PARAGON FUNDS MANAGEMENT

THE PARAGON FUND // DECEMBER 2014

PROFILE		PERFORMANCE *(after fees)*		DETAILS	
Fund Managers	John Deniz & Nick Reddaway	**1 month**	-0.5%	**NAV**	$1.3234
Strategy	Australian absolute return	**3 month**	-6.1%	**Entry Price**	$1.3254
Inception Date	01/03/2013	**6 month**	4.7%	**Exit Price**	$1.3214
Net Return p.a.	18.9%	**1 year**	15.9%	**Fund Size**	$23.1m
Total Net Return	37.5%	**Financial YTD**	4.7%	**APIR Code**	PGF0001AU

OVERVIEW & POSITIONING

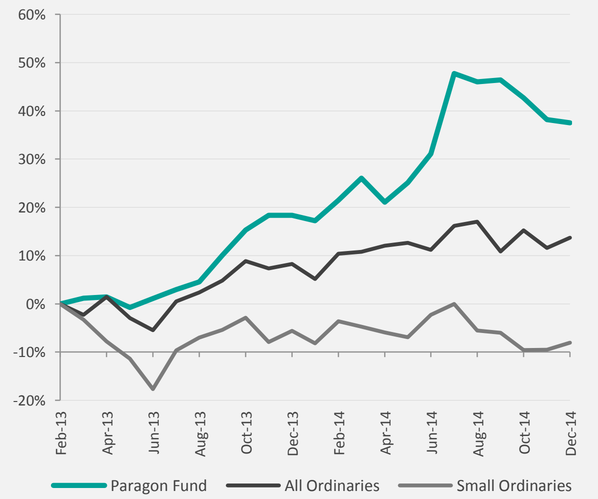
The Paragon Fund returned -0.5% after fees for the month of December 2014. Since inception the Paragon Fund has returned +37.5% after fees vs. the market (All Ordinaries Accumulation Index) +13.7%.

After falling 3% at the start of the month, the Australian equity market rose in December as global equity markets were buoyed by supportive interest rate comments from the Federal Reserve. Defensive sectors and those benefitting from global growth outperformed domestic focused equities and resources. Oil continued to trade lower, falling 19% for the month though most related equities were fairing much better by the end of the month despite little let up from the oil price weakness.

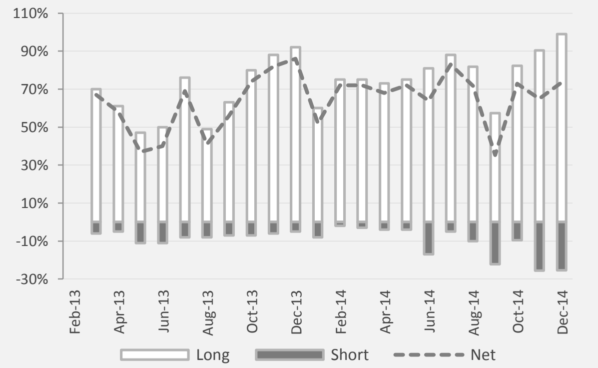
Key drivers of the Paragon Fund performance for December included solid returns from industrial firms Qantas, Orora, Brambles and emerging healthcare firm Nanosonics, offset by falls across our smaller company holdings. At the end of December the fund had 27 long positions and 11 short positions.

INDUSTRY EXPOSURE	Long	Short	Net
Resources	9.8%	-11.5%	-1.6%
Industrials	67.3%	-4.1%	63.2%
Financials	21.8%	-9.7%	12.1%
Total	**98.9%**	**-25.3%**	**73.6%**
Cash			**26.4%**

HISTORICAL PERFORMANCE *(after fees)*



HISTORICAL EXPOSURE



2014 YEAR IN REVIEW

In calendar year 2014, the Paragon Fund delivered a return of +15.9% after fees to our clients. In a tough year for domestic equity investors, the All Ordinaries Index returned +0.6% and the Small Ordinaries Index returned -7% while term deposits returned close to +4%.

Within the market lay some stark outliers in terms of sector performance for the year with the Resource sector falling -20%, Industrials rising +8%, and the Financials sector gaining over +12% (all inclusive of dividends). Against this backdrop we feel the fund's performance was solid considering we spent most of the year averaging ~30% in cash, made strong returns in resources, held little exposure to financial companies, and employed almost no leverage.

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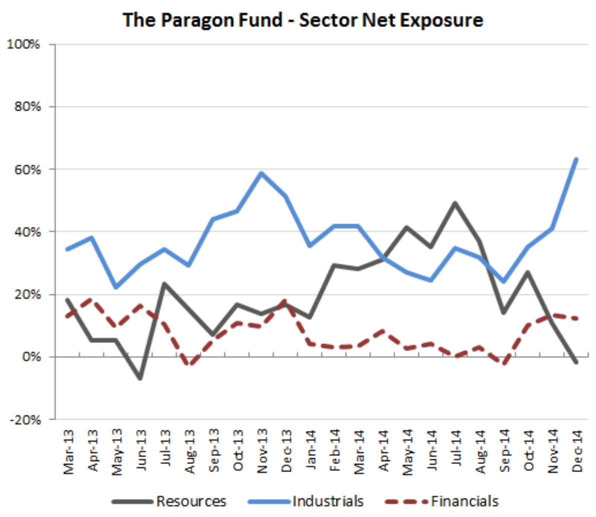

Additionally, in excess of 70% our performance for the year was generated investing in companies with market capitalisations in excess of $1bn, which stands us in good stead as the Paragon Fund grows.

While the funds annual return for 2014 exceeded our internal targets, the majority of the funds 2014 return was generated in the first 7 months of the year. In the back half of the year we were unfortunately unable to nullify the market weakness where the resource sector, small caps, and the market overall fell -22%, -10% & -4% respectively from their peaks.

As a business, Paragon Funds Management achieved several pleasing milestones during 2014. The Paragon Fund reached over 100 individual investors, providing a low level of client concentration within the fund which enhances the stability of the business. After starting the year with funds under management of $7m, the Paragon Fund grew to exceed $20m by November, driven by both new inflows and performance. As recognition for our strong performance, the Paragon Fund was nominated for the 2014 AsiaHedge "New Fund of the Year" award for new funds across the Asia Pacific. We hope that 2015 could bring a repeat of the former and going one better on the latter!

As we did for our first full year in operation, we would like to take a look back over the year to review in more detail the things that worked well for us and the things that didn't.

What Worked

The Paragon Fund delivered a return of +16% after fees when the overall market appreciated by 1% (or 5% including dividends). We believe our continued solid performance attests to our investment process that focuses on risk management and active, theme led stock picking rather than trying to hug the index. While our month to month performance can vary widely from the index return, over the year the benefits of this approach are clearly visible. Indeed over the 22 months since our inception, the Paragon Fund is delivering a return of +19% p.a. after fees, which is excellent in its own right, and looks favourable compared to the index return of +7% p.a.

Our focus on investing in businesses that are exposed to industries benefiting from long term secular drivers remains part of our investment process and continues to help us unearth interesting and profitable opportunities. Throughout this year we have maintained exposure to several themes we wrote about in 2013 such as the growth in electric vehicles; the ageing population; and the mobile internet. Together the companies we identified and invested in across the year to these themes generated almost half of our performance, with the standout being the companies which stand to benefit from the rise in lithium demand from electric vehicles (Orocobre and graphite companies).

A special mention should go to our investment in LNG given the company was the best performing stock on the ASX in 2014. We first invested in LNG in August 2013 at 20c. We were attracted to the business as we saw the US LNG export potential from its tier 1 Magnolia LNG project having previously invested in their large US peer, Cheniere Energy. We wrote about our investment in LNG in various monthlies detailing our investment case and the progress the company was making. As the company progressed through various milestones and one of the most successful investors in the world, Seth Klarman of the Baupost Group, took a substantial position in the company, the share price appreciated to a height of over $4/sh. We finally sold the last of the holding at $3/sh after major changes in energy market dynamics and the investment was a significant contributor to our returns for the year. An investment like LNG this year (or Xero in 2013) would be just fine with us!

What Didn't

While we avoided the domestically focused cyclicals given our negative view of the Australian economy, we held zero REITS and too little Infrastructure for the year as we underestimated the combined impact of falling bonds rates and cheap money on the sector. Australian bond yields fell -35% in 2014 as the economic outlook deteriorated, driving investors towards these relatively defensive and high yielding sectors which moved upwards in lockstep with bonds. The drivers for falling bond yields are still in place and we continue to allocate more capital to our two attractively priced infrastructure companies offering solid compounded growth in their distributions.

While we have expressed a positive view in the portfolio on the US growth engine to the world economy via Australian companies with significant offshore earnings, the late year rally in the USD and the oil price collapse played a major part in the broader resource sector weakness, and risk appetite generally, which impacted a portion of the portfolio. We have subsequently taken steps to address this exposure within the fund and have reduced the beta of the portfolio overall.

Looking Forward

We expect heightened volatility will continue in 2015. With so many central bank cards out on the table and faltering growth in China, Europe and Japan, it would seem to us that movements across bond, credit and commodity markets in 2014 are signalling global equity markets may soon be boxed in a corner. Either US led global growth starts to accelerate soon, along with large scale QE being implemented in Europe, or equities will correct to reflect the misplaced earnings optimism borne out from expectations of better economic conditions estimated this time last year.

With low inflation pressures there remains little impetus for the Federal Reserve to raise rates yet this eventuality will continue to weigh on investor skittishness after 9 years of loose monetary policy and a 6 year bull market in US equities. This dynamic will continue to drive global markets despite Europe, China and Australia continuing to loosen their own monetary policy stances.

Outside of those businesses exposed to our long term secular themes, we think that companies benefitting from falling input costs, global growth, pricing power, and companies with growing and sustainable dividends will continue to perform well.

We feel 2015 will again be a fruitful environment for active stock pickers with an ability to protect capital. We look forward to delivering more positive news this time next year on the Paragon Fund, and indeed on Paragon Funds Management.

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%	-2.5%	-3.1%	-0.5%	**15.9%**

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.