Paragon Australian Long Short Fund

MARCH 2020

www.paragonfunds.com.au

Since inception - 1 March 2013

PERFORMANCE DATA *(after fees)*	1 month	3 months	6 months	Financial YTD	1 year	2 year p.a.	3 year p.a.	5 year p.a.	Net Return p.a.	Total Net Return*
Paragon Aust. Long Short Fund	-18.2%	-28.9%	-29.7%	-23.5%	-10.5%	-22.4%	-6.1%	-2.0%	+4.4%	+35.6%
ASX All Ordinaries Accum. Index	-20.9%	-23.9%	-23.6%	-21.1%	-14.9%	-2.7%	-0.6%	+1.5%	+4.3%	+35.0%
ASX Small Ords. Accum. Index	-22.8%	-27.1%	-26.5%	-24.2%	-21.4%	-8.8%	-1.5%	+2.4%	+1.3%	+9.9%

OVERVIEW

March was an incredibly volatile month, in fact the most volatile in history – see chart 1 overleaf. Exponential growth in COVID-19 cases across Europe and the US saw governments enforce lockdowns globally. With a deteriorating macro backdrop, global markets were materially sold off at their fastest pace ever – see chart 2 overleaf. Global Indices saw intra-month lows of -26% (S&P500) to -35% (Russell2000, ASX200, Smalls Ords.), ending the month down -13% to -22% respectively. Despite being cautiously positioned with many of our longs in 'safe-haven' gold equities, they too experienced mass liquidation (gold indices were down -12% to -22%), which frustratingly saw the Fund down -18.2% after fees for March. Negative contributors were the bulk of our gold stocks, Adriatic and Atrum. These were partially offset by DeGrey (multi-million-ounce gold discovery) and shorts in Qantas, Hub24, and base metals and coal stocks. In the third week of March, with markets extremely oversold, we closed out all of the Fund's profitable short positions.

Everything was for sale across all markets in March - stocks, credit, commodities, currencies and most sovereign bonds. Gold, gold equities and other safe-haven assets including Utilities (-33%!), the Japanese Yen and the Suisse Franc, were all sold down intra-month as a source of liquidity. US 10yr yields collapsed a further 42% to record lows of 0.67%. US$ gold too saw volatility yet closed net to unchanged at US$1,576/oz and A$ gold closed +7.3% up to record highs at A$2,615/oz. Further, Oil prices crashed -30% to levels not seen since 2002, after Saudi Arabia declared an all-out price war after failing to reach an agreement with Russia on oil production cuts.

PORTFOLIO INSIGHTS – *US Fed responds aggressively to economic fallout and goes 'all-in'*

To try to circumvent the financial strain on markets caused by the pandemic, the US responded swiftly with unprecedented fiscal and monetary stimulus. Measures include: 1) Cutting rates to zero; 2) Initiating US$4t of QE4 (exceeding the GFC's combined QE1, 2 & 3), ever expanding the Fed's balance sheet; and 3) US$2t fiscal-stimulus bill (~10% of GDP, double what was initially announced in the GFC), and like the GFC response, likely to be the first of many. China, Europe, Japan and Australia's central banks have initiated similar massive fiscal and monetary stimulus measures to aid their economies. The US response will mean ballooning twin deficits (government and trade deficits) – currently ~7% of GDP and heading towards 12%, similar to 2011 when gold peaked**. These are all massive catalysts for gold. We are firmly of the view that US$ gold will break new all-time highs (US$1,921 intra-day high on 6/9/2011) in the short to medium term, resuming the re-rate in our gold stock picks.** Our gold stock picks look to have bottomed, and offer asymmetric risk-reward to the upside, examples such as Alacer and DeGrey.

Alacer is currently trading on a mere 4.5x FCF, despite being unhedged to rising gold prices and with production risk to the upside making it a free-cash generating machine. We expect to see its strong free-cashflows met by at least 2x expansion of its FCF multiple as the market once again embraces its strong growth outlook. **DeGrey** has made the most prolific gold discovery in Australia at its Hemi prospect in the Pilbara - on our modelling taking its gold resource to 4+ million-ounces (moz) amid record high A$ gold prices. Already doubling its share price since our entry in a very weak market, we expect strong upside as DeGrey derisks towards a $1b+ Net Present Value (NPV) project.

Furthermore, all longs in the portfolio today are net cash, including our 'super-performer' development stocks which have funding to see them through beyond 2020, eliminating the risk of dilutive recapitalisation capital raises that we're seeing right across the ASX. **Adriatic** has been hit hard in the last 2 months, attributable to a lack of liquidity and/or forced selling and not due to its fundamentals. Boasting arguably the standout resources project on the ASX and trading at Price to NPV of ~25%, we remain highly convicted we will see multiples in Adriatic's share price in due course, particularly given its not impacted by COVID-19 and with its resource still growing.

Despite the seriousness of the COVID-19 outbreak, we maintain our view that the current virus-led bear market is cyclical and not secular, comparing most closely to the cyclical bear-market crash of 1987 (Black Monday crisis – see chart 2 overleaf), in which there was a rapid sell-off that bottomed in short order and followed with a resumption of a secular bull market. We expect peak-virus 'negative-news' to occur in April – as the rate of change of contracted cases should decelerate in the US (consistent with the pattern/time-frame in other countries). The WHO has indicated that countries in Europe may have reached the top of their infection curves. Combining this with central banks and governments globally going 'all-in' with their fiscal and monetary responses, we expect a powerful market recovery once the pandemic subsides. Nevertheless, markets typically don't recover in a V-shaped pattern, and so, we need to be disciplined and exercise patience before we go 'all in'.

Global markets are currently undergoing a bottoming process which comprise of 4 stages: 1. Oversold; 2. Rally; 3. Re-test; 4. Breadth thrust; and presently are between stages 2 and 3. We are ready to act aggressively in several opportunities we already have marked as soon as the market enters stage 4. Small-caps, where we have proven capabilities and significant success, have been consistent outperformers after bear market bottoms and at the end of recessions – see chart 3 overleaf. We are confident that we will significantly outperform, bringing Paragon back to double-digit annualised returns within the foreseeable future.

FUND POSITIONING & RISK METRICS

Fund Size	$21.7m
Longs	10
Shorts	0
Net exposure	77%
Gross exposure	77%
Index futures	0%
Cash	23%
Beta-adj net exposure/ Average since inception	72%/70%
Correlation	0.55
% Positive Months	60%
Up/Down Capture	75%/60%

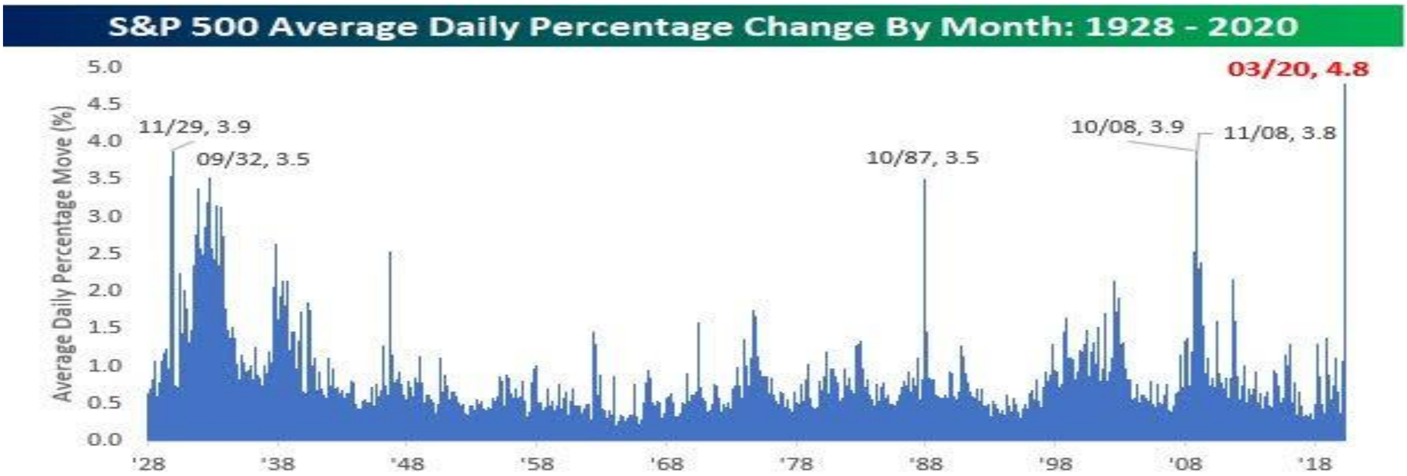
UNIT PRICING

NAV (Mid-Price)	$1.2595
Entry Price	$1.2614
Exit Price	$1.2576

FUND FACTS

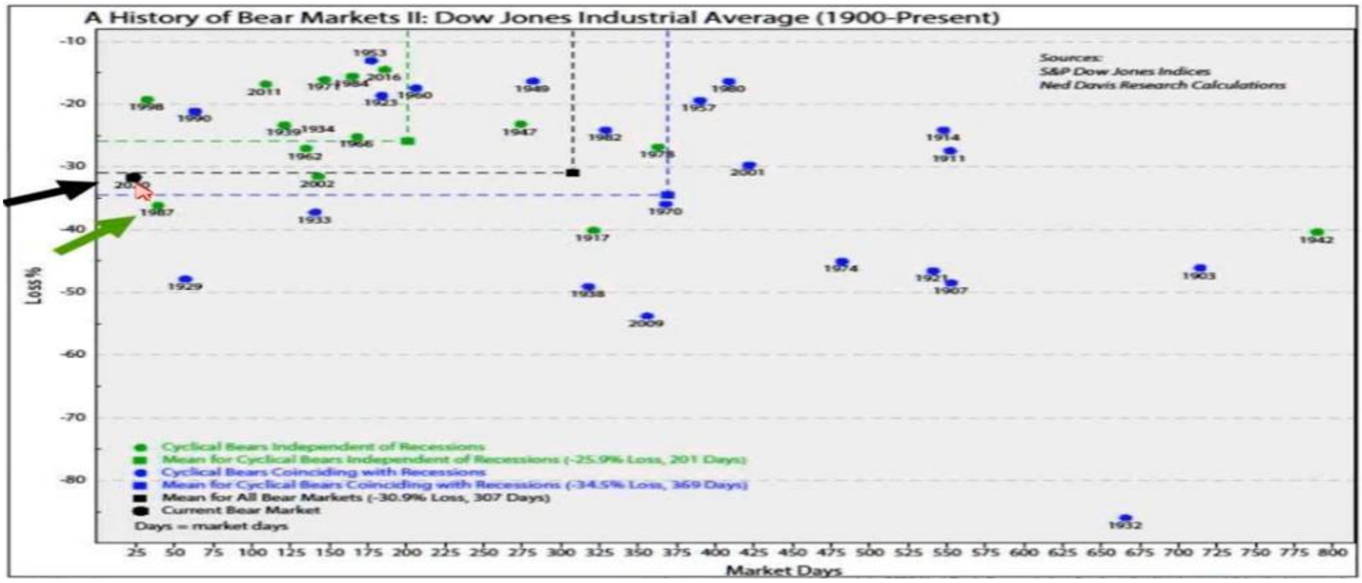
APIR Code	PGF0001AU
Responsible Entity & Investment Manager	Paragon Funds Management Ltd
Strategy	Aust Equities L/S, Long-bias, Fundamental, Concentrated
Objective	>10%p.a. over 5yrs
Structure	Unit trust
Domicile	Australia
Pricing/Applications/ Redemptions	Daily
Min. Investment	$25,000
Min. Additions	$5,000
Min. Redemptions	$10,000
Administrator	Link Fund Solutions
Prime Broker/Custodian	UBS

Chart 1: March 2020 saw historic highs in volatility – more volatile than the 1929-1932 Great Depression, October 1987 Black Monday crash and the 2008-2009 Global Financial Crisis.



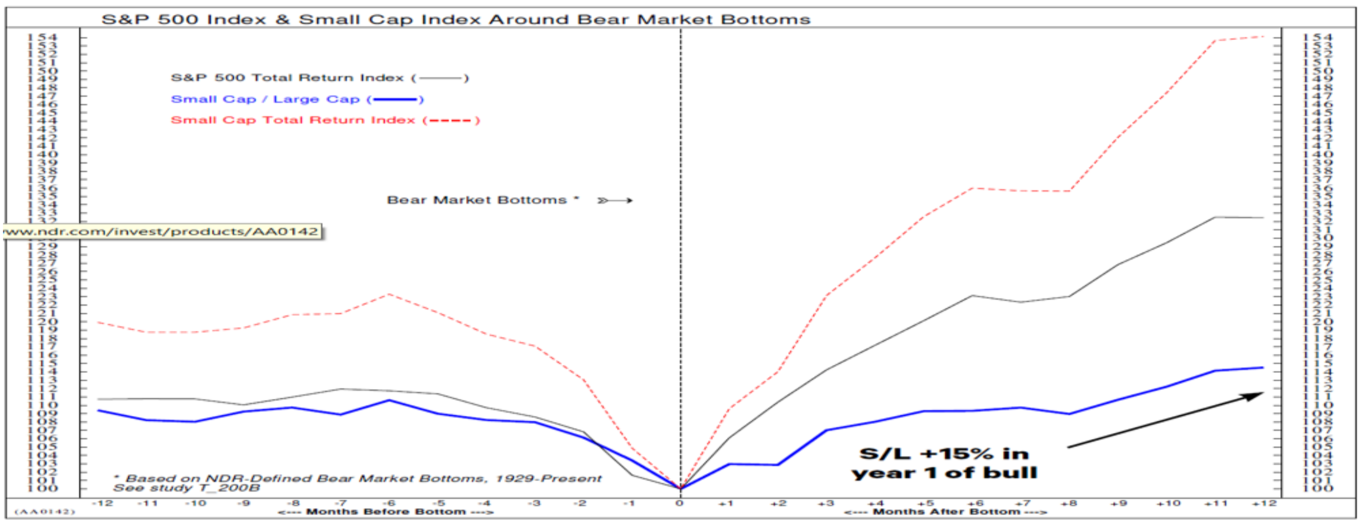
Source: BB

Chart 2: 2020 market sell-off the fastest in history. In our view, the current virus-led bear market is cyclical and compares most closely to the cyclical bear-market crash of 1987 (Black Monday crisis – green arrow).



Source: NDR

Chart 3: Small-caps, where we have proven capability and sucess, have been consistent outperformers after bear market bottoms and end of recessions.



Source: NDR