PARAGON FUNDS MANAGEMENT

THE PARAGON FUND // SEPTEMBER 2014

PROFILE		PERFORMANCE *(after fees)*		DETAILS	
Fund Managers	John Deniz & Nick Reddaway	**1 month**	0.3%	**NAV**	$1.4088
Strategy	Australian absolute return	**3 month**	11.5%	**Entry Price**	$1.4109
Inception Date	01/03/2013	**6 month**	16.0%	**Exit Price**	$1.4067
Net Return p.a.	27.2%	**1 year**	33.0%	**Fund Size**	$18.0m
Total Net Return	46.4%	**Financial YTD**	11.5%	**APIR Code**	PGF0001AU

OVERVIEW & POSITIONING

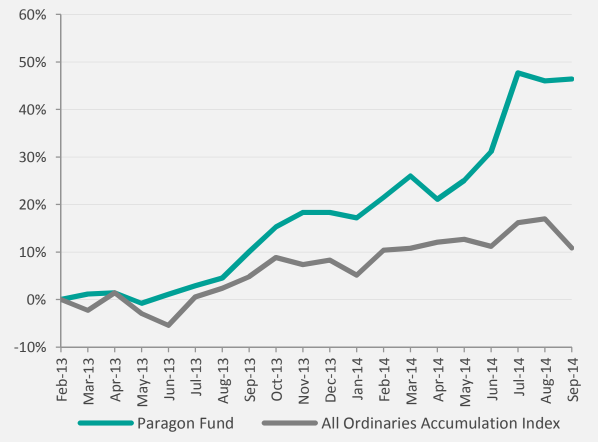
The Paragon Fund returned +0.3% after fees for the month of September 2014. Since inception the Paragon Fund has returned +46.4% after fees vs. the market (All Ordinaries Accumulation Index) +10.9%.

The Australian equity market suffered its heaviest fall in 27 months in September, falling 5.3%. All the major sectors were weak with Financials, Industrials and Resource Indices all down materially (from -6% to -8%). A strengthening USD and weakening AUD (falling over 6%) led offshore selling across the board. The Iron Ore price continued to slide (falling 10%), due to weak seasonal buying and as the market resumed discounting the outlook for material industry surpluses.

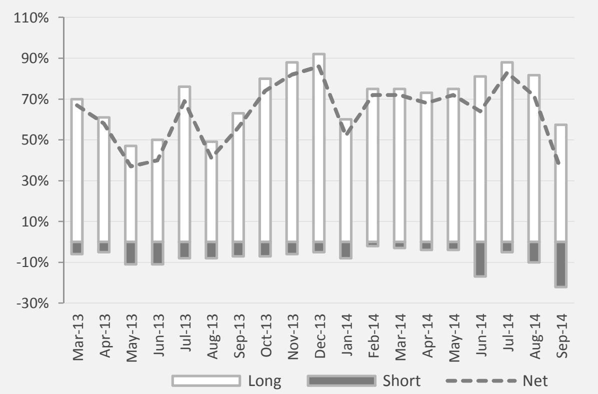
Key drivers of the Paragon Fund performance for September included solid returns from LNG Ltd, short positions in the major Banks, Rio Tinto, Syrah Resources and Sirius Resources, offset by falls in Orocobre, G8 Education and TFS Corp. At the end of September the fund had 17 long positions and 12 short positions.

INDUSTRY EXPOSURE	Long	Short	Net
Resources	29.5%	-15.8%	13.7%
Industrials	27.9%	-4.0%	23.9%
Financials	0.0%	-2.4%	-2.4%
Total	**57.4%**	**-22.1%**	**35.2%**
Cash			**64.8%**

HISTORICAL PERFORMANCE *(after fees)*



HISTORICAL EXPOSURE



PORTFOLIO INSIGHTS

Resources - Paragon's perspective

The poor performance of Australia's broad resources sector continues unabated as Australia's key export commodity prices for Iron Ore and Coal continue to fall. The bearish view is compounded by rising concern over the economic health of Europe, coupled with a strengthening USD pressuring commodity prices.

With resources making up 30% of the Australian market, clearly there is more to the sector than Iron Ore and the Big Australian. We have previously highlighted this through our monthlies when discussing sub sectors like Lithium and LNG.

The volatility in the sector is in fact an opportunity for active, disciplined stock pickers and indeed ~55% of our returns have come from the resource sector despite it being down ~10% since our inception.

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This month we wanted to highlight our approach to the sector, the diverging fortunes of several subsectors, and how we are currently positioned.

Supply-side dynamics dominate

From our experience, whilst demand is an important factor, the biggest driver for resource markets is supply, including exogenous events (adverse weather, strikes), contracting / depleting major mines (exhausted/finite resources, falling head grades) and sovereign risk factors (concentrate export bans &/or taxes, repatriating assets). The best Resources **bull markets** are typically undersupplied with inventory levels in or approaching sustained deficits. On the flipside, **bear markets** are typically oversupplied and inventory levels in sustained surpluses.

The respective performance of Iron Ore (down 40% off recent highs) vs Zinc (up 30% from recent lows) captures the divergent supply side dynamics very clearly.

Bull market

Select Base and Rare Metals are exhibiting strong fundamentals – and are either in or entering major bull market cycles. Zinc is arguably the standout, entering into the early stages of an exciting bull market. This is largely explained by large-scale global Zinc mines shutting down due to depleted Zinc resources - over 10% of global production is due to come offline in the next 12 months. The largest of these is Australia's Century mine (a large-scale 500ktpa producing asset) set to close by mid-2015. Also, India's Rampura Agucha mine will see the largest contraction, with production falling by 300ktpa by 2017 as it switches from open-pit to underground mining.

At the same time, demand is solid and growing at ~5% pa, implying new capacity of 500ktpa+ is required. Brownfield expansions are underway but most are modest-to-moderate in scale and will not fill the supply shortfall over the medium-term. Large-scale greenfield projects candidates across the globe are many; however all are challenged - whether it be geologically, geotechnically, and/or are in risky sovereign jurisdictions.

Zinc is a ~14mtpa (~US$30bpa) market. China, a large producing and consuming nation of Zinc, will continue to respond with new supply. However China's Zinc supply growth seems to be slowing and there are big questions whether they still have the required scale needed over the medium term. We are not surprised with their increasing involvement in trying to advance large-scale greenfield projects across the globe, many we view as challenging, capital intensive and uneconomic on current Zinc prices. These include Ozernoye in Russia, Dugald River in Australia, Daria in Indonesia, Citroen in Greenland, to name a few.

We cannot see where timely, material new supply will come from - not without a much higher Zinc price to incentive new supply. We expect moderate industry surpluses in 2014 to turn towards moderate deficits in 2015, before leading to larger deficits of over 300ktpa from 2016. We expect a major Zinc bull market cycle from mid-2015 to 2019.

We are invested in a Zinc company that reflects our approach to all our resource investments – very low pre-production capex, high-margin, and short timeline to production (< 12 months), with exceptional exploration upside and with well-aligned, competent management.

Bear market

All of the Bulk Commodity markets have become oversupplied and seen their prices slump considerably from peaks - all are in undeniable oversupplied bear markets. Industry deficits only a few years back have turned to or set to become substantial medium term surpluses.

Iron Ore is almost a 2btpa market. The Seaborne market is 2/3 of this, ~1.25btpa (~US$100b market) which only recently had annual deficits of ~50mt. The Seaborne market is now projected to swing into material surplus' of ~200mtpa+ by 2016 - as the lowest-cost majors Vale, RIO and BHP continue to materially expand and ramp up production. As these markets go further into material surplus, marginal producers - which includes up to 200mtpa of high-cost Chinese production - will continue to be displaced.

Closures to date have been more pronounced in Coal. Pure-play Iron Ore and Coal stocks have already been crushed. With the bulk commodities prices at or below marginal cost support, further downside risk to the pure-play stocks is likely to be limited. We have no interest in chasing the last 20% of a move, and therefore are no longer short.

Balanced market

After years of industry deficits, and with a lack of material supply-side disruptions, Copper more recently has been flirting between balanced-to-surplus markets. Material new supply across the globe will likely see balanced markets continue for the next 1-2 years, although there is a plausible case for surpluses. On the margin, Copper price upside is arguably limited and likely to continue to be range-bound. The current copper price of ~US$3.00/lb is at marginal / 3rd-quartile marginal all-in cash-cost support – hence we view downside risk to Copper stocks as limited.

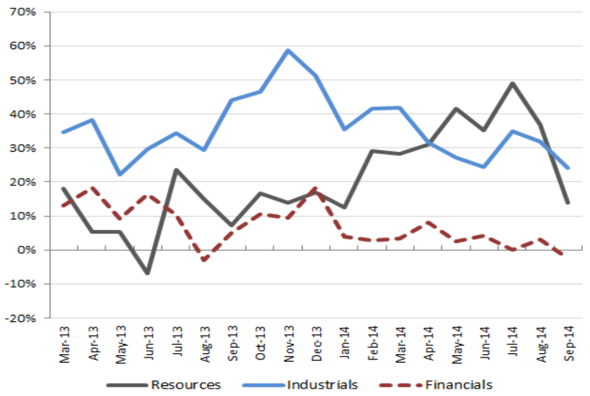
We are invested in a very attractively-priced emerging Copper company that again displays attributes we look for in the sector - its project is very low capital intensity and high margin, boasting lowest quartile all-in cash costs of US$1.00/lb. However given the metals balanced view, we have hedged this position with two Copper stock shorts, both challenged projects with inferior to uneconomic financial metrics and both unlikely takeover targets.

Gold currently offers limited up or down side given the gold price at ~US$1200/oz is at 3rd-quartile marginal / all-in cash-cost support. The highest cost producers are already in administration. The remaining high-cost marginal producers are already ~80% off their highs. With Gold stocks already substantially lower, we view downside risk to Gold stocks as limited. Equally we view golds price upside as limited, given a recovering US economy, strengthening USD and lack of any near-term, global inflation. We therefore are currently not exposed to the sector.

Disciplined stock picking is key

Our overall net Resources exposure has, since inception, ranged from -7% to +49% (as illustrated in the chart below) and remains a function of stock picking opportunities across both the long and short sides.

The Paragon Fund – Sector Net Exposure



The Resources sector will continue to offer active managers with the requisite skill set the potential to generate significant alpha. To date our investment disciplines have served us well.

MONTHLY PERFORMANCE BY YEAR

	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%	3.6%	-3.9%	3.2%	4.9%	12.5%	-1.1%	0.3%				**23.4%**

Performance results are presented net of all transaction costs, investment management and performance fees incurred by the Fund. Monthly performance figures are calculated based on the lead series using a monthly unit pricing methodology based on historical data.