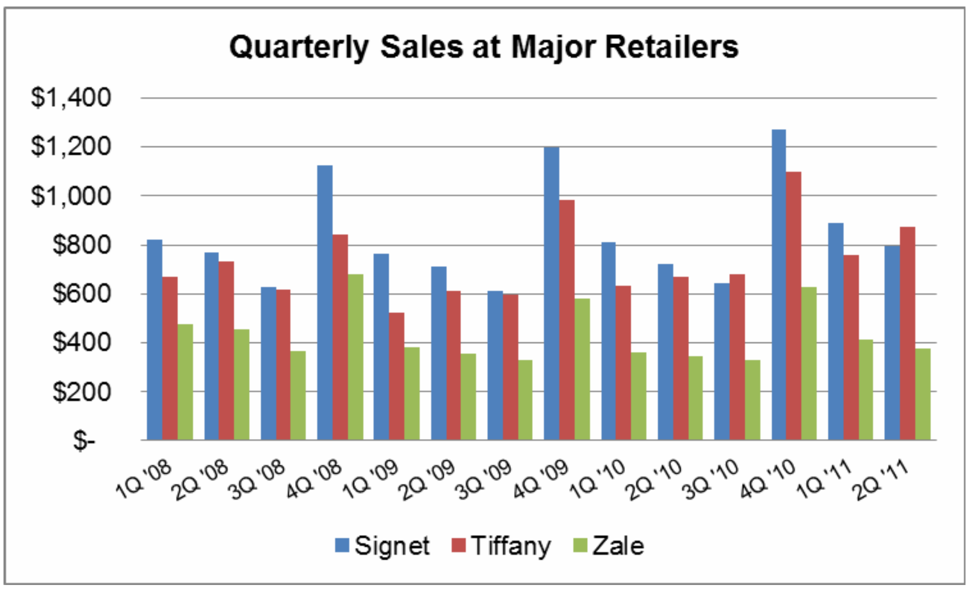

Figure 9

Data as reported by Tiffany & Co., Signet Jewelers, Zale Corporation. Data presented according to calendar year as companies report according to different fiscal timetables.

Signet reported that prices have continued to trend higher (see Figure 10) across each of its brands. Average price points at Kay Jewelers rose 12 percent year on year to $391 per item while average prices at Jared stores rose 9 percent to $834.

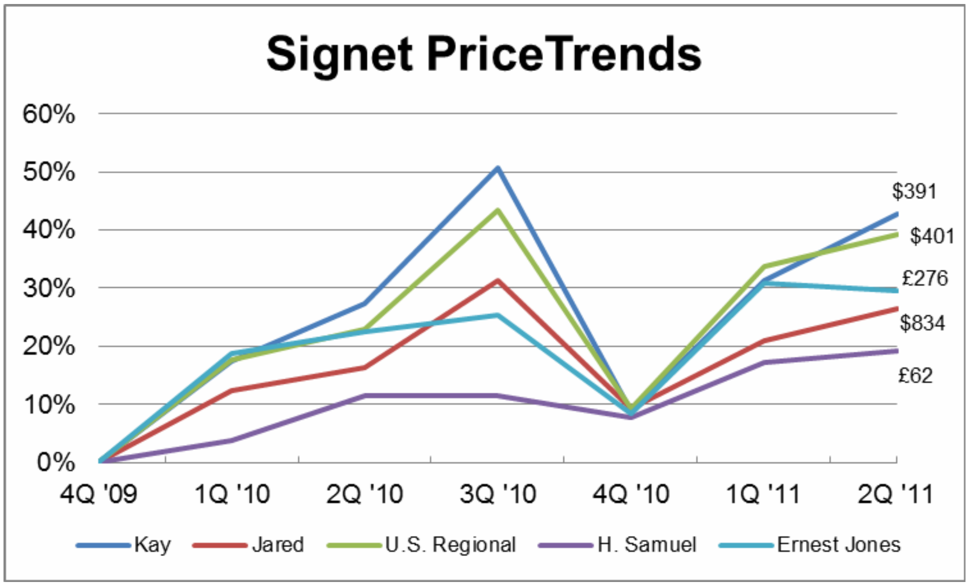

Figure 10

Based on data published by Signet Jewelers.

Jewelry prices in the U.S. rose to a record high in July, the most recent reporting period, and stood 12 percent higher than a year earlier, according to the U.S. Consumer Price Index (CPI) for jewelry published by the Bureau of Labor Statistics. Higher prices have buoyed U.S. jewelry store sales, which rose 2 percent year on year in the second quarter, according to the U.S. Census Bureau (see Figure 11).

Figure 11

Source: Bureau of labor Statistics and the U.S. Census Bureau.

A survey by XO Group Inc., which owns wedding sites TheKnot.com and WeddingChannel.com, indicated that the average spending on engagement rings fell to $5,200, from $5,800 in 2008, when the survey was last conducted. The group surveyed 10,000 brides and 1,000 grooms in the U.S.

Economic Factors

- Standard & Poor's (S&P) downgrades U.S. credit rating and says recession was deeper than previously thought.
- Gold soars to new high above $1,900/oz as investors seek safe-haven assets. Gold rose 12.5 percent through the month to close at $1,825.50/oz on August 31.
- U.S. Consumer confience dropped to 44.5 in August, from a revised 59.2 in July, according to the Conference Board index.
- Equity markets turned bearish and volatile with the Dow Jones Industrial Average (DJIA) falling 4 percent to 11,613 at the end the month (see Figure 12).

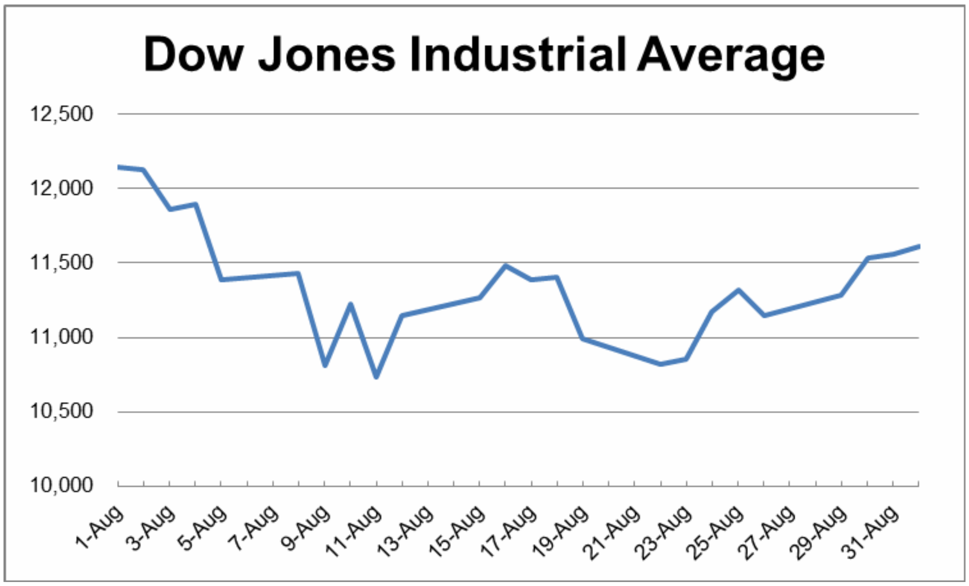

Figure 12

For additional information or if you have any comments or questions, please contact:

Avi Krawitz
M. + 972-54-345-0084
Email: avi.krawitz@diamonds.net

Media should contact:
Alissa Goren
M. +972-54-345-1317
Email: alissa.goren@diamonds.net

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