DIAMOND PRICES AND THE FORCES THAT SHAPE THEM

BY EDAHN GOLAN

JUST LIKE ANY OTHER TRADED GOODS, POLISHED DIAMOND PRICES INCREASE AND DECREASE, AND LIKE MOST COMMODITIES, A VARIETY OF FORCES CAUSE THESE FLUCTUATIONS. SOME PRICE CHANGES TAKE PLACE DUE TO EXTERNAL CONDITIONS, SUCH AS GENERAL ECONOMIC UPSWINGS AND DOWNSWINGS. OTHER FORCES ARE INTERNAL, FOR INSTANCE TRADER EXPECTATIONS.

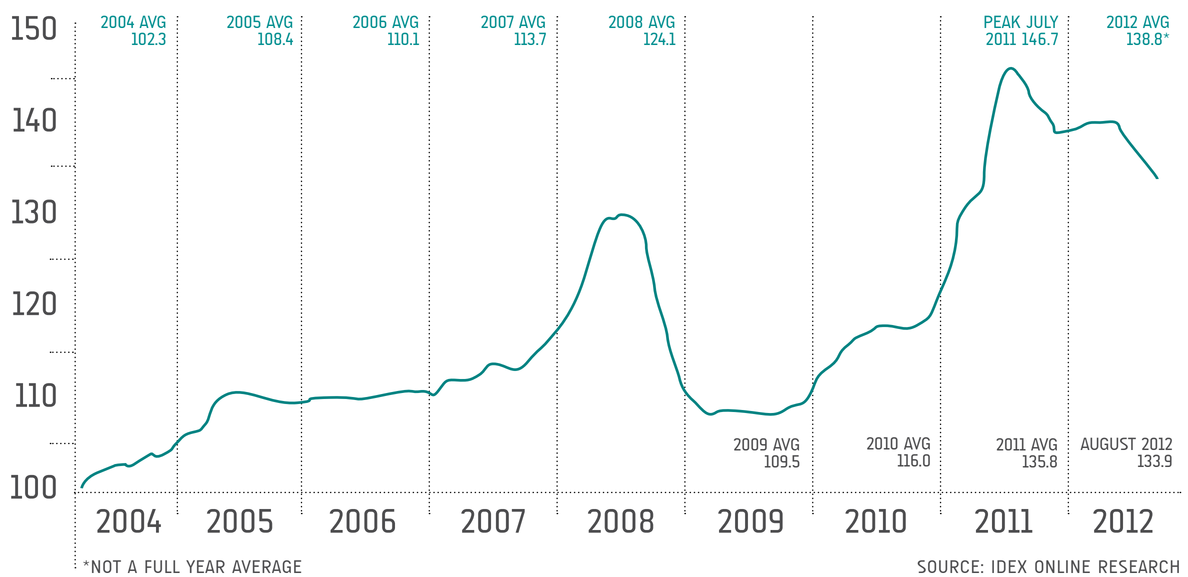
READ ON TO FIND OUT HOW THESE FORCES HAVE PLAYED OUT IN THE PAST FEW YEARS, AND THE LESSONS THAT CAN BE LEARNED.

POLISHED DIAMOND PRICES – AN OVERVIEW

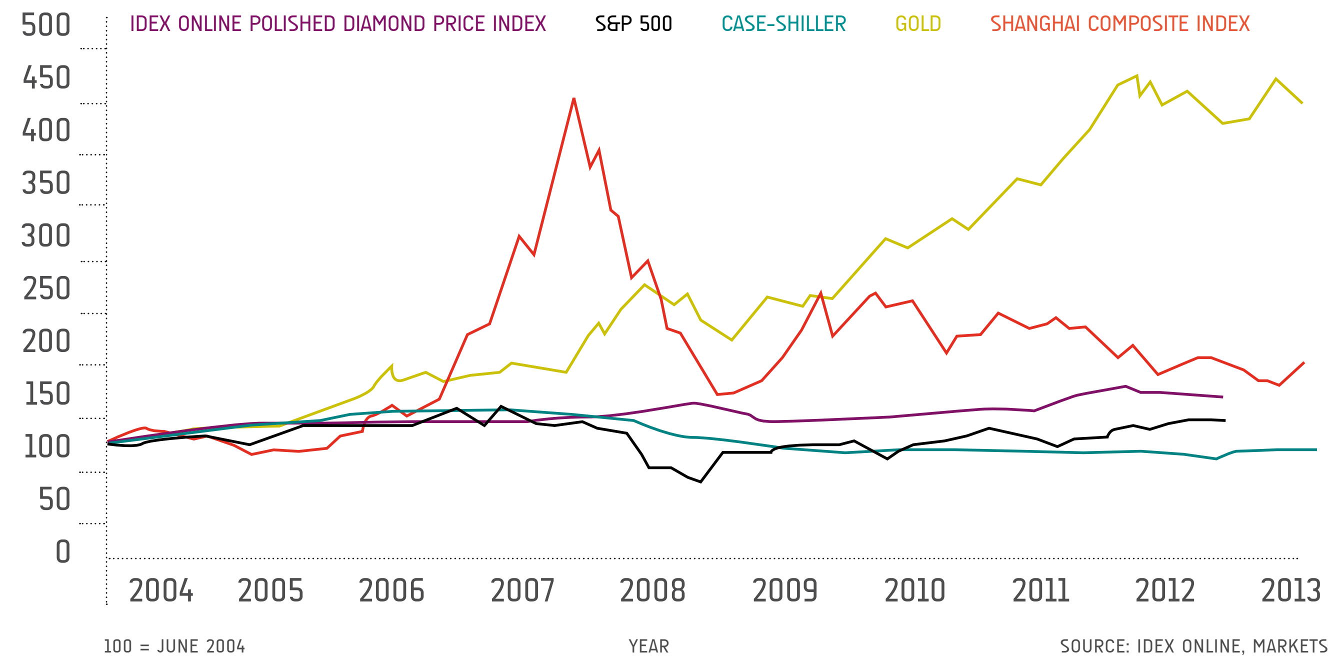
A LOOK AT THE IDEX ONLINE POLISHED DIAMOND INDEX SINCE 2004, IS POSSIBLY MISLEADING. GRAPH 1 DISPLAYS GREAT RISES AND FALLS OVER THE YEARS, AND IT APPEARS THAT THE PRICE INCREASES AND DECREASES WERE LARGE AND SWUNG WIDELY. DESPITE THEIR APPEARANCE, THESE CHANGES ARE FAR MORE MODERATE THAN THOSE EXHIBITED BY STOCK EXCHANGE INDICES, PRECIOUS METAL PRICES OR OTHER ECONOMIC INDICATORS.

IDEX ONLINE POLISHED PRICE INDEX JULY 2004 – DECEMBER 2012 GRAPH 1

AVERAGE ANNUAL INCREASE OF ~4.2%



POLISHED DIAMOND PRICES VS. S&P 500, HSI, GOLD AND SCI JUNE 2004 – JUNE 2012 GRAPH 2



The S&P 500, Shanghai Composite Index, Hang Seng Index, gold and oil all reflect different financial markets as in the short term, they all respond to different market forces. What unifies them is that they have all experienced broad changes over the past decade. In comparison (Graph 2), diamond prices did not swing as much, and seem almost dormant next to the great price flexibility of company shares and commodities.

The long-term trend, from mid-2004 to January 2013, shows that despite the apparent large peaks in price and the seemingly deep declines, the range of price changes is actually fairly narrow. Overall, prices have increased by some 33 percent in the eight-and-a-half year period since the IDEX Online Polished Price Index was introduced in mid-2004, a moderate 4-percent compounded annual appreciation.

PRICES IN AUGUST 2008 WERE ON AVERAGE DOWN BY MORE THAN 12 PERCENT COMPARED TO JANUARY OF THAT YEAR, AS THE FINANCIAL MARKETS COLLAPSED.

PRICES JOLTED UPWARDLY IN RESPONSE TO SURGING DEMAND AND GREATER FINANCING AVAILABILITY BEFORE SOFTENING WHEN BUYERS REFUSED TO CONTINUE TO ACCEPT THE PRICE HIKES.

During the year, price changes are usually fairly moderate. Peak to valley, prices typically fluctuate by about 5 to 7 percent. The two exceptions to this were in 2008 and 2011. Prices in August 2008 were on average down by more than 12 percent compared to January of that year, as the financial markets collapsed.

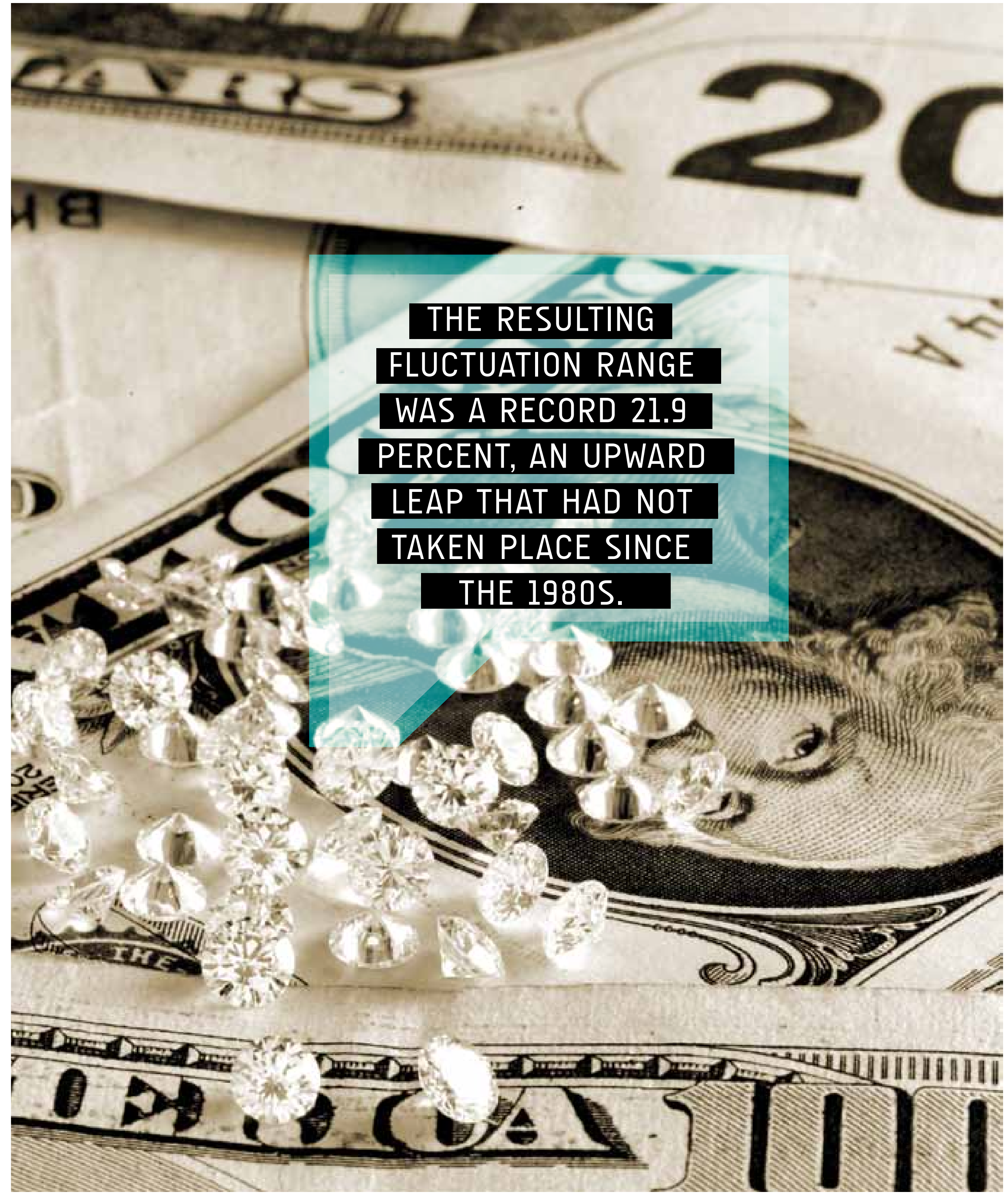
While a 12-percent decline is a large one, compared to the turmoil in other economic sectors and the deep falls in a wide variety of economic indicators – the stock markets and housing to name a few – polished diamond prices fared the crisis well, and declined much more softly.

During 2011, the situation was very different. Here, prices jolted upwards in response to surging demand and greater financing availability before softening when buyers refused to continue to accept the price hikes. The resulting fluctuation range was a record 21.9 percent, an upward leap that had not taken place since the 1980s.

The regular small changes are a reflection of polished diamond prices being constantly fine-tuned and adjusted by manufacturers and wholesalers according to their needs, limitations and the feedback they receive from their sales teams and buyers.

The IDEX Online Polished Diamond Index is a composite index. It is made up of 15 drivers, each a specific and limited size range and certain diamond shape, although most are round brilliants (see page 97 for more on the structure, basis and logic of the Polished Diamond Index).

Naturally, different diamond sizes see different price changes. So, while external and internal forces pull up and push down prices of diamonds of all shapes and sizes, different demand levels exacerbate or moderate the effect of these forces on the price of a particular type of diamond.

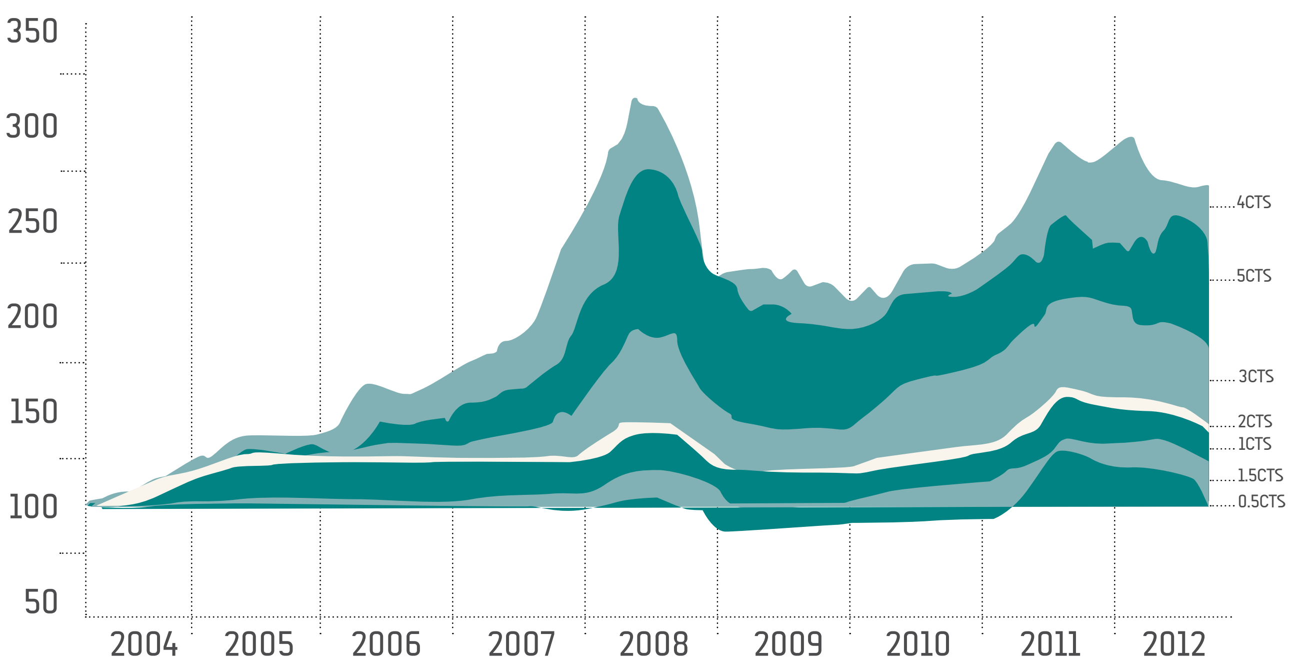


LARGER ROUND SHAPE DIAMONDS, WEIGHING 3 CARATS AND MORE, FLUCTUATE MORE WIDELY – IN FACT, ALMOST WILDLY – COMPARED TO THE SMALLER DIAMONDS, WEIGHING 2.99 CARATS OR LESS, DOWN TO 0.50 CARATS.

THE PRICE OF 4 CARAT ROUNDS, THE MOST ACTIVE OF THESE GOODS, MORE THAN TRIPLED BETWEEN MID-2004 AND THEIR PEAK IN MID-2008, ON THE EVE OF THE ECONOMIC COLLAPSE.

IDEX ONLINE ROUND POLISHED PRICE INDEX BY SIZE

JULY 2004 - DECEMBER 2012 GRAPH 3



SOURCE IDEX ONLINE RESEARCH

As Graph 3 shows, the price of some diamond sizes rises and falls at a steeper rate than others. Larger round shape diamonds, weighing 3 carats and more, fluctuate more widely – in fact, almost wildly – compared to the smaller diamonds, weighing 2.99 carats or less, down to 0.50 carats.

These larger goods climbed much higher over the past decade, more than doubling their price within a four-year period. The price of 4 carat rounds, the most active of these goods, more than tripled between mid-2004 and their peak in mid-2008, on the eve of the economic collapse. Although they lost a considerable amount of their price following the 2008 meltdown, these goods regained most of this lost value before declining again in the past year, albeit, to a lesser degree.

The changes in the price of goods in the 0.50-2.99 carat size range are smaller and far less substantial. Because the bulk of the value is in this size group – 1.00-1.49 carat rounds alone hold more than 12 percent of the total value, and 2.00-2.49 carat rounds represent another 8 percent of the goods – they moderate the overall index.

HOW DOES THE IDEX ONLINE POLISHED DIAMOND PRICE INDEX WORK?

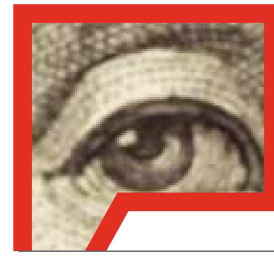
Derived in real-time from asking prices of the global diamond industry, the IDEX Online Diamond Price Index objectively reflects price trends as they happen.

Based on some half-million diamonds offered on the IDEX Online diamond trading platform, by some 1,400 diamond manufacturers representing about 80 percent of the market by value, the composite diamond index and the 15 diamond drivers which compose it were formulated following comprehensive research and analysis of the IDEX inventory database, aggregated since February 2001.

Research and development was conducted in cooperation with Dr. Avi Wohl, Senior Lecturer of Finance at the Faculty of Management, Tel Aviv University.

EXTERNAL ECONOMIC FACTORS

UNTIL 2008, POLISHED DIAMOND PRICES WERE ONE OF THE LEAST EVENTFUL ECONOMIC MARKERS, WHICH WAS ESPECIALLY TRUE FOLLOWING THEIR PRICE TUMBLE IN THE 1980S.



WHEN PRICES DECLINED, THE SUPPLY OF ROUGH EITHER SLOWED OR THE PRICE INCREASED – USUALLY SOME COMBINATION OF THE TWO – FORCING POLISHED PRICES BACK UP.

POLISHED DIAMOND PRICES STARTED THEIR ESCALATION IN MID-2007 AS THE STOCK MARKETS WERE NEARING THEIR PRE-CRASH PEAK.

One of the main reasons for their moderate behavior is attributed to De Beers' monopolistic control of the market, and its ability to manage both the flow of rough diamonds and their prices. When prices declined, the supply of rough either slowed or the price increased – usually some combination of the two – forcing polished prices back up. When prices increased too quickly, De Beers could increase the supply of rough, which would ease the polished diamond increases.

Once the company's stronghold waned, prices of rough and polished diamonds were more susceptible to wider economic forces of the kind that typically affect the prices of commodities, durable goods and consumer products.

This was clearly seen in early 2008, when the price of diamonds started climbing at a faster rate than they had done for some 30 years. This increase was, at least partially, driven by broad economic forces – some of them global, others local.

Polished diamond prices started their escalation in mid-2007 as the stock markets were nearing their pre-crash peak. The global economy seemed healthy, the mood was positive, and everyone was looking admiringly at the Chinese economic boom as the "Red Giant" readied itself for the Beijing Olympics. In India, the growing middle-class was consuming western brands at a growing pace, and in Europe, countries such as Iceland were experiencing unprecedented prosperity.

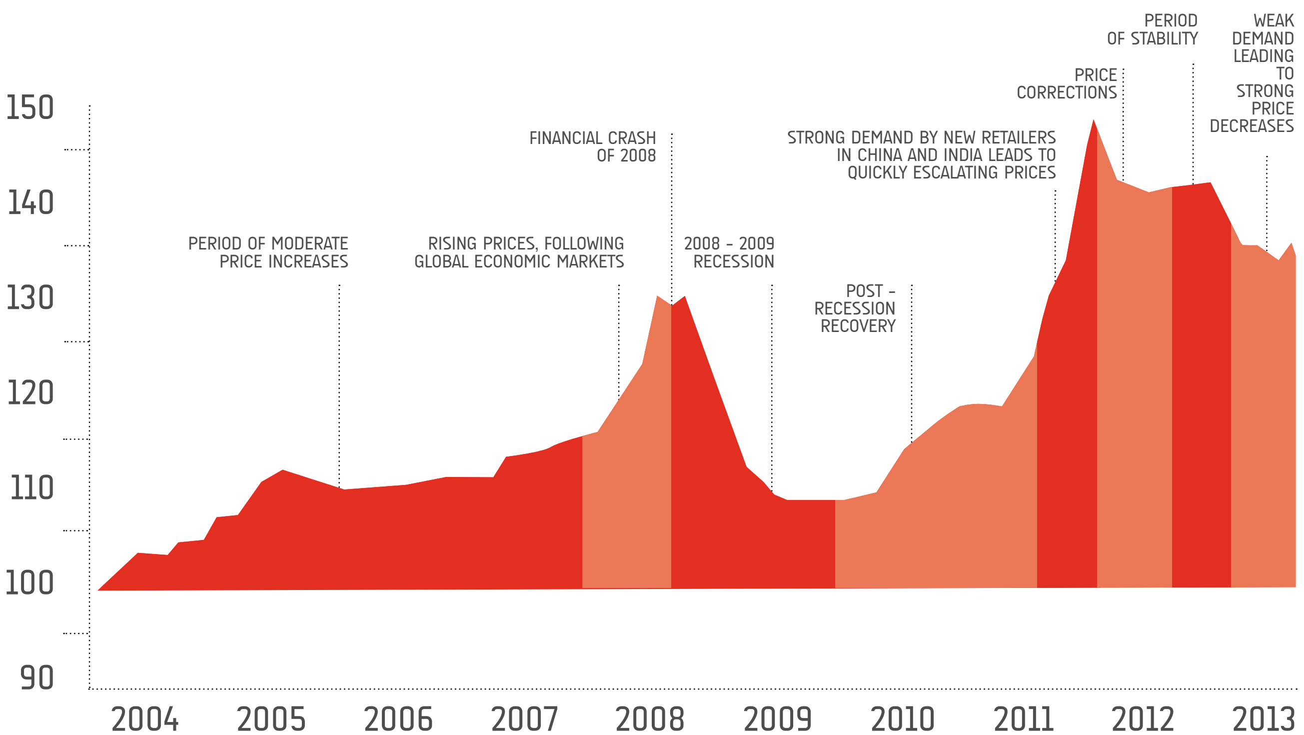
Against this backdrop, and encouraged by generic diamond marketing campaigns such as "A Diamond is Forever," consumers were buying more and more diamond jewelry. Their appetite was fueled by growing discretionary income, mainly in the U.S., China, India, Russia and the

THE ECONOMISTS REVISITED A STUDY THEY HAD CONDUCTED A FEW YEARS EARLIER TO EXAMINE THE LINKS BETWEEN CHANGES IN HOUSING WEALTH, FINANCIAL WEALTH AND CONSUMER SPENDING IN THE U.S.

SURPRISINGLY, AS THE STOCK MARKET STARTED TO DECLINE IN 2007, MANY INVESTORS EITHER GOT OUT OF THE STOCK MARKET GAME OR DECREASED THEIR STOCK HOLDINGS.

IDEX ONLINE POLISHED PRICE INDEX
JUNE 2004 – JANUARY 2012

GRAPH 4



SOURCE: IDEX ONLINE RESEARCH

Arab Gulf states. Together, these markets consumed about $16 billion worth of polished diamonds in wholesale prices, which represented about 80 percent of global consumption that year.

While many consumers were enjoying this growing economic affluence, unnoticed by most people, the looming economic crash was beginning to make its early presence felt. The stock markets, which had hit their peak in or around October 2007, started to decline, following – albeit, with a delay – the declining house prices in the U.S., which had started to decrease as early as February 2006 and which had an unprecedented effect on the economy.

The wealth of most U.S. consumers is tied to their housing. According to a recently published study by three well-known economists – Robert Shiller, Karl E. Case and the late John Quigley – entitled “Wealth Effects Revisited – 1975–2012,” consumer spending moves in tandem with housing prices. Shiller and Case are known for their Case-Shiller Index, the housing prices index they created for the U.S. market.

The economists revisited a study they had conducted a few years earlier to examine the links between changes in housing wealth, financial wealth and consumer spending in the U.S. In the new study, they used a much wider statistical base than in the old study, examining the economic trends in these three areas from 1975 to 2012 – including the years of the 2008-2009 economic crisis and its lingering effects.

They found that declines in house prices stimulated large and significant decreases in household spending in the U.S. However, this decrease in household spending skipped the diamond jewelry sector. Year-end bonuses, graduations and other important life events were still often celebrated with the purchase of diamond jewelry. The bridal jewelry segment remained resilient throughout.

Surprisingly, as the stock market started to decline in 2007, many investors either got out of the stock market game or decreased their stock holdings. Either way, they found themselves with large amounts of cash – additional discretionary income. Furthermore, the feeling that they had sold their stock holdings profitably meant that this money was more often spent then saved.

IN CHINA AND INDIA, HOWEVER, HOUSING PRICES DID NOT LEAD TO A DECREASE IN CONSUMER SPENDING. IN THAT PERIOD, HOUSING PRICES ONLY INCREASED, AS DID THE COST OF LIVING.

WITH THE DECLINE AND DECREASE IN CONSUMER SPENDING, CHINA AND INDIA LOST THE POWERFUL ENGINES THAT PULLED THE GLOBAL ECONOMIC TRAINS, AND THEIR GROWTH WAS SUDDENLY STUNTED AS WELL.

This trend continued, and intensified in the first half of 2008. In China and India, however, housing prices did not lead to a decrease in consumer spending. In that period, housing prices only increased, as did the cost of living.

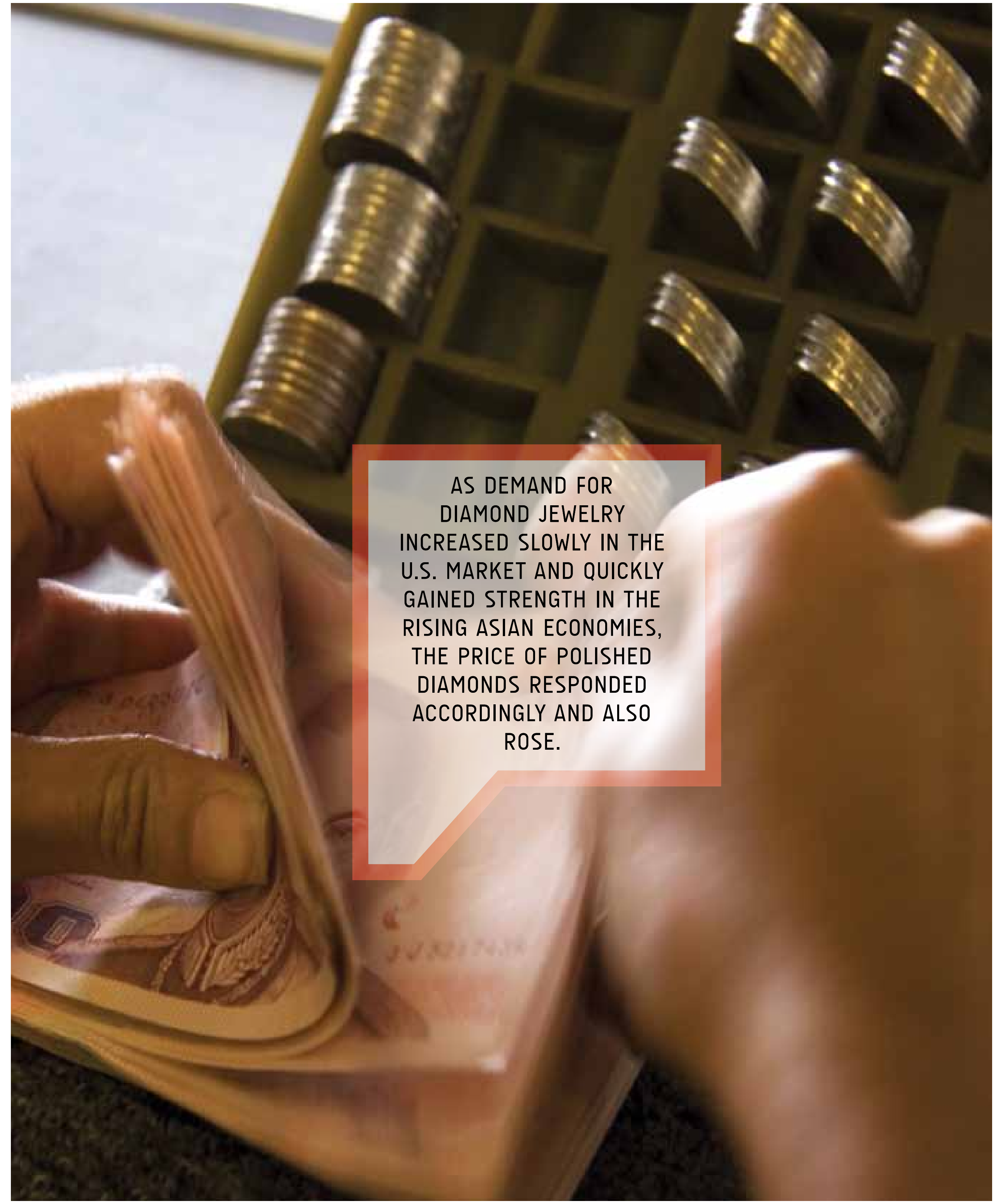
Further, in these two emerging markets, total consumer spending continued to increase as new wealth was found, nourished and enjoyed. As demand for diamond jewelry increased slowly in the U.S. market and quickly gained strength in the rising Asian economies, the price of polished diamonds responded accordingly and also rose. As demand increased at a growing pace, polished diamond prices also escalated at a quicker rate.

All of this came to a violent halt when the financial markets, first in the U.S. and then in Europe, entered a free fall, with several leviathan financial institutions disappearing almost overnight. Many of the financial bodies that did make it through survived, thanks to government interventions and bailouts. But the failing banks dragged behind them companies and business from every economic sector, leading to financial turmoil in many households. After many employees lost their jobs, health benefits and even their retirement money, buying diamonds and diamond jewelry was low on the spending list, leading to a subsequent decline in polished diamond prices.

Demand for diamond jewelry not only fell in the U.S. and Europe. With the decline and decrease in consumer spending, China and India lost the powerful engines that pulled the global economic trains, and their growth was suddenly stunted as well.

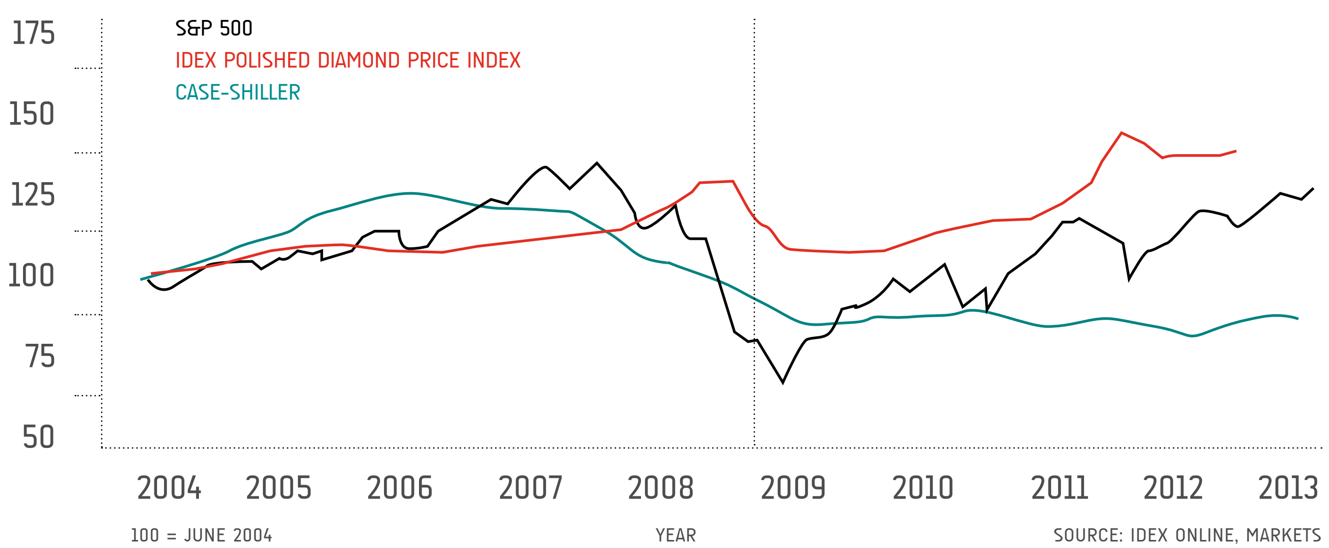
From their peak prices in August 2008, when the IDEX Online Index averaged 130.2, diamond prices tumbled for more than a year, stopping only in September 2009 when the Index stood at 108.6, a 16.6 percent decline.

A new finding in the Shiller, Case and Quigley study is that compared to the declines in housing prices and consumer spending, when housing prices increase, consumer spending increases at a slower rate. This finding is backed by studies by economists Daniel Kahneman and Amos



POLISHED DIAMOND PRICES VS. S&P 500, HOUSING PRICES
JUNE 2004 – JAN 2013

GRAPH 5

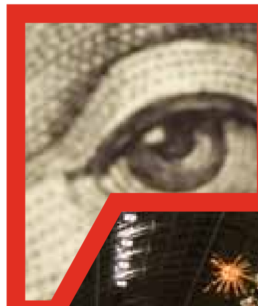


Tversky, (for which Kahneman won the Nobel Prize in Economics in 2002) researching risk aversion and consumer prudence.

Kahneman's study found that the concerns and anxiety that come with a downward shift in our personal financial situation have a longer lingering effect than when the opposite happens. The negative feelings last longer than the happiness bought about by a financial improvement.

This situation was borne out when it came to diamonds. The steep fall in diamond prices was followed by lingering lower prices that lasted well into 2010. Even when prices started to increase, the post-recession rate of recovery was slower than the 2008 drop, just as Kahneman observed.

This post-recession recovery – and slowly increasing diamond prices – took place near the end of 2010. Consumers, mainly in the U.S., felt that they were "good to go" after decreasing their spending – especially when it came to their deep dependence on credit and credit cards – putting more of their income in savings. They felt it was okay to splurge a little, and sought venues that had long-term value, be they real or perceived.



AS THE 2010 NOVEMBER-DECEMBER HOLIDAY NEARED, DIAMOND JEWELRY BUYING WAS BACK IN VOGUE, AND TRADERS, MOST OF WHO WERE SITTING ON LIMITED INVENTORIES, SCRAMBLED TO MEET THIS RENEWED DEMAND.

As the 2010 November-December holiday neared, diamond jewelry buying was back in vogue, and traders, most of who were sitting on limited inventories, scrambled to meet this renewed demand. That holiday season, and the subsequent stock replenishment by retailers in January and February 2011, led the way for price increases all along the pipeline, from rough through wholesale and even to a moderate increase in retail prices.

2011: EXPLOSION AND SHAMBLES!

Although U.S. consumers, who represented some 40 percent of global diamond demand, were back to buying jewelry, in 2011, the market also picked up in China and India as the economic recovery began, and retailers in these two growing giants started to prepare for growing consumer demand.

In China, retailers sought to expand their geographic presence and began opening new stores across the country. These new outlets offering diamond jewelry needed to build an inventory from scratch, which led to a sudden jump in demand from China.

At the same time, jewelry stores in India, which historically offered gold jewelry but no diamond jewelry, also responded to the improving global economy. Increased offerings from large diamond manufacturing firms, as well as rising competition, coupled with an increase in consumer marketing spending that raised the visibility of branded diamond jewelry with the help of Bollywood's biggest stars, led traditional gold jewelry retailers to add diamond jewelry to their inventory.

WITH THE EXCEPTION OF A BRIEF PERIOD DURING THE 2012 HOLIDAY SEASON, POLISHED DIAMOND PRICES HAVE BEEN SLOWLY DECLINING SINCE JUNE 2012.

THE EXTERNAL FORCES INFLUENCING DIAMOND PRICES ARE, THEREFORE, A COMBINATION OF GLOBAL AND LOCAL ECONOMIC SITUATIONS THAT HAVE THE POWER TO ENCOURAGE OR DISCOURAGE CONSUMER SPENDING.

The combination of the swelling demand from these two markets led to bloated loose diamond prices. The mounting demand led to an escalation of prices, pulling them high above their pre-crisis levels and even soaring to record highs. Within three years of the September 2008 crash, the IDEX Online Index registered a new record high, averaging 146.7 in July 2011, touching a single-day high of 148.1 on July 29.

But diamond prices were not sustainable at this level, and in the third quarter of 2011 buyers curbed their loose diamond purchases, sending diamond prices plummeting. This decline in prices continued until January 2012 when it was followed by a short period of price stability.

Continued concerns over the European economies took their toll, and global discretionary income spending on diamond jewelry, or even other fashion-related products, took a backseat to smartphones, tablets and other high-priced communication and high-tech devices.

With the exception of a brief period during the 2012 holiday season, polished diamond prices have been slowly declining since June 2012.

The external forces influencing diamond prices are, therefore, a combination of global and local economic situations that have the power to encourage or discourage consumer spending. Discretionary income generated from the profits made on the stock market allowed greater spending. Shifting consumer moods reacting to the perceived economic situation serve as a motivator, or a barrier, to purchasing diamond jewelry. Retailer plans and expectations determine willingness to invest in large inventories of loose diamonds and diamond jewelry alike, as well the inclination to pay higher prices – or turn them down.

Although not purely an external force, industry marketing efforts – from De Beers now defunct "A Diamond is Forever" generic diamond promotional campaigns to local brand jewelry ads targeting India and China's 20- and 30-something new members of the middle-class – are exerting their influence on demand and, by extension, price. The lack of such marketing efforts has the opposite effect – waning demand and therefore decreasing prices.

INTERNAL ECONOMIC FACTORS

WITHOUT DE BEERS EXERTING ITS INFLUENCE AND LIMITING PRICE CHANGES, PRICES OF ROUGH DIAMONDS STARTED TO BOTH FLUCTUATE BOTH MORE FREQUENTLY AND MORE WIDELY IN THE SECOND HALF OF THE LAST DECADE THAN THEY HAD EVER DONE BEFORE.

AT TIMES, TRADERS WERE WILLING TO PAY 10 PERCENT, 15 PERCENT AND EVEN UPWARDS OF 20 PERCENT TO BUY THE ROUGH GOODS.

GOING DOWN THE PIPELINE, THERE ARE MORE PARTICIPANTS AND PLAYERS, THE COMPETITION FOR THE GOODS IS LESS INTENSE, AND PRICE MODERATION IS ENFORCED BY MARKET FORCES.

Broadly speaking, rough diamond prices oscillate to a greater degree than wholesale polished diamond prices, while prices in stores are affected the least. This is a result of different levels of financing capabilities, marketing limitations and price buffers.

When demand for rough is growing, traders and polishers are willing to gamble and buy goods at a higher price. They do so with the assumption that there will always be someone willing to pay the higher price when they sell the goods. Naturally, when demand rises, shortages are created, and traders feel they must pay more to get the goods.

This leads DTC Sightholders (the Diamond Trading Company, the rough diamond sales and marketing arm of De Beers) who buy directly from the miner, to offer their goods to the secondary market at a large premium. At times, traders have been willing to pay 10 percent, 15 percent and even upwards of 20 percent to buy rough goods.

By the time this more expensive rough diamond stock arrives at the polishing plants, the price is so high that manufacturers are forced to increase the resultant polished diamonds for more. This will happen even if demand for polished goods would not ordinarily necessitate price increases.

This situation is part of what limits the price fluctuations for polished diamond prices compared to rough diamond prices. Going down the pipeline, there are more participants and players, the competition for the goods is less intense, and price moderation is enforced by market forces.

Retailers face a different reality – the price point. Large specialty retailers, such as Zale and Signet Jewelers, as well as other large mass marketers, such as JCPenny and Wal-Mart, offer diamond jewelry by price category. They plan their offerings well in advance and order large quantities of diamonds to exact measurements and by specific color/clarity categories. If the price of

INTERNAL DIAMOND PIPELINE FORCES THAT INFLUENCE POLISHED DIAMOND PRICES START WITH FLUCTUATING ROUGH DIAMONDS AND THE PREMIUMS THEY MAY CARRY.

AS BUYERS IN DIAMOND EXCHANGES AROUND THE WORLD ENTER OFFICES AT A GROWING FREQUENCY, EITHER PURCHASING POLISHED DIAMONDS OR PICKING THEM UP ON MEMO, SELLERS START TO FEEL THE GROWING DEMAND.

the components of the jewelry items changes – either because the price of gold or diamond has changed – they still want (some may argue need) to maintain the retail price to ensure they have an offering for each price category.

To do so, these retailers try to limit their costs by either choosing diamonds with lower color or clarity with a somewhat lower price, or they absorb the price difference by decreasing their margins. Either way, the result is that, at least in the store, the price will change very little.

Internal diamond pipeline forces that influence polished diamond prices start with fluctuating rough diamonds and the premiums they may carry. In particular, trade fairs have a great influence over prices, especially in the period leading up to the opening day of the show. This mechanism is an interesting one.

In the weeks leading up to a trade show, diamantaires in the trading centers start rounding up goods. As buyers in diamond exchanges around the world enter offices at a growing frequency, either purchasing polished diamonds or picking them up on memo, sellers start to feel the growing demand. Responding to this sense of increasing interest in goods in the market, wholesalers start raising prices and, at some point, as this trend widens and buyers face new and higher prices in every office they enter in the diamond exchanges, they start to accept them and are willing to pay more for the goods.

This trend only intensifies as the deadline to send goods to the particular show nears. As the opening grows closer, there are fewer and fewer goods available in the market, and sometimes the only stock available is the less-desirable second-choice goods. This again reinforces buyers, understanding that they need to pay more for the better items.

At the shows, exhibitors try to sell the polished for a higher price in order not to lag behind increasing prices back home – regardless of how sustainable these new price levels may be.

Sometimes, demand at shows is high enough to allow for these price increases. The Hong Kong trade fair in March 2011, a time when demand from China was especially strong, was just such an event. Polished diamond prices climbed in the weeks leading up to the show, continued climbing during the fair and kept climbing in the days following the end of the exhibition, as Graph 6 shows

Traders seeing this strong showing and good results at the Hong Kong show arrived just a couple of weeks later at the Baselworld trade show in Switzerland

DIAMOND PRICE FACTORS:

TRADE SHOW EXPECTATIONS FUEL GROWTH IN PRICES – IDEX INDEX 2011

GRAPH 6

SOURCE: IDEX ONLINE RESEARCH

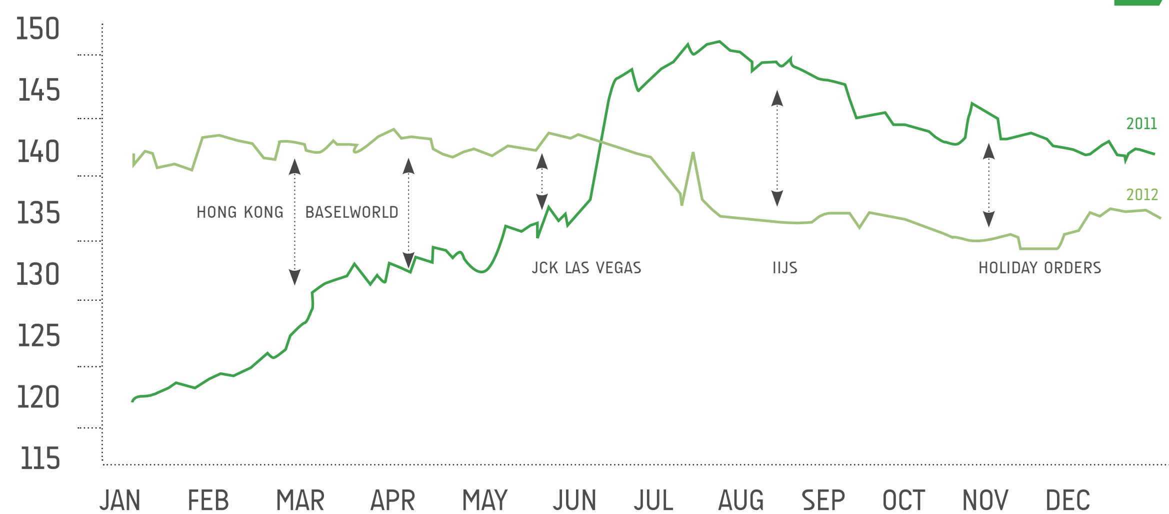
TRADERS SEEING THIS STRONG SHOWING AND GOOD RESULTS AT THE HONG KONG SHOW ARRIVED JUST A COUPLE OF WEEKS LATER AT THE BASELWORLD TRADE SHOW IN SWITZERLAND WITH HIGH EXPECTATIONS.

CHINESE RETAILERS WERE IN A STATE OF EXPANSION. THEY NEEDED THE GOODS TO CREATE THE INVENTORY LEVELS NECESSARY TO OPEN NEW STORES ACROSS THAT VAST COUNTRY.

DIAMOND PRICE FACTORS:

TRADE SHOW EXPECTATIONS FUEL GROWTH IN PRICES – IDEX INDEX 2011-2012

GRAPH 7



SOURCE: IDEX ONLINE RESEARCH

with high expectations. Wholesale loose diamond traders exhibiting at the prestigious trade fair expressed confidence that their goods would fly off the shelves at the new high prices.

They were wrong. The economic situation in Europe to which Baselworld caters, was very different from the economic situation in China at which the Hong Kong show is aimed. Chinese retailers were in a state of expansion. They needed the goods to create the inventory levels necessary to open new stores across that vast country. Europe at the time was already in the midst of what would later develop into a long period of depressed economic activity, a situation we still see very clearly today.

Lower demand from buyers was a rude awakening for many exhibitors, leading to an almost immediate drop in prices, as Graph 7 shows. It is not that the economic outlook was new to traders or unknown to them; it is that they ignored it, buoyed by the good mood from the Hong Kong show.

AS A RESULT OF THE BELOW-EXPECTATION ACTIVITY DURING THE BASELWORLD SHOW, AND FOLLOWING IT, THE DTC INCREASED PRICES DRAMATICALLY AT ITS THIRD SIGHT OF THE YEAR.

THE TENDENCY TO INCREASE PRICES AHEAD OF SHOWS REPEATS ITSELF BEFORE ALMOST EVERY LARGE TRADE FAIR. IF BUSINESS GOES WELL, THE TRADE FAIR'S OUTCOME SENDS POLISHED DIAMOND PRICES HIGHER.

IMAGES: BASELWORLD

While the decrease in asking price was needed, it was taken further than was strictly necessary. The depressed mood of traders sent the prices lower than they needed to be to meet the European budget. Their disappointment was a strong-enough force to bring down prices.

As a result of the below-expectation activity during the Baselworld show, and following it, the DTC increased prices dramatically at its third Sight of the year. The rough price increases totaled some 11 percent, sending manufacturers who were already hard pressed to protect their margins to increase polished prices again, just a couple of days after they had decreased them.

The tendency to increase prices ahead of shows repeats itself before almost every large trade fair. If business goes well, the trade fair's outcome sends polished diamond prices higher. If business is disappointing, it pressures prices downwards in the days following the show.

Another major force in the manufacturing and wholesale sectors of the diamond pipeline is financing. Diamond traders lean heavily on bank credit and bank borrowing. One reason for this system is because of the way the diamond cycle works.

Rough is bought for cash (in fact, goods are often only delivered after payment is made), and then the polishing process requires cash for salaries. This means that when the polished goods are ready to be sold, a great outlay of money has already taken place. It also means that some three months after the rough was purchased – the time it usually takes to sort and polish the goods – this rough has still not created any revenue.

Even when the polished goods are finally sold, the return is not immediate. Retailers demand and get 30-, 60- and 90-day payment terms. At some points in the year, they are able to get 120-day terms or memo goods that may never sell. This means that six months can pass between spending and revenue – and this is without taking late payments into consideration. Because of the high price of diamonds and the narrow margins polishers and traders operate under, diamantaires cannot operate without bank financing.

A small glimpse into the role of bank financing in the diamond industry was provided in late 2012 when ABN AMRO, one of the largest financiers of the diamond sector, decided to call in the debts of one of its clients, Arjav. According to an exposé by industry analyst Chaim Even-Zohar, at the end of 2011, the Arjav group's global debts were in the $800 million range, with a turnover of $900 million. This financing-to-revenue ratio is probably very large, but maybe not wholly exceptional in the diamond sector. ABN, it should be pointed out, did not request that Arjav pay its debts to the bank because of this financing ratio; it was due to Arjav's refusal to accede to the bank's request for a business review. In other words, in some ways, ABN found the 8:9 financing review acceptable.

This anecdote illustrates the importance and level of bank financing that some diamond firms – no doubt the larger ones among them – enjoy. This influences diamond prices in a couple of ways.

When more bank financing is available, borrowers tend to use it quickly. The most extreme instance was when Standard Charter

Bank sought to expand its diamond portfolio. The new source of funds in the market, estimated at hundreds of millions of dollars, was one of the drivers fueling the price increase in the second quarter of 2011.

With the additional funds, companies can turn to the market to buy more goods, creating a two-stage process. First, the additional demand contributes to increased prices, but then, the ability to pay more for the goods as their prices escalates sustains the higher prices and fuels it even further, pushing prices higher.

However, bank financing can also play the opposite role and cool prices. Traders want to protect their credit levels and make sure they do not lose them. This at times leads to them buying and selling goods simply to show turnover. In such instances, the price of the goods is less important – they are not traded to generate an income; they are traded to protect financing. Therefore, even though it is a great opportunity to generate an extra profit, goods are often sold below market prices, just to ensure that turnover is generated.

Diamond firms also want to make sure they do not default on any payments. It is not

TRADERS WANT TO PROTECT THEIR CREDIT LEVELS AND MAKE SURE THEY DO NOT LOSE THEM. THIS AT TIMES LEADS TO THEM BUYING AND SELLING GOODS SIMPLY TO SHOW TURNOVER.

DIAMOND FIRMS ALSO WANT TO MAKE SURE THEY DO NOT DEFAULT ON ANY PAYMENTS. IT IS NOT UNUSUAL FOR A FIRM TO HOLD WHAT IS IN EFFECT A FLASH SALE JUST TO RAISE THE FUNDS NEEDED TO MEET BANK PAYMENTS.

IMAGES: BASELWORLD

unusual for a firm to hold what is in effect a flash sale just to raise the funds needed to meet bank payments. Once the necessary revenue is generated, they will increase prices again.

In both cases, buyers prefer to buy from the sudden (and temporary) lower-cost source in the market, which provides a fantastic buying opportunity for them. This, however, puts pressure on other wholesalers who are possibly in a similar situation of needing to generate a certain level of income by a specific date, creating a short-lived dip in prices of certain goods. Although this is not a major force in pressuring prices down, it is strong enough to be noticed by many players in the wholesale sector of the industry, and sometimes raises concerns in the market that the reason for the quick decline in prices a company offers is a bigger, graver one. Uncertainty, not only in the diamond industry, but also in any industry, has its own negative effect on prices.