Paragon Australian Long Short Fund

FEBRUARY 2023

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	-11.1%	-8.8%	-10.9%	-8.0%	-22.7%	-14.2%	+6.8%	-3.1%	+7.3%	+102.0%
ASX All Ordinaries Accum. Index	-2.5%	+0.4%	+5.7%	+13.8%	+6.0%	+8.0%	+8.5%	+8.1%	+8.1%	+118.0%
ASX Small Ords. Accum. Index	-3.7%	-1.2%	-2.0%	+9.8%	-8.0%	-1.7%	+4.2%	+3.6%	+4.9%	+61.2%

OVERVIEW

The Fund returned -11.1% after fees in February. Global Indices were down: Nasdaq -0.5% and S&P500 -2.6%. Local Indices were also down: All Ords AI -2.5%, Small Ords AI -3.7% and Small Resources -9.1%. It was a very tough month for Resources with average equity declines in precious metals -18%, Copper -15%, Nickel -13%, EV -12%, Uranium -12% and bulk commodities -8%. The Fund had declines in its Lithium, precious metals and base metals stocks, and Platinum AM was also sold off on its 1H23 result.

Global markets were sold off on tight labour markets and high inflation, as well as a hawkish Fed calling for more cash rate rises and remaining higher for longer. The USD bounced, sending commodity prices lower. Commodity markets remain constrained from a supply perspective and coupled with a golden age for demand = a Supercycle is coming.

Portfolio insights: Reviewing Lithium's short-term headwinds

With 1Q23 being a seasonally soft period for China's EV market, Lithium inventories have risen from <1 week of supply in November to 3+ months. Downstream battery producers have been working down inventories, driving Lithium's price correction off elevated highs set in 4Q22. Sentiment has turned bearish despite the equities already discounting materially lower Lithium prices - producers are pricing in ~US$1,500/t Spodumene and ~US$15,000/t Lithium (vs spot prices of >3x this) - implying industry surpluses premised on incremental supply outpacing incremental demand growth.

Lithium supply in 2022 was ~800k. New supply continued to disappoint, and demand surprised to the upside, causing modest deficits and hence the price spike. The bears are calling for incremental supply of +300kt this year. Note however, it took the last 7 years to add 600kt pa. The bulk of the new supply will come from Australian spodumene, South American brines and Chinese lepidolite – all of which have challenges in meeting desired output, specification, cost and schedule. Chinese lepidolite – touted by some to flood the market in 2023 - is the most questionable due to being very low grade and having logistical and environmental complexities. Its all-in cost is currently >US$25,000/t, the highest on the cost curve, and well north of what the equities are discounting. Further, over the past few months almost all new supply projects announced ongoing 6+ months delays. We believe new supply is a long way off reaching commercial run rates. The industry will do well if incremental supply is +200kt for 2023, noting it also needs to be EV battery-grade!

On the Lithium demand side, the key driver is global EV penetration which went from 8% in 2021 to 13% in 2022 and set to go to 17% in 2023 (and growing +5%/year). Global EV demand is expected to be ~14m cars in 2023. China EV sales are key as they represent ~9m EV sales vs 6m last year. The USA is also growing rapidly at 50%/yr albeit off a lower base. See Figures 1 & 2 overleaf. Risks to demand from China not extending their EV subsidies will be offset by their re-opening and EV price drops. Battery sizes are getting bigger, and assuming an average 60kwh battery consuming 0.8kg Li per kwh implies ~750kt battery-grade Lithium demand. Add energy storage systems (ESS) of ~30kt demand and ~200kt industrial demand, results in a total demand for Lithium of ~980kt for 2023. Tesla's 'Masterplan 2030' is targeting 20m EVs and 1TWh ESS pa vs ~2m EVs and 100GWh ESS order book in 2022. Whilst Musk is clearly a super bull, he is progressively executing.

We continue to expect industry deficits, as Lithium is in a structural growth cycle with EV demand entering the mass adoption phase. This one-time electrification of a 1.4b global car fleet (vs 100m+ EV's on the road) offers a very long runway of growth for Lithium set to grow by multiples.

FUND POSITIONING & RISK METRICS

Fund Size	$40.1m
Longs	18
Shorts	0
Net exposure	87%
Beta-adj net exposure/ Average (rolling 12mths)	69%/66%
Gross exposure	87%
Cash	13%
Index Futures	0%
Correlation	0.55
% Positive Months	58%
Up/Down Capture	108%/101%
Liquidity (% saleable inside 10BD)	87%

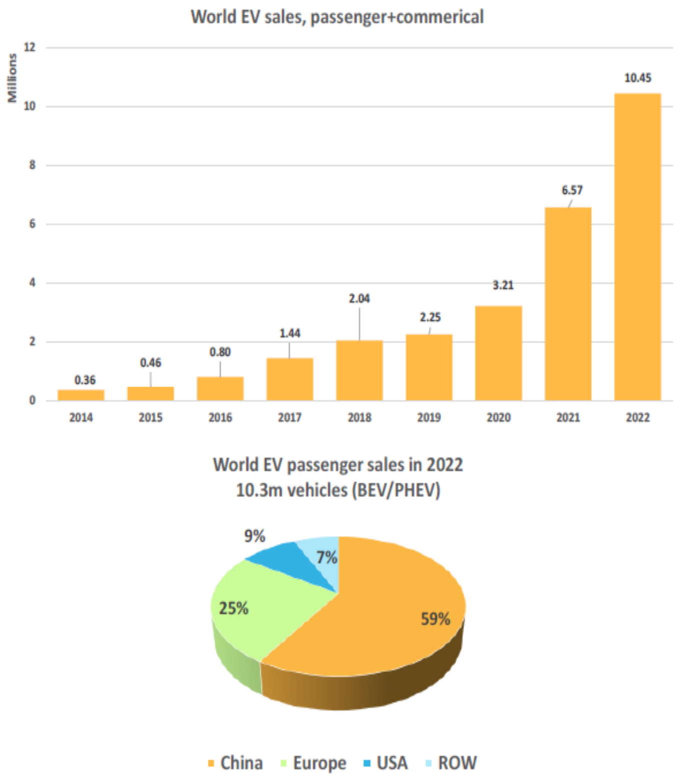
UNIT PRICING

NAV (Mid-Price)	$1.5240
Entry Price	$1.5263
Exit Price	$1.5217

FUND FACTS

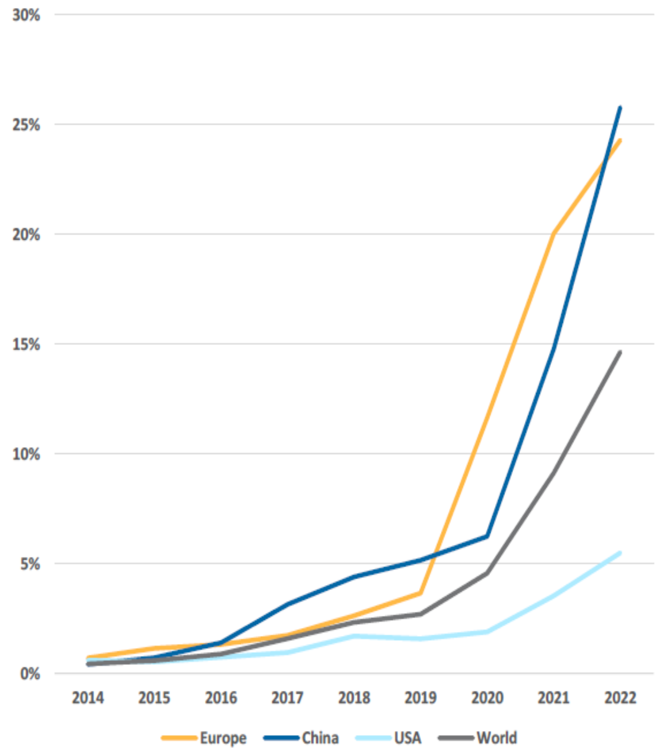
APIR Code	PGF0001AU
Responsible Entity & Investment Manager	Paragon Funds Management Ltd
Strategy	Aust Equities L/S (long-bias), Fundamental, Concentrated. Global and unlisted permitted.
Objective	>10% p.a. over 5yrs
Structure	Unit trust
Domicile	Australia
Pricing/Applications/ Redemptions	Monthly
Min.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

Fig 1 Global EV sales by year: dominated by China and Europe – total growth of 69% in 2022



Source: Rho Motion, Macquarie Strategy, February 2023

Fig 2 EV (BEV+PHEV) sales as a percentage of all vehicle sales – market shares rising sharply in Europe and China



Source: Rho Motion, Macrobond, Macquarie Strategy, Feb 2023