Paragon Fund Monthly Performance Report

November 2013

PARAGON FUNDS MANAGEMENT

PARAGON FUND UPDATE – November 2013

KEY FUND FACTS

Fund Managers	John Deniz & Nick Reddaway
Strategy	Australian absolute return
Inception Date	01/03/2013
Total Net Return	18.6%

FUND PERFORMANCE (net of fees)

1 month	2.8%
3 month	13.5%
6 month	19.6%
1 yr	-

COMMENTARY

The Paragon Fund returned +2.8% net of fees for the month of Nov 2013 vs. the market (All Ordinaries Accumulation Index) - 1.4%. Since inception 01 Mar 2013 to 30 Nov 2013 (9 months), the Paragon Fund has returned +18.6% net of fees vs. the market +7.3%.

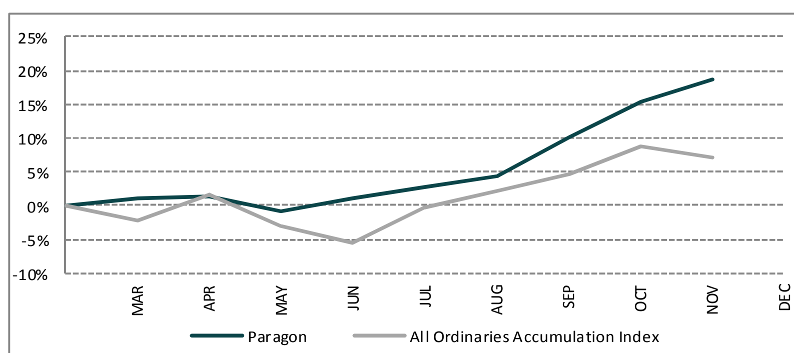
Australian centric issues saw our market down for the month – its 4th negative month year to date. These issues included a rush of IPO's coming to market before Christmas requiring investors to raise cash levels to participate, a spate of fairly ordinary corporate operating updates (material downgrades by Worley Parsons and the broader mining services sector), a relatively soft GDP growth rate and a weak AUD creating selling pressure from offshore institutions. This saw our market underperform international markets which continued to post positive gains.

Key drivers of the Paragon Fund performance for November included a combination of:

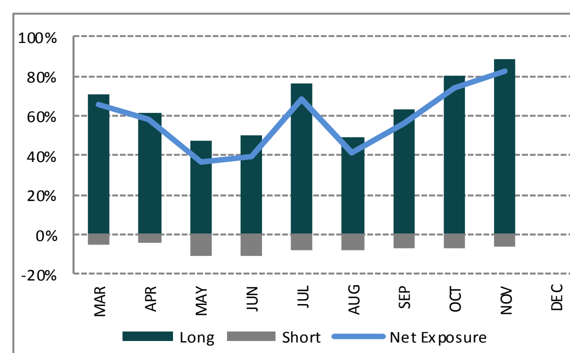
- Solid performances from core holdings in Xero, Donaco, Virtus Health and our short position in Sirius Resources
- Maintaining net equity exposure ~75% on average for the month

This month we discuss some of the broader market concerns being debated in the financial community and how we view the outlook for the Australian equity market today.

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%	1.6%	5.3%	4.9%	2.8%		18.6%

PORTFOLIO BREAKDOWN

INDUSTRY EXPOSURE

	Long	Short	Net
Resources	20.3%	6.4%	13.9%
Industrials	58.8%	0.0%	58.8%
Financials	9.5%	0.0%	9.5%
Total	**88.6%**	**6.4%**	**82.2%**
Cash			**17.8%**

HOLDINGS

Long	23
Short	2
Total	25

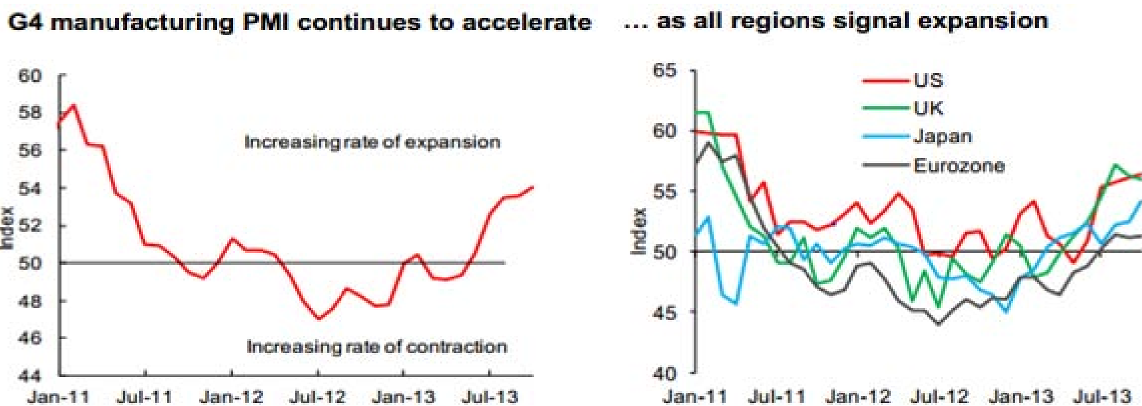
CONCENTRATION

Top 5	39.7%
Top 10	59.1%

Much debate has been circulating the global finance community surrounding for how long and high the equity market can move next year after such a strong year in 2013. The broader market concerns follow a familiar thought process that has been debated at length since this recovery started in 2009:

- When and even if, will the global central banks begin to start pulling back from their extraordinary stimulus measures (namely quantitative easing (QE)) deployed over the last 5 years.
- At that time how will it impact equity markets and the very instruments they sought to control in order to stimulate the economy – interest rates.
- Should interest rates normalise to higher levels, how will consumers react to the rising cost of finance given a potential structural shift in savings rates.
- How will corporate earnings be impacted with less attractive refinancing and buy back opportunities and potentially lower revenue growth.
- And of course, can China maintain an economic equilibrium that appeases all forces, internal and external, on its growing economy.

Perhaps somewhat counter intuitive but true to form, equity markets have climbed the wall of worry since mid-2012. The Australian market in this time has rallied 30% including dividends while the US has rallied 37% and Europe 23%. Simplistically, we feel the strong performance is because of supportive global central banks driving interest rates lower and the broadly positive trajectory of global economic growth (see below charts) which combined are forcing investors to seek out higher returns in riskier assets.



Source for all above: ISM, Markit, Macquarie Research, November 2013

This has led to rising equity valuations (see chart below) and more positive investor sentiment in anticipation of better times ahead. The one year forward P/E ratio for the Australian market stands at 14x, certainly higher than the 11x seen in the middle of 2012 but it's just on its long run average of 13.5x which we contend isn't so extreme as to require a stronger contrarian investment stance.

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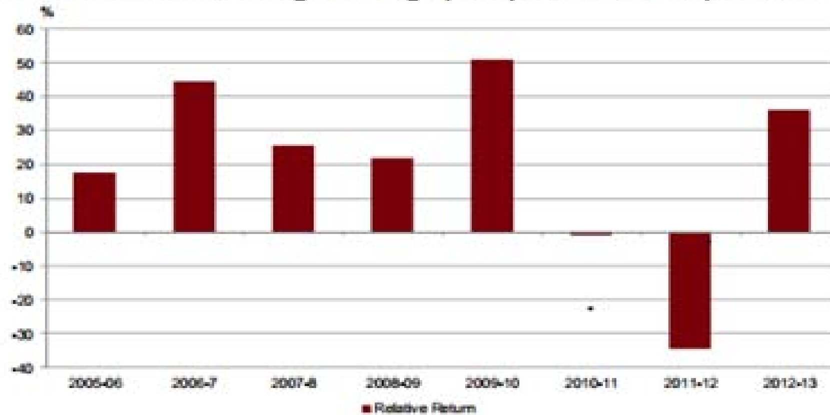
If there was no confidence to drive corporates to seek out attractive acquisitions, if there were investors still fleeing from equities to bonds or cash, if global growth was slowing, if corporate earnings were forecast to be lower next year than this, and if interest rates were not still close to record lows then maybe, we would be less sanguine. The fact is that today the opposite is true and valuations still remain ok. We therefore maintain that from what we can see today, the equity market continues to provide attractive risk reward especially when compared to other traditional asset classes (cash, property, bonds).

We continue to be mindful of the rate of change in economic data whilst also monitoring leading indicators such as investor sentiment, corporate debt spreads and copper prices. **Yet above all we remain committed to finding great companies at good prices which we have comfort investing in through the cycle.** The chart below shows that historically, these companies which we define in part as exhibiting high and sustainable or improving returns tend to outperform the overall market over time. This rings especially true given the spate of negative profit announcements from the likes of Worley Parsons, Qantas and QBE, and the broader mining services sector that are all facing cyclical and/or structural challenges.



To that end, in our July 2013 update we talked about several thematic trends that we continue to invest in given our belief that their long term drivers will allow the related companies to benefit through stronger returns, cash flow and earnings than the market over time. As a reminder, below are our dominant themes in the portfolio today and the companies we view as being able to deliver compounded growth rates well in excess of the market average:

Mobile Internet

- Technological advances and the smartphone have changed the way we 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 and mobile data traffic will increase 13 fold.
- Main beneficiaries: 21st Century Fox; Xero

Emerging Consumer

- 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.
- Main beneficiaries: Crown Resorts; 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.
- Main Beneficiaries: Virtus Health; G8 Education

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