Paragon Fund Monthly Performance Report

February 2014

PARAGON FUNDS MANAGEMENT

PARAGON FUND UPDATE – February 2014

KEY FUND FACTS	
Fund Managers	John Deniz & Nick Reddaway
Strategy	Australian absolute return
Inception Date	01/03/2013
Net Return p.a.	21.8%
Total Net Return	21.8%

PERFORMANCE (net of fees)	
1 month	3.8%
3 month	2.7%
6 month	16.6%
Financial YTD	20.7%
1 year	21.8%

FUND DETAILS	
NAV	$1.218
Entry Price	$1.220
Exit Price	$1.217
Fund Size	$9.6m

COMMENTARY

The Paragon Fund returned 3.8% after fees for the month of February. Since inception the Paragon Fund has returned 21.8% after fees vs. the market (All Ordinaries Accumulation Index) 10.4%.

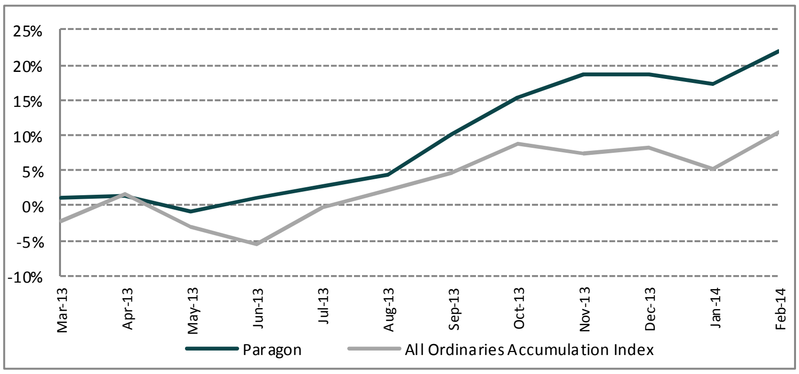
The Australian equity market continued the weak trend from January, posting further losses in early February. This was driven by the ongoing reduction in liquidity by the US Fed (another $10b of tapering) creating emerging market volatility and poor US economic data. Dismissed as poor weather related, global markets looked through the US data as temporary and emerging market volatility as secondary to the primary trends of reasonable global growth and supportive central banks. Coupled with a decent Australian corporate reporting season, the Australian equity market finished February with its strongest gain in 7 months.

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

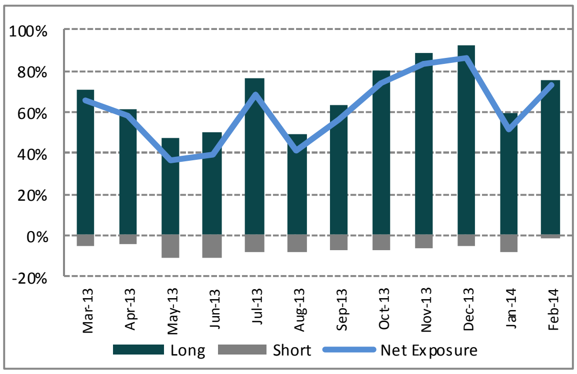
• Strong returns from our core holdings G8 Education, Donaco, and our emerging Copper investment
• Increasing the net equity exposure from 50% at the beginning of the month to 74% by month end

The close of February marks an important milestone – the Paragon Fund turned one. So this month we review our first 12 months managing the Paragon Fund.

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%	0.0%	18.7%
2014	-1.1%	3.8%											2.6%

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

PORTFOLIO BREAKDOWN

INDUSTRY EXPOSURE			
	Long	Short	Net
Resources	30.9%	1.8%	29.1%
Industrials	41.6%	0.0%	41.6%
Financials	2.9%	0.0%	2.9%
Total	**75.4%**	**1.8%**	**73.6%**
Cash			**26.4%**

HOLDINGS	
Long	23
Short	3
Total	26

CONCENTRATION	
Top 5	32.4%
Top 10	49.6%

With the close of February 2014, the Paragon Fund turned one. In our first year we delivered capital growth of 21.8% after fees, when the broader equity market returned 10.4% (4.6% of which was dividends) and term deposits returned approximately 4%.

We achieved this return holding on average 35% of assets in cash and with substantially less volatility than the market. We had positive contributions for the year in each of the three key market sectors of Industrials, Resources, and Financials despite their mixed fortunes, while we generated over 70% of the total return in mid to large capitalisation stocks.

Overall, we feel this level of capital growth with lower than market risk, is a positive endorsement of our combined skill sets and the portfolio and risk management processes we put in place to manage the Paragon Fund. It is also particularly pleasing that at a business level Paragon Funds Management was breakeven in its first year.

Of course within our strong result, there were certainly some ideas that worked better than others and this month we wanted to take a look back over the year to review exactly that – both to give our clients insights into the fund workings and to enable us to learn and grow as fund managers.

What Worked

While no one can expect to get everything right, we are pleased that we got much more right than wrong in our first year. At the individual stock level, when considering investments generating in excess of +/- 0.2% in performance, we got 7/10 right. When considering positions generating in excess of +/- 1% in performance, we got 9/10 right.

We feel this is a good barometer of our ability to pick stocks, our capital management and stop loss discipline.

Similarly pleasing is that our investment process works. We wrote in our update for June 2013 that there were 3 dominant structural trends and one macroeconomic trend we had identified which provided several compelling investment ideas. Within the commentary for the structural trends of Mobile Internet / Emerging Consumer / Ageing Society, we highlighted 9 companies we felt would benefit from these trends. 4 of our top 5, and 5 of our top 10 performing stocks for the year were in this list contributing over 15% of our gross returns. We continue to own 4 of these core holdings including Xero, Crown Resorts, Donaco and G8 Education, whilst the delisting of 21st FOX (from the ASX to the NYSE) meant it needed to be sold.

The macroeconomic trend of global growth and more specifically the contrarian opportunity presented in Iron Ore equities in 2H13, delivered 1 of the top 10 returns for the year and over 6% of our gross returns. Note we took profits and exited our iron ore holdings once their valuations exceeded fair value, though we continue to have exposure to improving global growth as a continuing macroeconomic trend.

Overall gross returns for the year attributed to these themes and their existing weight in the portfolio are as follows:

Mobile Internet		
	Current weight	14.4%
	1yr gross return	6.7%
Emerging Consumer		
	Current weight	15.2%
	1yr gross return	6.2%

Global Growth		
	Current weight	10.8%
	1yr gross return	6.3%
Ageing Society		
	Current weight	9.7%
	1yr gross return	4.0%

We also wrote 4 individual stock briefs on Xero, Orocobre, Tiger Resources and Sirius Resources (short). Together these positions contributed to over 8% of our gross returns and we maintain positions in all except Sirius which we closed on the back of changing nickel market dynamics post Indonesian export bans.

Other notable mentions include moderate gains made on our negative stance on mining services and taking advantage of two instances of excessive market pessimism related to McMillan Shakespeare and Forge Group on negative outlook statements (one government driven and the other internal mismanagement).

What Didn't

There were several stocks that worked well last year that we had initially believed to be too expensive. Yet their operating momentum was enough to send them materially higher for the year. While we did capture some of the move in the fund managers (HGG/BTT) we missed opportunities in market favourites such as Realestate.com, Ramsay HealthCare, and Domino's Pizza.

We feel we failed to capitalise on gold and mining services downside given the extent to which these sectors fell during the year. Again while we were right on the theme and individual shorts applied (RRL, EVN & RSG gold shorts and AAX, ASL, NWH, BLY mining services shorts) we weighted our shorts too small and/or covered our shorts too early.

What Have We Learnt

In our first year we admit to being under self-imposed "performance pressure". On occasion during periods of market volatility, we were not in a position to hold our view, because we felt that negative results in the short term were not something we could ask our clients to accept, given we were a new business.

The reality is that our overarching objective will always remain the preservation of our clients' capital. In hindsight, this resulted in us being too cautious through market sell-offs during the year, despite knowing that the broad trends of better global growth and supportive central banks remained in place.

Most importantly, we have learnt that we are a strong combination that has worked well together. We have implemented processes in our portfolio and risk management that delivered strong results in our first year and will continue to do so going forward.

We would like to take this opportunity to thank all of our business partners for their continued support and efforts over this past year. They include our Prime Broker & Custodian Merrill Lynch BoA, our Administrator White Outsourcing, our Accountants and Auditors Nexia Australia, and our external compliance team and CFO.

17 March 2014

Paragon Funds Management