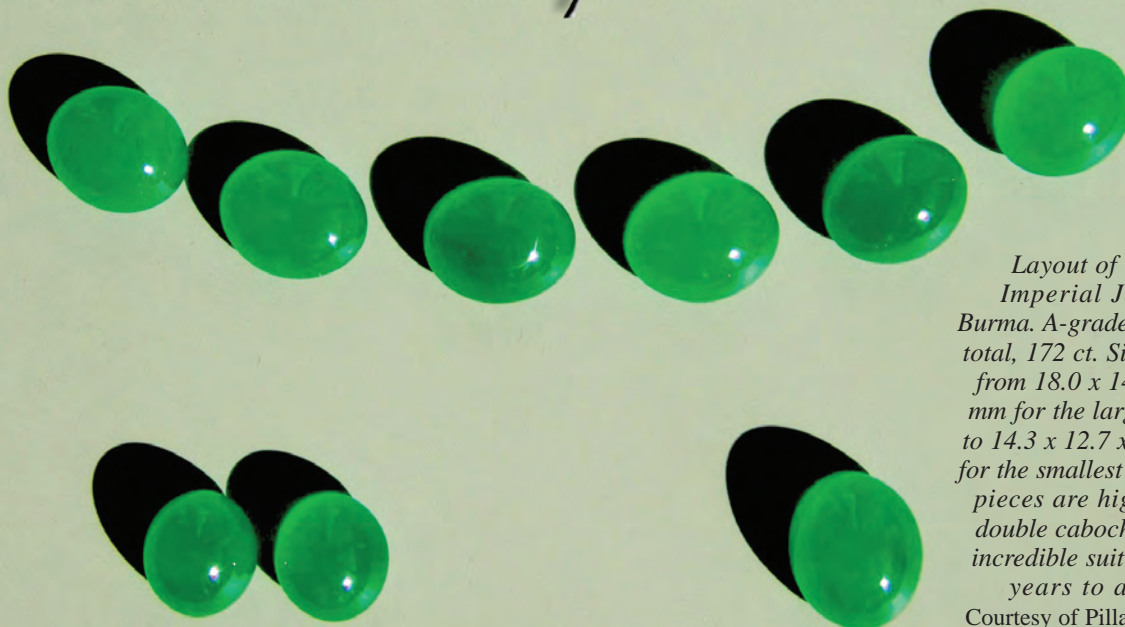


The Industry In Review



Layout of untreated Imperial Jade from Burma. A-grade, 9 pieces total, 172 ct. Sizes range from 18.0 x 14.8 x 10.9 mm for the largest stone to 14.3 x 12.7 x 10.3 mm for the smallest stone. All pieces are high domed double cabochons. This incredible suite took ten years to assemble.
Courtesy of Pillar & Stone.

The landscape is changing. We all know that. The industry does not look anything like it did ten years ago and in another few years, more changes will descend upon us. Here we look at the trends that are impacting our business: global events, internet, treatments, consumer trust (mistrust), laboratories, and favored/un-favored gems. What will the future hold and how can we best make profits?

By Richard B. Drucker, GG

Perhaps the greatest influence in all of the jewelry industry in the past few years is the global influence and how the global market has formed into world dominance compared to the past history of U.S. dominance. The booming markets in Europe and Asia with the weakness of the U.S. dollar and overall economics have combined to create a situation where there are global

rivals for the top gems being offered. The effects are being felt in diamonds and colored gems. Prices for top end gems continue to rise for U.S. retailers despite their economic struggles. All costs of living from food to fuel are up, rent is up, health care is more costly, and now, stocking diamonds and gems is more expensive as well. However, the moral of this story is to buy it fast when you can because the price may be higher tomorrow and your

new competition may be continents away and not just the local jeweler across the street.

Global Events

In the past 10 months we have seen many global events that are shaping the gem industry. Starting with the typhoon that hit the Leizhou Peninsula in China in mid-August of 2007, this natural disaster greatly affected the pearl crops. The water beds affected are saltwater that are

Industry Review

used to create Chinese saltwater akoya cultured pearls. The typhoon caused a rapid decline in the salinity level that in turn led to a mortality rate as high as 95%. While devastating to the crops and to the people who rely on these cultured pearls for income, the prices of saltwater cultured pearls were hardly affected. Perhaps the supplies of Japanese product and the pressure from less expensive Chinese round freshwater pearls kept prices from any rapid increase.

The Burma embargo that was actually first put in



Rescuers search for students in the debris of a school in Duijiangyuan. Photo: Reuters

place in July, 2003, became front and center conversation toward the end of 2007 leading into the Tucson gem show in February 2008. U.S. sanctions were aimed at Burma as a political statement against the illegal government in control there. With 400,000 junta troops in power, the embargo was aimed to cut financial support to the government. With gemstones, these sanctions had little initial effect since loopholes existed. Gems typically mined there went to Thailand for cutting and eventual export and thus were imported as products of Thailand. Efforts were now being made to close the loopholes and sign into law a new bill on the embargo. All major industry groups worldwide and major U.S. retailers such as Tiffany & Co. and Cartier supported the ban on Burma.

The American Gem Trade Association, while supporting the ban in principal, also realized the delicate balance of social responsibility. Since so much of the population there are poor, subsisting on just dollars a day, taking away this income is as damaging or worse to the small miners as it is to the ruling junta. Meeting with the U.S. State Department last December, panel members of the AGTA stated that most ruby trades through unofficial channels. There is substantial transformation that occurs and added value in the steps taken through Thailand. The impact on small mining communities is greater than on ruling Junta, they said.

Their suggestion was for a Kimberley-like process to be put in place for Burma goods.

Just as the bill to enact the embargo was close to being signed by the president with loopholes closed, a major cyclone hit Burma May 2nd of this year. With more than 34,000 dead and 28,000 missing, and more expected as disease and famine plague the country, the U.S. turned its focus on aid and support. The United Nations predicts that the death toll could be 62,000-100,000 before this is done. U.S. Secretary of State Condoleezza Rice stated that "...this is a humanitarian issue, not a political issue..." In light of the devastation of this country, the bill sits unsigned and it is not likely to be anytime soon. Even if signed, it would matter little as Burma gems are not currently the focus of the country. Now, it is about survival.

Recently, an interesting political development occurred in Madagascar that also will have global impact on gem supplies from that country. With its rich resources, we have come to rely on many gems exported from there including sapphire. What transpired is that an important large emerald crystal was legally exported into France. When the president of Madagascar found out about this, he declared it a national treasure and demanded its return. The French government declined as it was done through legal channels. As a result, the president ordered no more importing or exporting of gems until the situation is



Photo after cyclone Nargis hits Myanmar. Photo: AFP

sorted out. This stoppage is obviously devastating to all who are in the gem trade there or dealers planning to go there to buy. Orders taken in Tucson by Malagasy dealers are currently on hold if not delivered prior to the ban.

And finally, we have the tanzanite flood disaster that took place in March 2008. Eight pits flooded from heavy rains and 66 miners were estimated dead. This is not the first mining disaster in Tanzania. In 1998, 70-100 miners died in a collapse due to heavy rains

and in 2002, 48 died when a clean air compressor failed. While past disasters had a more significant effect on tanzanite supplies and prices, the situation seems different this time. Prices before the disaster had been holding relatively high. Demand was level for many reasons including the U.S. economic climate and declining demand the past few years with a lack of consistent supply. So, the temporary stoppage in mining does not seem to have much effect on prices at this time.

And finally, a major earthquake hit China in mid-May killing an estimated 10,000 people. While the areas affected are not thought to be major gem centers, thus not directly affecting the gem business, no doubt the people of China will be more involved in internal care, than on concern for export of gems. We suspect that the trade will go on near normal soon but with all mourning the losses and working on rebuilding efforts.

The Internet

What hasn't been said about the internet? It is the greatest tool for business but the thorn in the sides of so many jewelers. With about 10% of all jewelry today being sold on the internet, that still leaves 90% for other outlets including retail jewelers. However, the internet presence alone creates profit margin nightmares as people come to jewelers with internet pricing in hand, asking what the store can do for them. Considering that some of the better known sites work on 5-20% margins on loose diamonds and often with no sales tax, the jewelers are hard pressed to make a reasonable profit on a sale. This is not to say that all jewelers are buckling to the internet low margins, but they certainly all deal with the competition.

The answers to the internet cannot be solved in a few short sentences here. However, those that have been successful seem to have a multi-level strategy that includes value added services. Brands are one method of competing but even those are getting more diluted and easier to shop and compare online. Quality, service, and trust are key factors as customer loyalty is harder to achieve and maintain.

Treatments 'Heat' Up

The year so far has been interesting as all eyes are looking close at the future of gem treatments. If we were not there before, let us declare 2008 as the year that gem treatments went from the dangerous to the disastrous.

In the past two years we watched as beryllium became more prevalent in corundum and lead-glass appeared in rubies. While these two treatments are

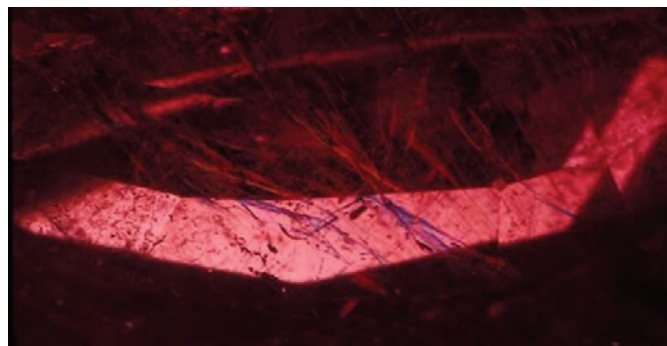
detectable (beryllium can sometimes be challenging but lead-glass is easy to identify), they are now so prevalent in the trade that one wonders if the natural product even exists anymore. The Laboratory Manual Harmonization Committee has proposed language to use on reports (shown below). However, some rubies encountered at the AGTA laboratory defy any reasonable terminology. If a product that has glass filling is described as such (lead-glass filled ruby), then how should one describe a ruby that is more lead-glass than ruby? Perhaps new terminology is needed for these—'ruby-filled lead glass.' When 'gemstones' are sold for as little as \$1.50 per carat, filled with a foreign substance, can we really call them gems anymore?

And just when we think it is safe to buy a gem, we discover a new problem. Such was the case with tanzanite, formerly heated only, now cobalt coated and difficult, if not impossible to detect at the retail counter. (See article *Gem Notes-Coated Tanzanite* in this issue.)

We have referred often to the Laboratory Manual Harmonization Committee. This international group consists of major worldwide laboratories that meet during the year to discuss issues such as nomenclature and treatments. With corundum, the two concerns are the glass filling and the beryllium treatment. Here is the suggested language for each of these gem treatments.

For glass-filled corundum, the comments should state: '*(Indications of) Clarity enhancement/modification by a glass filler in fissures' or 'Glass filled fissures' or 'Glass in fissures,' plus (the appropriate filler quantification terminology – 'alpha numeric and/or text description' - see table), (the identification of the glass material - e.g., lead glass, silica glass, etc.) and/or the statement (introduction of glass into fissures involves heating). The table then quantifies the filler as minor (C1), moderate (C2), or significant (C3).*

For beryllium, the comments should state: '*Indications of heating pluseither: Further analyses*



One of the key identification features of lead glass-filled rubies is the flash effect. This sample shows a strong blue flash in brightfield illumination, and the orange flash is visible in dark-field. Photomicrograph by Shane F. McClure, magnified 10x. © GIA.

Industry Review

are necessary to determine whether or not beryllium and/or other chemical element(s) from an external source is (are) present.’ or ‘Heating may involve the diffusion of beryllium and/or other chemical element(s) from an external source.’

To review the complete details of these or any of the LMHC reports, they can be downloaded from the AGTA-GTC website at www.agta-gtc.org.

Consumer Mistrust in the Industry

Recently, DeBeers released the results of a survey they did regarding the trust factor that consumers have with jewelers. The results are staggering. Consumers had multiple choice answers and only 5% of all respondents said they trusted jewelers a lot. More than half of all respondents said they ‘actively mistrust’ or ‘mistrust jewelers a lot’. DeBeers stated that as an industry, we must do better. (Note that one could speculate that DeBeers released this information in an attempt to eventually lead consumers to the DeBeers diamond brand as a name consumers can trust.) These results might have been about diamonds, but the same would probably hold true if the questions were posed regarding color.

For the more than 25 years that I have been in the jewelry business, I have been talking about the lack of disclosure in the industry. Twenty five years later, it is marginally better. On the wholesale end, it has improved due to efforts of organizations such as the American Gem Trade Association. The AGTA requires members to disclose treatments of gems. However, on the retail level, other than some brave stores that have implemented full disclosure policies, it is still greatly lacking. As independent appraisers, we continue to successfully educate consumers regarding treatments with only minimal problems from the consumer learning this information. If anything, their problem is that they were not told of the treatment. How do retailers expect to gain consumer trust if they knowingly hide information relevant to the sale of the gem? Retailers are so fearful of losing out on a sale, some will seem to do anything or say anything to make that sale. A case study illustrating this follows in this next section on *The Laboratory Game*.

The Laboratory Game

Today there are more laboratories that grade diamonds than ever. Services vary from strictly diamond grading to light performance and cut grading. But the labs are not equal. For the American Gem Society conclave in Seattle, I did a statistical analysis of diamonds and their grading reports and selling prices.

The analysis used a 1.00 carat round diamond of

G color and VS2 clarity—a popular size and grade category. I analyzed more than 800 diamonds. For excellent and very good cuts, the GIA and AGS labs were about the same price. Some GIA excellents and the AGS ideal cuts had a slight premium in price as expected. The better cut GIA graded diamonds in this category sold for within 1% of published *GemGuide* prices. Diamonds with less than *Very Good* proportions sold with a discount as expected. The EGL USA laboratory statistically sold for about 15-21% below the *GemGuide* prices for the “core” diamonds with better cuts overall. A few excellent cuts sold for about a 6% discount from the *GemGuide*. Using the same parameters, the EGL Israel lab graded diamonds sold for 19-27% below the *GemGuide*.

So, why does the industry use different labs for diamonds? Sometimes, especially in the early days, it was for faster service. GIA used to take 4-6 weeks to grade diamonds but that turnaround time is significantly less these days. New services such as cut grading or light performance reports are reasons today that a variety of labs might be used. However, the main thrust behind the growth of some labs over the years was leniency in grading standards. The grading system is subjective so there is nothing that prevents any lab, wholesaler, or jeweler from rendering an opinion. If the GIA or AGS grade was thought to be too strict, other labs might have offered a better grade. However, when we analyzed the statistical selling prices of diamonds from all labs, we found that there were discounts. So, the better grade in the end might translate to the same dollars when graded more strict without a discount. It is a game that the industry plays.

Case study: Recently, our appraisal office was asked to evaluate two diamonds for a consumer that he was intending to purchase as earrings. The diamonds had lab reports from a “not so reputable” overseas lab to remain unnamed here. Both diamonds were unmounted allowing for more accuracy in grading. When we analyzed the diamonds, the color and clarity grades were off by two to three grades in each category. When the call is close, we understand the subjective nature of the grading scale. However, this great discrepancy had to be delicately discussed with the client. When the client did not buy the diamonds, the angry jeweler called us to discuss the situation. This jeweler declared that it was so hard to make a sale these days, especially when customers like this were searching on the internet, that she was forced to use other labs knowing that they were more lenient so she could “compete” with the prices on the internet. This is scary. To fight competition, the jeweler is willing to deceive the customer by stating that she can sell the

same grades for the internet price or less. The lesson here is easy. Remember the mistrust survey by DeBeers? Add one more jeweler to the mistrust category. Certainly this consumer and all of his potential referral friends will not be shopping there.

Favored/Un-favored Gems

Sapphire had been enjoying a good run in the industry when only heat was an issue. Now, with beryllium treatments, uncertainty exists. The demand for fine, untreated sapphires is growing with insufficient supplies. Ruby is struggling a bit right now, mainly due to the high price of better goods. The lead-glass issues discussed and the glass residue of Mong Hsu are also contributing to keeping ruby out of favor, though the latter is becoming more acceptable when the flux residue is minor. Dealers, jewelers, and appraisers are concerned with trying to identify and disclose all that is being done to rubies today.

By contrast, of the big three, emerald continues to gain strength. Following at least a decade of slumping sales, two to three years of solid sales and increasing prices are a welcome sight for this gem. While we are still concerned over treatments such as opticon and palma oil, overall problems with treatments are fewer. Recent reports of low grade commercial emeralds being treated in the rough with a glue-like compound are now thought to be isolated to some low grade Brazilian and Colombian stones in smaller quantities than originally reported. The La Pita mine is producing a good supply of emeralds and it is now number two behind only the Muzo mine for production. Prices remain firm due to the weakened U.S. dollar.

Underrated and very favored are the garnets and the spinels. With so much variety at reasonable prices and almost no treatment controversies to deal with, one wonders what has taken so long for these gems to arise as stars. The Tanzanian red spinels are the best we have seen with prices topping out at \$1,500 per carat (1-3 cts.) and many beautiful gems for about \$500 per carat.

Pearls, pearls, and more pearls. With more than 8,000 freshwater pearl farms in China, the supply is endless, the prices are affordable, and the variety allows for product to be sold many times over to clients. Creativity is endless with these pearls. New on the charts are the abalone pearls from Australia. These are 100% natural unlike the similar looking assembled mabe pearls. Though not a large supply, they are quickly catching on with designers.

Profitable Business

The money today is in the buying end of the business. More jewelers than ever are now offering to



Pearls, pearls, and more pearls. Chinese freshwater pearls in many shapes and varieties offer unlimited possibilities.

buy metals and diamonds. What used to be advertised sales events for some jewelers are now advertised buying events. Several jewelers we spoke with at the JCK show noted that this new buying plan was keeping them afloat.

Buying to make money has even hit the wholesale end. I regularly receive solicitations to buy diamonds from various companies as I am sure many readers do, too. Recently, one of these companies sent the first ever solicitation to help jewelers buy diamonds from their customers. They will put up the money, have the diamonds recut if necessary, certified, and then offer them back to the dealer with no obligation to buy at a 'significant discount.' He sees the lagging orders in his wholesale business and this is an opportunity to make money from the buying end.

While this new business strategy may be good for the retail jeweler short-term, it is hardly a long-term business plan. What this also means is that the wholesale jewelry sector is feeling the crunch as well. If the retail jewelers are buying off the street, they are using their cash for that segment and not purchasing new stock.

They say that business is cyclical. If so, we are certainly near the bottom of the cycle and that means business can only go up. This is all about survival right now. The strong will survive but that means having a solid business plan. ♦