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Demand intensifies – but a diamond futures market is still some way off

NEWS ANALYSIS

The Rapaport Group wants to demystify the world of diamond pricing – but progress is less than rapid, writes Kathryn Tully

Last month, with the close of its first monthly internet diamond auction, diamond broker and publisher of diamond prices, the Rapaport Group, took a first baby step toward its goal of forming a New York-based diamond futures market. But while interest from financial institutions is there, diamond indices and diamond derivatives are still some way off.

The Rapaport Group wants to bring some clarity to the mysterious world of diamond pricing and trading by using price data from its new monthly spot cash internet auctions to form a cash-price index. From this, it hopes diamond-based cash-settled futures contracts could be developed.

But Martin Rapaport, chairman of the group, said in a conference call after the first auction closed on September 20 that sales were disappointing. Only 27 of the 210 lots included in the auction were sold for a total of \$223,840 (£158,516, £111,050), although some 1,999 bids were made overall and many bids fell slightly short of the reserve price.

"You try to do something new like this and it's difficult; it's a process," he says. He expects subsequent monthly sales will generate more interest as people become familiar with the mechanics of the auction and the quality of the stones on offer.

To date, the wholesale diamond market has been to a considerable extent a closed shop dominated by the biggest producers. There have been few opportunities for financial investors to get involved. All buyers in the first auction were from the trade, but Mr Rapaport is confident diamonds can be made into an investment class and that the financial sector will become involved, bolster liquidity and make a cash-price diamond index viable.

"We purposely haven't gone to specific financial partners, although we have been talking to some who are interested," says Mr Rapaport in a separate interview. "I don't think we need to seduce the financial sector into the diamond industry. There are huge growth opportunities here."

He cites intensified demand by affluent consumers in India, Russia and China coupled with a declining mineral reserve base, limited new mining initiatives and inventories of rough diamonds at historically low levels. "The idea that diamonds will go up in price shouldn't surprise anybody when you see that diamond mining stocks are continuing to appreciate."



What a handful: diamonds are difficult to trade with as they vary widely in quality and price

Alamy

He hopes a diamond futures exchange may exist by late 2009 or early 2010. Diamond derivatives would allow lenders, retailers and manufacturers to hedge against future needs, but also broaden access for would-be investors. Nevertheless, he reckons people in the trade and investors could start to use price information from the monthly auctions to manage future risks well in advance of development of the first contract.

He is not the only one working on diamond futures. Rival diamond information provider PolishedPrices group has held talks with groups such as ABN Amro and the Chicago Board of Trade about this subject. Loet Kniphorst, global head of the international diamond and jewellery group at ABN Amro, one of the largest lenders to the industry, has said over-the-counter derivatives for polished diamonds might be the first step.

"We want to create the possibility for our diamond clients to hedge part of their supply, on the one hand, by securing future supply at fixed prices and, on the other hand, to sell forward. We realise this is still far away but we need to start somewhere," says Mr Kniphorst. "The derivative discussion also highlights the need for objective price information, which currently is not available."

A spokesman for the Chicago Board of Trade said the exchange would not comment about products it may, or may not, launch.

Charles Wyndham, founder of PolishedPrices, has criticised Mr Rapaport's auction because he is only offering diamonds of one carat

or more graded by the Gemological Institute of America, which do not reflect all diamond prices (see Financial Times, September 16).

Certainly, unlike precious metals, diamonds vary widely in quality and price, which makes trading them more difficult. But concen-

trating on a very specific type of diamond makes the price data more meaningful, says Mr Rapaport. "We're taking the crème de la crème of very well-cut, one-carat stones, and tracking those prices. You can't tag every bird, but you can tag some species."

Mr Rapaport is talking to the US Commodity Futures Trading Commission about forming a diamond futures market in New York, rather than London, or Antwerp, because he reckons New York is an important hub for high quality, graded diamonds – 50 per cent of diamonds are sold to the US – and because he thinks the US regulatory regime is more conducive to transparent diamond trading.

Nevertheless, he has tried and failed to launch diamond futures in New York before. He filed a proposal for diamond derivatives with the New York Commodity Exchange in 1982. "We tried to launch a physical delivery contract and that was shot down by the diamond industry," he says.

This time though, individual diamond producers have less influence on the industry. De Beers, for example, has seen its market share fall from about 90 per cent 20 years ago to 50 per cent today.

"We're coming out of a hundred years of monopolistic, manipulative control of diamond prices," says Mr Rapaport. Legislation in the US and Europe to stop the trade in conflict diamonds has also increased the need for transparency. Mr Rapaport also thinks diamond companies will be forced to embrace diamond derivatives now if they want more financing.

"Diamond debt [during] the last four years has doubled to \$12bn. Major banks don't want to keep on increasing their levels of diamond bank debt, so they are encouraging companies to find alternative sources of finance."

Plans do not stop with diamond derivatives. Mr Rapaport envisages once there is sufficient liquidity, it will be possible to form diamond exchange-traded funds.

That would work if physical and index-based precious metals ETFs are anything to go by. State Street Global Advisers launched the first physical gold ETF in November 2004, which has now amassed \$13.6bn worth of gold bullion.

In January, PowerShares and Deutsche Bank also launched silver, gold and precious metal index-based ETFs. But the July launch of what would have been the first traded physical diamond fund has been postponed, which does not bode well.

Diamond Circle Capital's planned \$400m IPO on the London Stock Exchange of a closed-end fund, to invest in large cut diamonds, was temporarily shelved amid equity market volatility.

The desire to make diamonds a tradable commodity may already exist – but Mr Rapaport and his competitors have their work cut out to actually bring that state of affairs into being.

US import and export of diamonds

	\$ million				Net diamond account
	Polished import	Polished export	Rough import	Rough export	
2002	11,501	4,399	567	213	7,456
2003	12,161	5,006	707	193	7,669
2004	13,872	6,597	753	268	7,760
2005	15,374	8,090	864	381	7,768
2006	16,450	9,097	801	443	7,711
2007*	17,524	10,067	902	638	7,721

* Extrapolation based on first three months of 2007

Diamond jewelry retail sales, 2006

	Sales (\$bn)	World share (%)
US	34.7	50.4
Japan	9.3	13.6
Europe	7.8	11.3
Gulf	4.9	7.2
Asia Pacific	3.3	4.9
China and India	3.1	4.6
Others	5.6	8.2
TOTAL	68.9	

Source: Rapaport