PARAGON FUNDS MANAGEMENT

PARAGON FUND UPDATE – July 2013

KEY FUND FACTS

Fund Managers	John Deniz & Nick Reddaway
Strategy	Australian absolute return
Inception Date	01/03/2013
Total Net Return	2.8%

FUND PERFORMANCE (net of fees)

1 month	1.8%
3 month	1.4%
6 month	-
1 yr	-

COMMENTARY

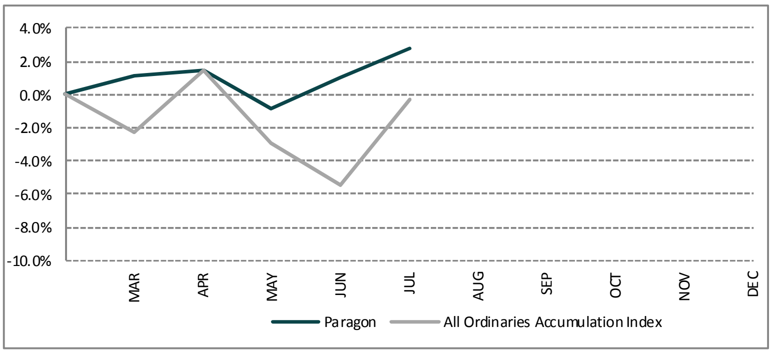
The Paragon Fund returned +1.8% net of fees for the month of July vs. +5.5% for the market (All Ordinaries Accumulation Index). Since inception the Paragon Fund has returned +2.8% net of fees vs. -0.3% for the market.

Proving that the stock market is not the economy, the equity market rallied strongly in July despite weak domestic economic news and several profit warnings from the likes of Woodside, Orica, Treasury Wine Estates and various industrial companies. After 2 months of heavy falls, the equity market was boosted by “non-tapering” talk by the US Federal Reserve, providing the spark for risk assets across the globe. Low-quality, beaten up resource stocks caught a bid with the resources index up strongly after months of material declines.

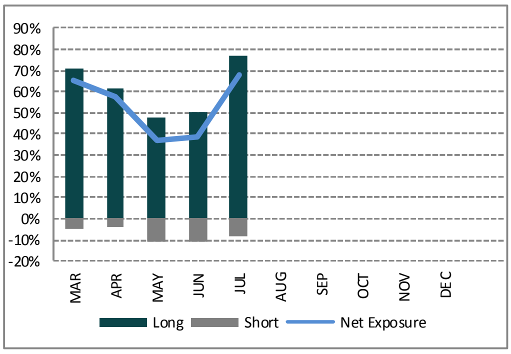
Key drivers of performance for July included a combination of:
• Overall equity market exposure averaging ~55% for the month
• Resource, Consumer and select Financials Long exposures

This month we provide insight into the rationale behind establishing Paragon and walk our investors through how we manage money.

HISTORICAL PERFORMANCE (net of fees)



HISTORICAL EXPOSURE



	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	YTD
2013			1.1%	0.3%	-2.2%	1.8%	1.8%						2.8%

Performance results are presented net of all transaction costs, investment management and performance fees and all other costs incurred by the Fund.

PORTFOLIO BREAKDOWN

INDUSTRY EXPOSURE

	Long	Short	Net
Resources	29.1%	-5.5%	23.5%
Industrials	37.2%	-2.9%	34.4%
Financials	10.3%	0%	10.3%
Total	**76.6%**	**-8.4%**	**68.2%**
Cash			**31.8%**

HOLDINGS

Long	20
Short	8
Total	28

CONCENTRATION

Top 5	28.2%
Top 10	50.3%

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At Paragon, we believe that the investing environment in Australia post the global financial crisis will continue to depart significantly from that experienced in the 20 years prior. To put this in context, from 1993-2007, the Australian market rose 496% (including dividends) and fell in only 2 of those years while from 2003-2007 the market rose 156% without a negative year. **However from 2008-2012, the market has returned just 6% and has endured 2 negative years out of 5.**

As the debt burden created in the credit boom prior to the global financial crisis has largely been shifted from corporations to sovereigns rather than solved, we view this volatility of the last 5 years will remain for some time. In our view, the traditional "buy and hold" approach adopted by most private investors and traditional funds management businesses is not an optimal strategy. Time in the market will only increase the risk of capital loss. We believe that successfully managing a portfolio today demands significantly more time, resources, and expertise than most individuals can provide. Therefore we seek to generate higher returns by focusing on investing in a concentrated number of companies, through active portfolio management with the ability to move to cash, and the ability to benefit from declining share prices of challenged businesses.

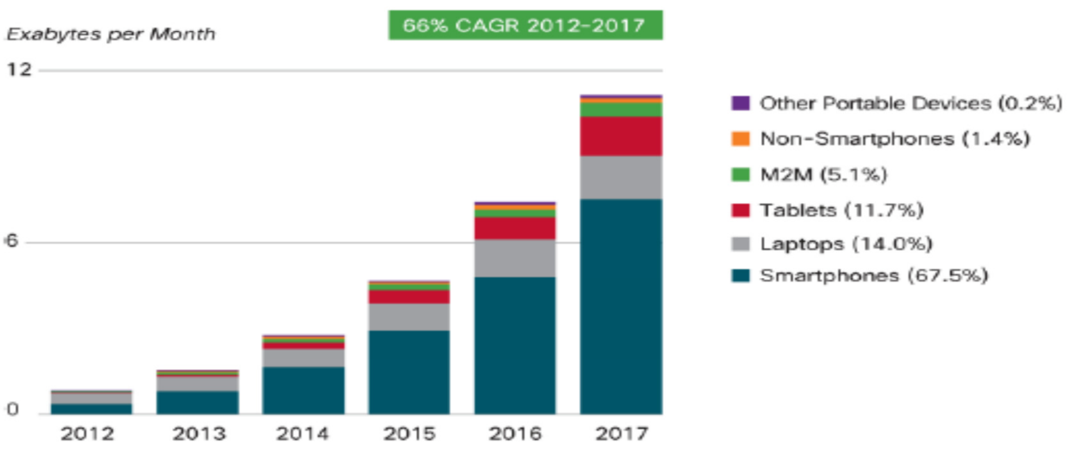
When we invest in a business, we seek to identify companies that exhibit sustainable or improving returns on capital driven by volume growth, pricing power and competitive advantages. A higher return for every dollar spent enables management to reinvest to grow or distribute more to shareholders and generally leads to share price outperformance. These are attractive attributes we feel can be found in companies that are going through internal change (restructuring, acquisitions, demergers) or more commonly in companies enjoying the tailwind of structural growth and dominant macroeconomic trends. This process of stock selection affords us the ability to focus on a few businesses rather than trying to cover the whole market at any given time. It also forms the basis of a stable, a high conviction portfolio that bears little resemblance to the ASX index.

We discuss the major investment themes that currently account for over 65% of our current portfolio below.

Mobile Internet

Technological advances, the smartphone and the ability of Apple to enchant consumers with its product innovation and design have driven immense change in the way we communicate, use the internet and consume content. According to Cisco, by 2017 devices connected to IP networks globally will be nearly three times as high as the global population, mobile data traffic will increase 13 fold, and video viewed and downloaded on the internet will represent over 80% of all global consumer internet traffic.

Figure 3. Smartphones Lead Traffic Growth



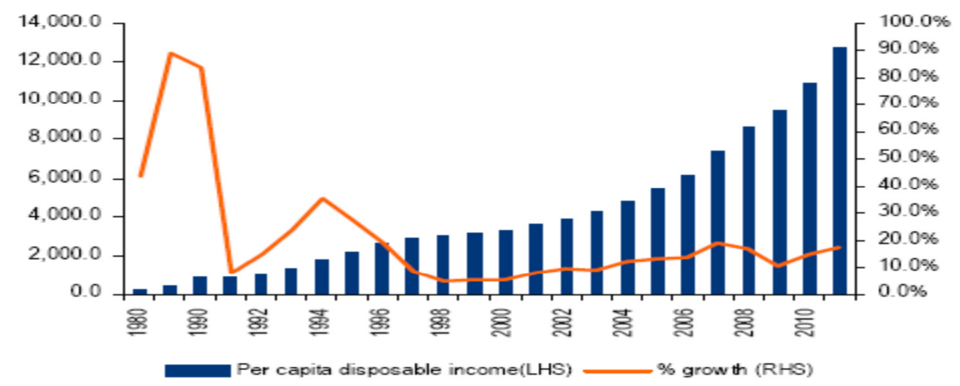
Figures in legend refer to traffic share in 2017.
Source: Cisco VNI Mobile Forecast, 2013

This is driving significant pricing power to those who create the content we view (21st Century Fox) and to those who supply the infrastructure we view it on (Telstra). Technological advances and cloud computing have also given rise to disruptive business models that are changing the way we have worked for decades (Xero) while driving the need for industries that didn't exist in 2000 such as co-location data storage (NextDC).

Emerging Consumer

With 25% of income earners in China, or roughly 330m people defined as middle class today (vs. 50m in the US), China is already the world's biggest consumer of cars and luxury goods. By 2022, McKinsey Consulting expects more than 75% of China's income earners will be classified as middle class. Asia's middle class as a whole is forecast to triple over the next decade to 1.7bn people, comprising roughly half the words middle class population. This trend is a major strategic driving force behind most of the big consumer orientated companies globally and is impacting global demand for everything from cars to infant formula.

Chart 10: China per capita disposable income



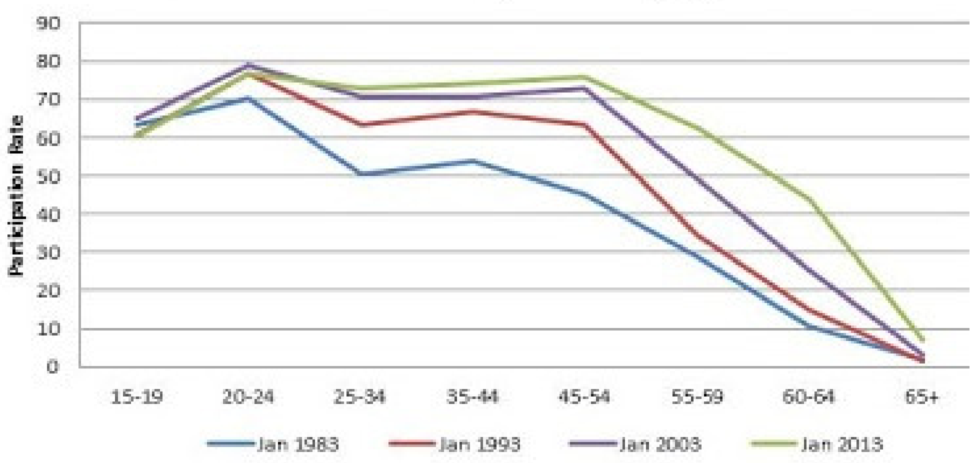
Source: National Bureau of Statistics, China, BofA Merrill Lynch Global

We view gambling in Macau - where total gaming revenue exceeds the Las Vegas strip by 4 to 1 - and Vietnam, as major beneficiaries of this secular trend given gambling is illegal in China (Crown Casino, Donaco).

Ageing Society

Since the middle of the 70's, Australia's fertility rate has fallen below the level required to maintain the population without immigration, while we are also healthier and living longer. As society on average becomes older, there are wide-ranging ramifications for the provision of services like healthcare and housing (Ingenia Communities) but this secular trend has other implications. For example, the proportion of older mothers classed as 35 and over has continued to increase, rising from 17.5% in 2001 to 23.5% today which has partially been driven by more women choosing a career before motherhood.

Chart 2: Female Workforce Participation Rate by Age, 1983 to 2013



Source: ABS, Labour Force, Australia, Detailed - Electronic Delivery, Jan 2013 (cat. no. 6291.0.55.001) - Table 1: Labour force

This has positive long term ramifications for the provision of childcare in Australia (G8 Education) as well as the use of IVF technology to assist in pregnancy (Virtus Health).

Global Growth & Resources

As markets have wobbled since May over the uncertainty surrounding the unwinding of quantitative easing, the US continued to show a positive economic trajectory built on a recovering housing market and manufacturing sector. Over the last 2 months, most other major economies have also seen improving trends. Australia however continues to suffer a crisis of confidence as the mining super-cycle boom recedes which is constricting consumption despite declining interest rates and a falling AUD (Myer, Toll - short). Importantly for Australian investors, the Chinese economy also appears to have stabilised, supported by recent government commitments to support GDP growth at 7.5%.

Resource stocks have borne the brunt of uncertainty over demand in the face of rising supply for most metals. The level of extreme pessimism globally for the sector is unwarranted in our view given the improving global backdrop, particularly for Iron Ore (BHP, Rio Tinto, Fortescue, Atlas Iron). Iron ore stocks would require the spot price of iron ore to fall some 25% to justify their current valuations. We view this scenario as unlikely due to depressed iron ore inventory levels held by end consumers, strong restocking, Chinese steel production at next to record levels and seasonality.