RAPAPORT MONTHLY REPORT
www.diamonds.net December 2016

U.S. Optimism Lifts Diamond Market

Executive Summary

The diamond industry has mixed short-term expectations given two opposing dynamics influencing sentiment. The elimination of high-denomination rupee notes squeezed liquidity and slowed trading in India, while improved U.S. consumer confidence helped raise forecasts for the holiday season.

Polished trading slowed in November as Indian dealers and manufacturers closed for two to three weeks during the Diwali festival that began October 28. U.S. retailers completed their holiday inventory purchases in the third quarter and limited their buying to fill specific orders thereafter.

Polished prices were relatively stable amid slow dealer trading. The RapNet Diamond Index (RAPI™) for 1-carat, RapSpec A3+ diamonds gained 0.5% in November. RAPI for 0.30-carat diamonds rose by the same margin, while RAPI for 0.50-carat stones fell 1%. RAPI for 3-carat diamonds firmed by 1.2% (see Figure 1).

RAPI for 1 ct. declined 3.8% since the beginning of the year and is 2.8% lower from a year ago (see Figure 2, Page 2).

Rough trading was quiet, with De Beers recording its smallest sale of the year as Indian manufacturers closed for Diwali. Rough prices were stable on average, while demand slowed for smaller and lower-quality goods due to the cash crunch in India.

U.S. retail sentiment improved after Donald Trump's surprise win in the U.S. presidential elections sparked a stock market rally and strengthening of the dollar. Hong Kong jewelers continue to report double-digit sales declines and, along with their U.S. counterparts, are reducing their inventory requirements.

The diamond industry is hoping a good retail season will offset the impact of India's liquidity challenges and bring stronger activity in the first quarter when U.S. retailers typically restock. Jewelry retailers are managing with less inventory as consolidation continues and sales in Hong Kong and China decline. The trade must therefore focus on profit rather than turnover in the New Year.

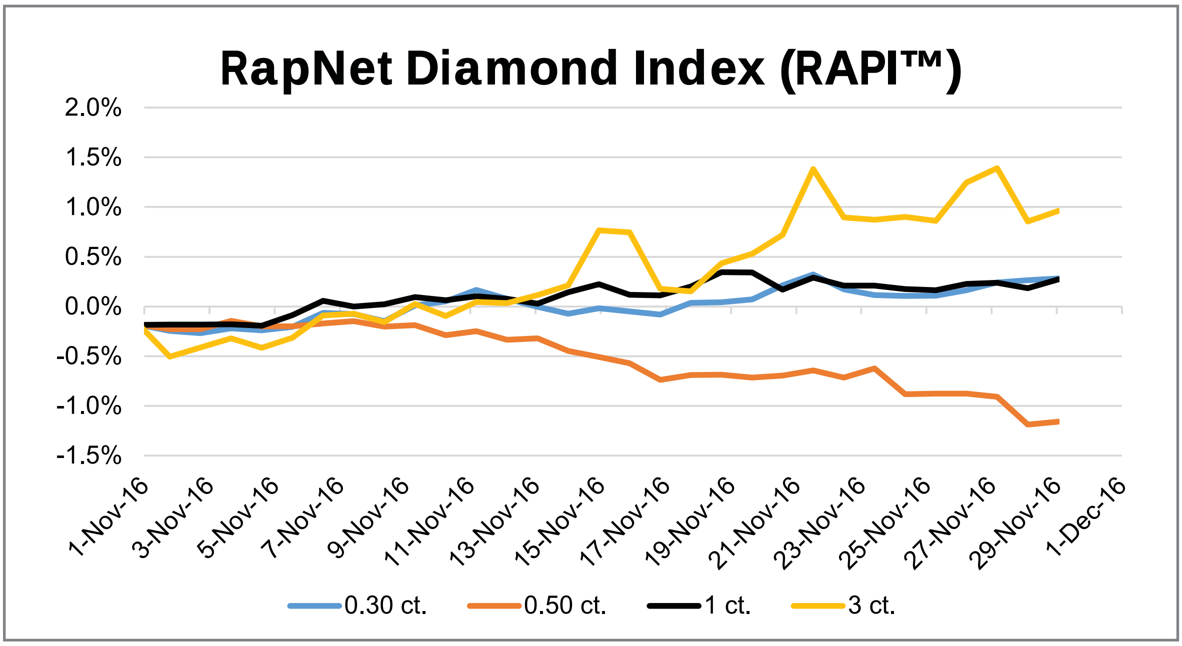

Figure 1

The RapNet Diamond Index (RAPI™) is the average asking price in hundred $/ct. of the 10% best priced diamonds, for each of the top 25 quality round diamonds (D-H, IF-VS2, GIA-graded, RapSpec-A3 and better) offered for sale on RapNet - Rapaport Diamond Trading Network.

The Polished Market

Liquidity in India was under extreme pressure after the government scrapped INR 500 and INR 1,000 currency notes on November 8. Consumers initially rushed to dump available cash on gold and jewelry, but sales subsequently slumped an estimated 60%, with small "mom and pop" stores bearing the brunt of the decline. The slowdown is expected to last six to nine months as new currency notes slowly enter circulation. The surprise policy move disrupted the positive sales momentum that emerged during the Diwali season, just as the busy wedding season began.

Polished Headlines

- **Sotheby's Geneva sells $136M (87% by lot) with emerald-cut, 17.07 ct., fancy intense pink, VVS1 diamond sold to Graff for $21M ($1.2M/ct.).**
- **Christie's Geneva sells $97M (77% by lot) with pear-shape, 9.14 ct., fancy vivid pink, VS2 diamond fetching $18M ($2M/ct.).**
- **India Oct. polished exports +37% to $2.5B, imports -31% to $196M.**
- **Belgium Oct. polished exports -17% to $775M, imports -10% to $796M.**
- **U.S. Sep. polished imports +33% to $2.2B, exports +18% to $1.7B.**
- **Hong Kong Jan.-Sep. polished imports -2% to $13.2B, exports +2% to $10.2B.**
- **Shrenuj scales down Botswana operations, has De Beers sight suspended.**
- **Kiran Exports and Shimansky Diamonds gain De Beers Accredited Buyer status.**
- **Sarine 3Q sales +82% to $17M, profit of $4M vs. loss of $1.4M a year earlier, unveils automated color and clarity grading machines.**
- **Alan Bronstein elected president of Natural Color Diamond Association.**

RapNet Diamond Index (RAPI™)

	November	YTD Jan. 1 - Dec. 1	Y2Y Changes at Dec. 1
RAPI 0.30 ct.	0.5%	0.3%	4.2%
RAPI 0.50 ct.	-1.0%	0.8%	2.9%
RAPI 1.00 ct.	**0.5%**	**-3.8%**	**-2.8%**
RAPI 3.00 ct.	1.2%	-7.6%	-7.7%

Figure 2

The RapNet Diamond Index (RAPI™) is the average asking price in hundred $/ct. of the 10% best priced diamonds, for each of the top 25 quality round diamonds (D-H, IF-VS2, GIA-graded, RapSpec-A3 and better) offered for sale on RapNet - Rapaport Diamond Trading Network.

Diamond dealers and manufacturers were largely absent from the market in November due to Diwali. They returned to cautious trading as domestic demand for diamonds plunged in the wake of the government's currency intervention.

Global demand softened for lower-quality diamonds as they're typically traded in rupees among the local trade. Opportunistic foreign buyers tried to take advantage of the liquidity crunch, seeking out bargains from Indian suppliers.

Larger manufacturers with legitimate invoicing were relatively unaffected as they continue to supply their export customers, particularly in the U.S. In fact, India gained a larger share of the U.S. market in the third quarter, according to Commerce Department data.

U.S. polished imports grew 3% year on year to $5.59 billion during the three months that ended September 30, with inflows from India up 18% to $2.39 billion. Imports from Israel, however, fell 1%, and inbound shipments from Belgium slumped 18% during the period (see Figure 3).

Indian supply shifted to larger sizes as the average price of U.S. polished imports from the subcontinent increased 19% to $1,362 per carat. Imports from India of goods 0.50-carat and larger jumped 20%, while imports of diamonds 0.50-carat and smaller grew just 4%.

Overall trading targeted the U.S. holiday season with steady demand for 1 ct., G-H, VS-SI, RapSpec A3+ diamonds. Demand was largely driven by independent retailers ordering select pieces they still needed for the holiday season, while larger chains completed their buying in the third quarter (see Retail section on Page 4).

Demand from other consumer markets was relatively sluggish, with Chinese buyers cautious after the yuan depreciated 2% to $1/6.88 in November. More diamond suppliers attended the Hong Kong Jewelry Manufacturers' Show (Nov. 24 to 27), however diamond sales were weak. Buyers came to assess trends and prices, but they focused more on finished jewelry, color gemstones and pearls in their actual purchases.

As U.S. Christmas orders start to slow, diamond trading is shifting toward the Far East ahead of the Chinese New Year on January 28. With Hong Kong jewelers still experiencing notable sales declines (see Retail Section, Page 4), diamond traders remain cautious about the Chinese market in the short-term.

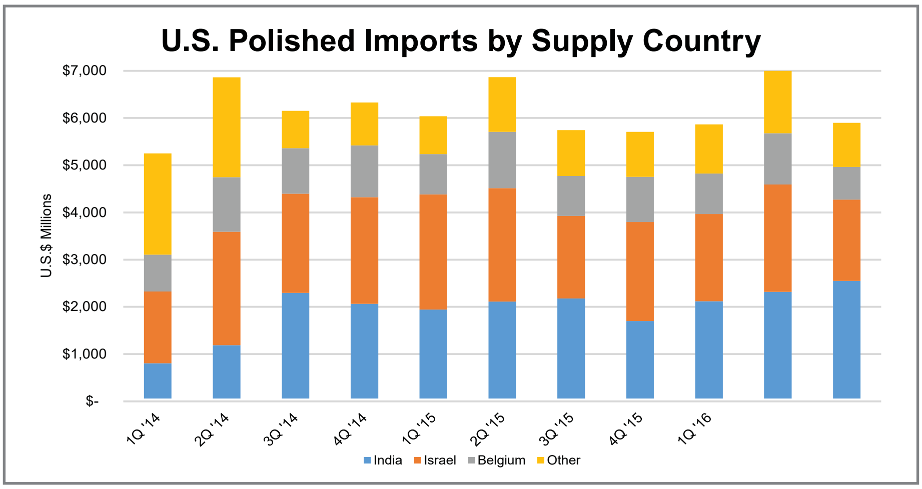

Figure 3

Based on monthly data published by the U.S. Commerce Ministry.

The Rough Market

Diamond mining companies recorded a significant increase in sales in the second half, largely on account of the low comparative base last year. Rough demand slumped mid-way through 2015 because of excessive polished inventory and tighter manufacturing profit, while rough prices were high relative to polished.

The market is more in balance this year after rough prices corrected by about 15% in the second half of 2015. Rough prices remained stable in 2016, with both De Beers and ALROSA maintaining steady average prices at their November sales.

Demand softened for smaller rough midway through the De Beers sight when the Indian government announced its demonetization policy, given that these goods are largely traded in the local Indian market in rupees.

Rough Headlines

- De Beers $470M Nov. sale smallest of the year.
- ALROSA 3Q revenue +70% to $1.1B, profit of $414M vs. loss of $237M a year earlier, Oct. rough sales $431M.
- Dominion 3Q sales -29% to $103M, Ekati mine production +22% to 1M cts.
- Stornoway 3Q loss of $12M. vs. profit of $9M a year earlier, sells 38,913 cts. for $7.7M ($195/ct.) at first Renard tender.
- Lukoil's 3Q Grib diamond sales +33% to $62M.
- Letšeng 3Q sales -6% to $62M, average price -37% to $1,619/ct.
- Lucara 3Q sales -58% to $38M, loss of $4M vs. profit of $44M a year earlier.
- Trans Hex sales +3% to $20M, profit of $2.4M vs. loss of $2.4M a year earlier.
- India Oct. rough imports +17% to $1.3B, rough exports +51% to $101M.
- Belgium Oct. rough imports -7% to $897M, rough exports -29% to $721M.

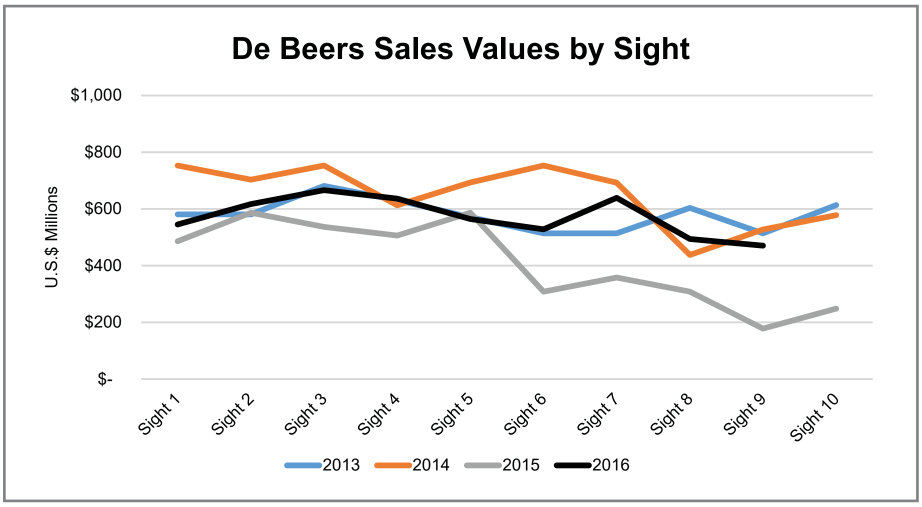

Figure 4

Based on De Beers reported sales and Rapaport estimates.

De Beers sold $470 million worth of rough in November, its smallest sale of the year so far. With most Indian dealers away for Diwali, the November sight is typically small. Still, the company's sales increased 34% to $5.2 billion in the first 11 months of the year. With one sight remaining (Dec. 5 to 9), we expect De Beers sales will exceed $5.6 billion in 2016, compared with $4.1 billion last year.

ALROSA reported diamond sales jumped 83% to $982 million (RUB 63 billion) in the third quarter, while profit grew to $414 million compared with a loss of $237 million a year earlier. The company reduced its rough inventory by 8 million carats this year, after a stockpile build-up, resulting from the drop in demand in 2015. ALROSA increased its sale of cheaper category diamonds in the second half whereas demand for higher-priced rough was stronger in the beginning of the year.

Gem Diamonds noted demand for its high-value large diamonds from the Letšeng mine in Lesotho remained firm during the third quarter. However, average prices at Letšeng fell 37% year on year to $1,619 per carat, while prices have dropped sequentially in the past four quarters (see Figure 5). The lower average price was a consequence of a continued deficiency of high-quality large diamonds at the mine, rather than a decrease in demand or a weakening of the market, Gem Diamonds assured.

The major mining companies are being careful to accommodate the midstream and avoid another period of oversupply – as was experienced in 2015. The December rough sales cycle is therefore expected to be relatively quiet. There is some concern that supply will increase in 2017, with three new mines coming on stream (Ghacho Kué, Liquobong and Renard), and production rising at other mines. That said, the major miners have downplayed the possibility of excess supply, emphasizing they'll supply as per demand, in order to keep the market in balance.

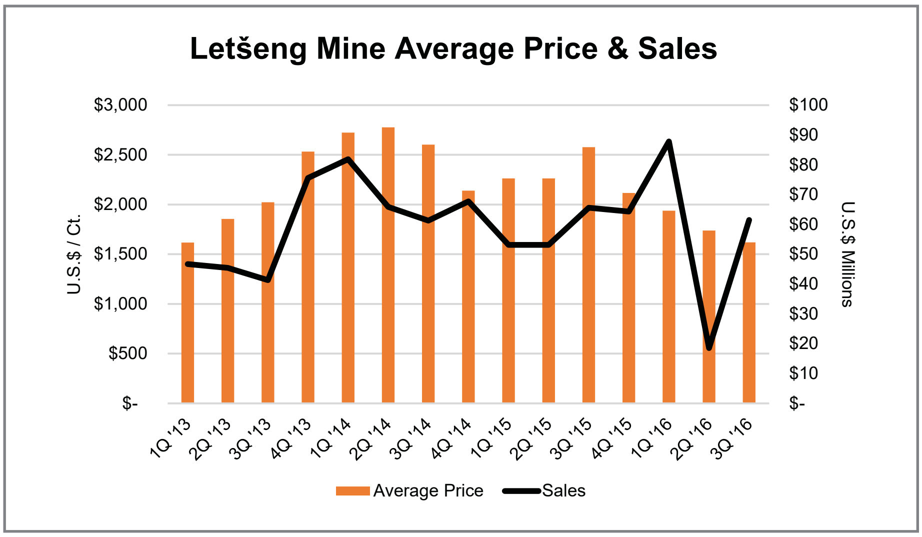

Figure 5

Based on reports by Gem Diamonds.

The Retail Market

The conclusion of the U.S. presidential election eliminated uncertainty surrounding the political process, prompting a rally in financial markets and strengthening of the U.S. dollar. Retail sentiment improved at the start of the holiday season even as foot traffic and in-store sales fell over the Thanksgiving weekend. Online sales continue to grow substantially.

Consumer confidence rose to a nine-year high as measured by the Conference Board index. That, combined with a gradual uptick in the economy and lower levels of unemployment, underpins a near consensus the Federal Reserve will raise interest rates in December.

The major jewelers noted slightly weaker sentiment in the jewelry sector than in general retail. Tiffany & Co. reported cautious spending by its higher-end U.S. customers in the third quarter because of macro, market and political uncertainties.

Retail Headlines

- **Retail store sales & traffic -4% over Thanksgiving weekend, reports RetailNext.**
- **Cyber Monday sales +13% to $3.5B, according to Adobe Digital Insights.**
- **Signet Jewelers 3Q sales -3% to $1.2B, profit +13% to $17M.**
- **Tiffany 3Q sales +1% to $949M, profit +5% to $95M.**
- **Blue Nile sold for $500M to Bain Capital and Bow Street, 3Q sales -4% to $105M, profit -35% to $1.3M.**
- **Richemont 1H jewelry sales -2% to $2.2B.**
- **Chow Tai Fook 1H revenue -24% to $2.8B, profit -19% to $164M, opens first U.S. outlet in Macy's.**
- **Luk Fook 1H revenue -22% to $705M, profit -6% to $56M.**
- **Titan Company 2Q sales +2% to $824M, profit +24% to$27M.**
- **JBT reports number of U.S. jewelry businesses -5% to 27,142 in 3Q.**

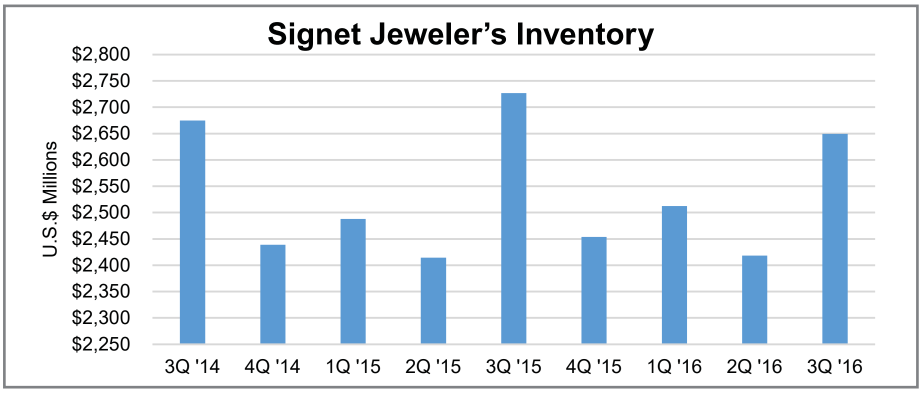

Figure 6

Based on reports by Signet Jewelers.

Sales to foreign tourists in the U.S. increased, particularly to Japanese visitors, who benefited from a yen appreciation against the dollar.

Tiffany's third quarter results were better than expected and driven by a strong fashion jewelry segment, while its engagement and wedding jewelry sales were flat and high-end statement pieces weak. The company maintained its outlook for a low single-digit sales decline for the full year. Fourth quarter sales are anticipated to be in line with last year's $1.2 billion, according to Rapaport estimates.

Signet sales fell 2% during the third quarter, while it offered a more upbeat outlook for the rest of the year. The company singled out fashion diamond and gold jewelry and select bridal jewelry as its top performers. Signet's 'Ever Us' two-stone ring collection is gaining momentum and expected to be a strong feature this holiday season, with other retailers and brands also pushing the two-stone ring concept.

Signet, which through its Kay Jewelers, Zale and Jared stores is the largest jewelry chain in the U.S., reported sales fell 3% to $1.2 billion in the third quarter, while profit increased 13% to $17 million. Inventory fell 3% from a year earlier – that's in line with a drop in sales even as a net 50 stores opened in the previous 12 months. Signet's inventory tends to peak in the third quarter as it prepares for the holiday season (see Figure 6), with this year's lower stock indicating a more conservative outlook.

Similarly, Chow Tai Fook, the largest jeweler in Greater China, is working with less inventory as its sales have been on a steady decline in the past two to three years. Jewelers in the Far East traditionally have stronger sales in the second fiscal half – October through March – as that includes the busy retail periods of the October 1 National Day holiday and the Chinese New Year, which this year falls on January 28.

However, sales trends have been in disarray in recent years due to a slowdown in Chinese economic growth and sporadic "gold rushes." Chow Tai Fook's revenue dropped 23% in the first fiscal half, while its inventory levels dropped 12% (see Figure 7).

Jewelry retail inventory levels are expected to decline as sales rise over the upcoming U.S. and Chinese holiday seasons. That tends to spark an increase in diamond buying in the first quarter as jewelers replenish stock. What remains to be seen is whether they'll match last year's levels as they continue to streamline operations.

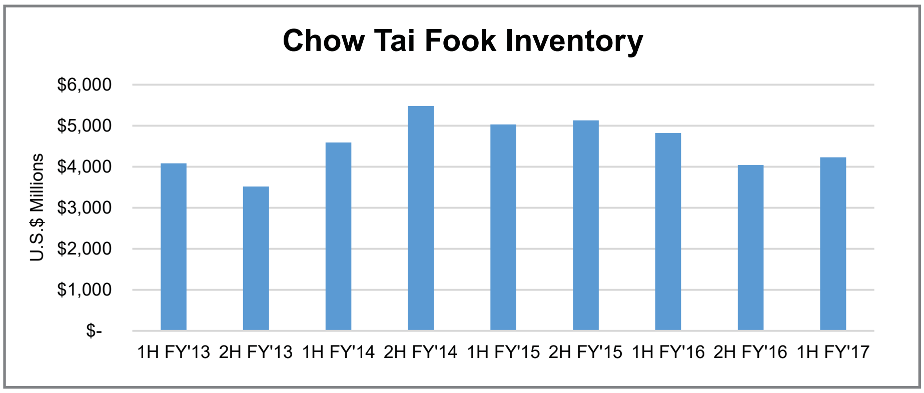

Figure 7

Based on reports by Chow Tai Fook.

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