THE PARAGON FUND // September 2016

PERFORMANCE SUMMARY *(after fees)*

	1 month	3 month	6 month	Financial YTD	1 year	2 year p.a.	3 year p.a.	Net Return p.a.	Total Net Return
Paragon Fund	+4.3%	-1.0%	+24.7%	-1.0%	+33.5%	+17.8%	+22.6%	+21.8%	+103.1%
ASX All Ordinaries Acc.	+0.4%	+5.3%	+9.5%	+5.3%	+14.0%	+6.7%	+6.4%	+6.7%	+26.2%
RBA Cash Rate	+0.2%	+0.4%	+0.9 %	+0.4%	+1.9%	+2.1%	+2.2%	+2.3 %	+8.5%

RISK METRICS

Sharpe Ratio	1.3
Sortino Ratio	2.7
Volatility p.a.	+13.9
% Positive Months	+72.1%
Up/Down Capture	+98%/-5%

FUND DETAILS

NAV	$1.9112
Entry Price	$1.9140
Exit Price	$1.9083
Fund Size	$85.1m
APIR Code	PGF0001AU

FUND STRATEGY

The Paragon Fund is an Australian equities long/short fund established in March 2013. The Fund's strategy is fundamentally driven, concentrated and transparent for investors. Paragon's research process and active portfolio management is overlaid with strong risk management and a focus on capital preservation.

The objective of the Paragon Fund is to return in excess of 10% p.a. after fees over a 3-5yr investment horizon.

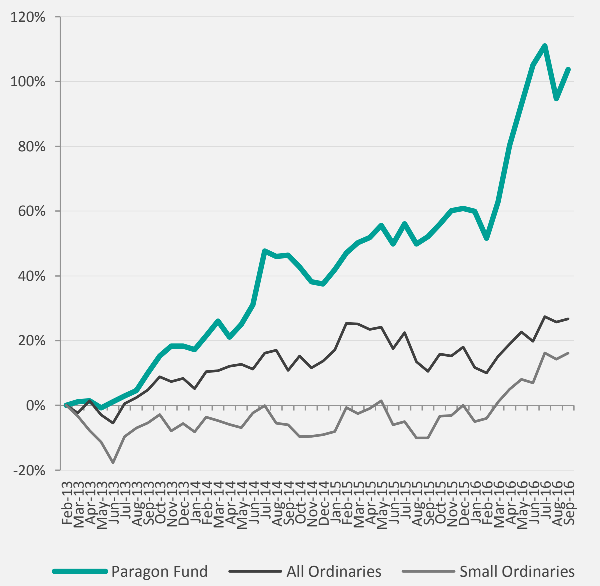
OVERVIEW & POSITIONING

The Paragon Fund returned +4.3% after fees for the month of September 2016. Since inception (March 2013) the Fund has returned +103.1% after fees vs. the market (All Ordinaries Accumulation Index) +26.2%.

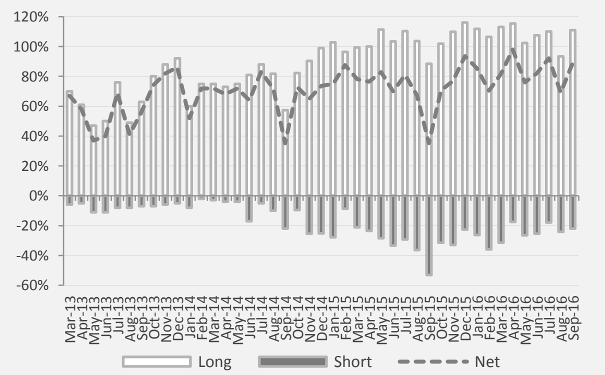
Main contributors in September were Kidman Resources, Mayne Pharma, gold holdings and a short position in Pilbara Minerals. At the end of the month the Fund had 32 long positions and 11 short positions.

INDUSTRY EXPOSURE	Long	Short	Net
Financials	+28.7%	-4.7%	+24.0%
Industrials	+33.6%	-4.7%	+28.9%
Resources	+49.3%	-13.0%	+36.4%
Index Futures		0%	0%
Total	**+111.6%**	**-22.4%**	**+89.2%**
Cash			**+10.8%**

HISTORICAL PERFORMANCE *(after fees)*



HISTORICAL EXPOSURE



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%**
2015	3.2%	3.6%	2.1%	1.1%	2.4%	-3.8%	4.3%	-4.2%	1.6%	2.5%	2.6%	0.3%	**16.8%**
2016	-0.5%	-5.2%	7.4%	10.8%	7.0%	6.3%	2.9%	-7.8%	4.3%				**26.5%**

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.

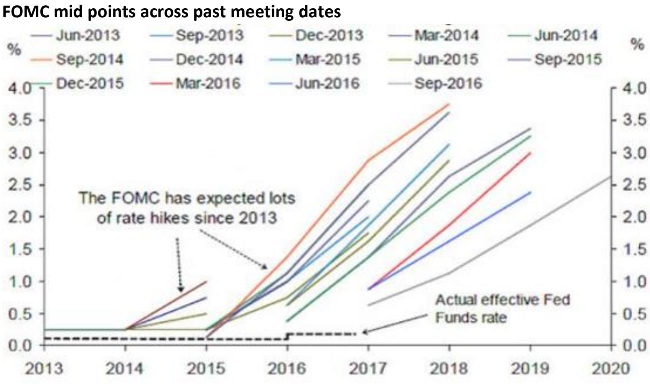
Our return target for the Paragon Fund is in excess of 10% per annum over an investment cycle, typically 3-5 years. In order to achieve this irrespective of the market's performance, we are charged with finding companies that can deliver better than average levels of growth and purchasing them at a level providing us with a degree of safety. In order to do this, we typically focus on investment themes we think can drive operational performance over long periods of time and then seek out the best individual companies exposed to those themes. It is a globally orientated approach, gleaned from our respective global investment backgrounds that pays little heed to the actual index and has to date helped achieved net returns in excess of 21% p.a.

In a perfect world we would identify a particularly attractive thematic, identify the best companies exposed to those themes through company meetings and our own internal research, and then let the rest of the market play catch up. In practice, however, sometimes our long term themes persist while the ability to find attractive investment opportunities at the stock level does not. For example our exposure to the continued growth in the ageing population has been at zero for some time because while one sub sector is fully valued the other has been hit with regulatory uncertainty. Clearly this isn't stopping the global population from getting older on average each year, so we wait patiently for better opportunities to arise.

Similarly, the Fund at times has invested in companies that are positively exposed to the relentless 30yr fall in bond yields. The yield on 10yr government bonds in the US peaked at close to 16% in the early 80's as energy and wage inflation drove the then Fed chairmen Paul Volcker into a series of rate rises that saw the fed funds rate rise close to 20% and drove the country into recession. Today the fed funds rate sits barely above 0% and the yield on 10yr US government bonds is 1.7%. Amazingly, over $13t in government bonds globally are yielding below 0% (i.e. it is costing investors to hold them) as central banks fight to drive spending and growth through quantitative easing programs. Valuations of defensive industries have benefitted from this trend given their income stream becomes more attractive the further the return from the risk free rate falls.

In September these companies were hit by rhetoric from the ECB and the BoJ that their intentions towards asset purchases (bonds) may be changing, given there is a finite amount of bonds they can actually buy. As calculated by famed fund manager Ray Dalio of Bridgewater Associates, the ECB may indeed run out of bonds to buy at their current pace within 8 months. This potential shift by the central banks saw real rates rise marginally above zero and was amplified by probabilities of the Fed raising their fed funds rate again as near as September, if not December 2016. As the below chart shows, the Fed has continually been more optimistic on the outlook for rate rises for a long time.

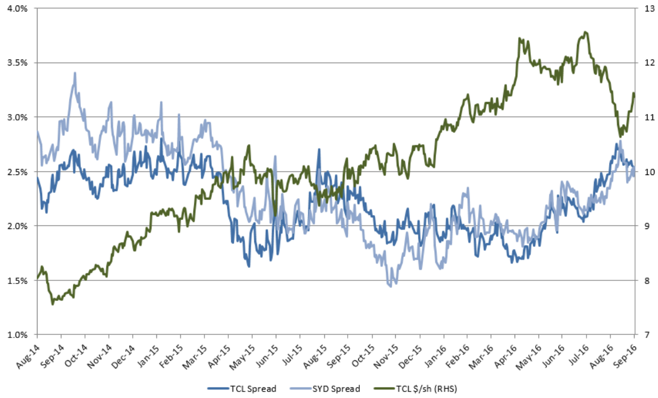
FOMC mid points across past meeting dates



Source: Deutsche Bank

Previous periods of investor unease around the tapering of quantitative easing (May 2013 and June 2015) saw yields on US 10yr government bonds rise on average 32% over several months before continuing their march lower. On average in both occasions Transurban and Sydney Airports fell ~10% in the following month before appreciating in excess of 20% over the next 6 months. To the middle of September 2016 both stocks had fallen some 15% in a month suggesting to us that any near term concerns over rising yields (up 15% since July) was priced in. These companies typically trade on a dividend spread relative to bond yields and the below chart shows the spread between the dividend yield and Australian 10yr bond yields over the last 2 years for both Transurban and Sydney Airport.

Transurban + Sydney Airport Dividend Spread



Source: Paragon, Bloomberg

What's clear is that this spread rose significantly in September as the stock prices fell (increasing the dividend yield) while the bond yield also rose, making an investment in these companies relative to the risk free rate as attractive as any time over the last 2 years. In the context of a market still generally hunting for income in a low income world, in September we again were active in taking advantage of compelling short term entry points in yield related companies. Both Transurban and Sydney Airports are defensive by nature, are able to grow their free cash flow available for distributions by 5% p.a. and satisfy these payments via their own cash flow. Our view that the Fed would stay put in September and that issues such as poor global growth (the IMF now estimate US GDP of 1.6% for 2016, down from 2.2% in July), a potential Trump presidential victory, the health of Deutsche Bank, a hard Brexit and Italian referendum would continue to weigh on investors, driving a continued demand for defensive, income producing assets.

It's important to note that on a long term view, we do believe we are certainly closer to the end of the bond bull run than the beginning and eventually this spread could revert higher if bond yields normalise to historic levels. In the short to medium term this type of normalisation would require stocks to fall over 40% and bond yields rise 50% to approach the types of relative spreads seen back in 2012. In a world without inflation or growth, this seems unlikely for now. However, in order to provide a level of portfolio protection, we have partially paired our long exposure with shares in similar companies that are exhibiting less favourable dynamics with less ability to withstand any further increase in yields.

Please note, Paragon Funds Management has moved as of 1 October 2016. Our new address is Level 19, 80 Collins St, Melbourne 3000 and phone number is +61 3 9652 2500.