



PARAGON AUSTRALIAN LONG SHORT FUND // August 2019

PERFORMANCE SUMMARY *(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	+2.6%	+13.3%	+27.9%	+12.3%	+9.8%	+7.3%	+0.7%	+6.4%	+11.2%	+99.0%
ASX All Ordinaries Accum. Index	-2.2%	+4.6%	+9.8%	+1.2%	+9.1%	+12.5%	+11.3%	+8.1%	+8.8%	+73.1%
ASX Small Ords. Accum. Index	-3.9%	+1.4%	+4.1%	+0.5%	+0.9%	+11.1%	+8.4%	+7.8%	+6.0%	+45.7%

*Since inception 1 March 2013

RISK METRICS

Sharpe Ratio	0.6
Sortino Ratio	1.1
Correlation	0.4
% Positive Months	62%
Up/Down Capture	81%/39%

UNIT PRICE & FUM

NAV	\$1.8483
Entry Price	\$1.8510
Exit Price	\$1.8455
Fund Size	\$40.0m
APIR Code	PGF0001AU

FUND STRATEGY

An Australian equities long/short fund, with a long-bias, fundamentally driven with a concentrated portfolio of high conviction stocks, managed by a dedicated investment team and offering transparency to investors. Paragon's proprietary research and extensive investment process includes active portfolio management and is overlaid with strong risk management. The objective of the Fund is to return in excess of 10% p.a. after fees over a 3-5yr investment horizon.

OVERVIEW AND POSITIONING

The Fund returned +2.6% after fees for August vs the All Ords AI of -2.2%, Small Ords. AI -3.9%, with the ASX300 Resources AI and Small Resources AI both -7.0%. Positive contributors were from our gold holdings, iSignthis (upgrade), Pilbara (downgrade; short), Jumbo (upgrade) and Mincor, partially offset by a decline in Champion Iron. Overall, the Fund had a solid August reporting season. The US yield curve inverted (10yr-2yr rates turned negative) for the first time this cycle and futures markets are pricing in a further 100bps of Fed cash-rate cuts by June 2020. These key factors continue to provide a strong tailwind for our gold thesis, with US\$ gold up 7.5% and A\$ gold breaking all-time highs.

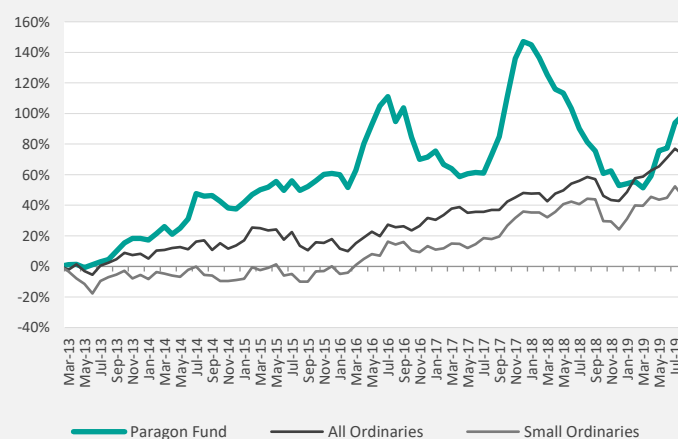
FUND POSITIONING

Number of Longs	32
Number of Shorts	7
Net exposure	126%
Gross exposure	153%
Index futures	0%
Cash	-26%
Beta-adj net exposure	50%

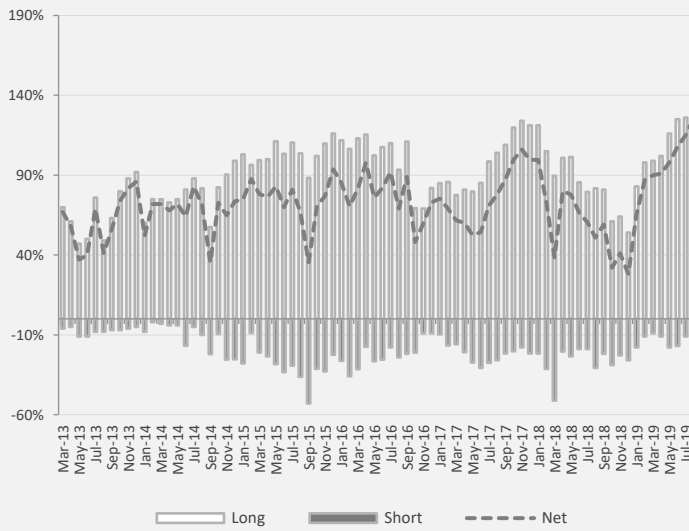
FUND FACTS

Structure	Unit trust
Domicile	Australia
Applications & Redemptions	Daily
Minimum investment	\$25,000
Min. addition/redemptions	\$5,000/\$10,000
Administrator	Link Fund Solutions
Prime Broker/Custodian	UBS

HISTORICAL PERFORMANCE *(after fees)*



HISTORICAL EXPOSURE



MONTHLY PERFORMANCE BY CALENDAR 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%	-9.0%	-7.9%	0.8%	6.8%
2017	2.3%	-5.0%	-1.6%	-3.2%	1.3%	0.4%	-0.2%	7.3%	7.0%	14.0%	11.9%	4.7%	44.1%
2018	-1.3%	-3.0%	-4.7%	-4.2%	-1.2%	-4.7%	-6.5%	-4.6%	-3.2%	-8.4%	0.9%	-5.8%	-38.1%
2019	0.8%	1.0%	-2.7%	5.1%	10.4%	0.9%	9.4%	2.6%					30.2%

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 daily unit pricing methodology based on historical data.



Market and Portfolio insights

Macro concerns weigh on markets; Yield curve inverts

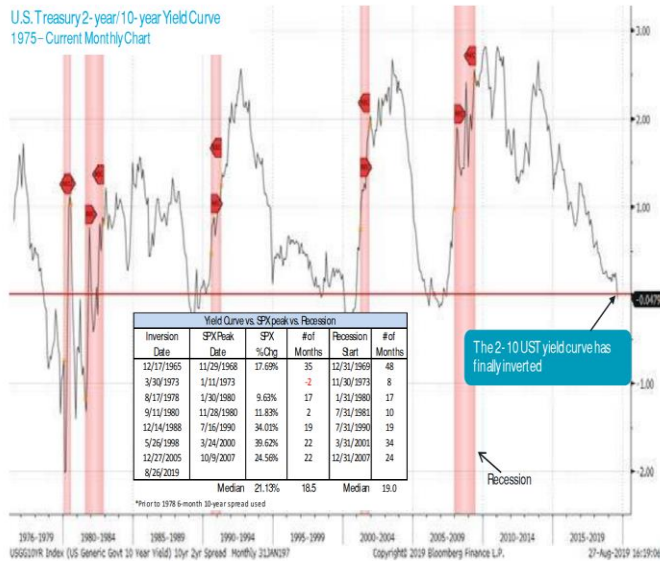
The USA-China trade war escalated after setbacks in trade talks in early August. President Trump abruptly announced a new 10% tariff on US\$300b of Chinese imports not yet subject to US duties effective from September. China retaliated first by allowing its currency (RMB) to fall further against the USD (breaking above 7 RMB to the USD), and then later in the month, by imposing tariffs on a further US\$75b of US goods. Trump then retaliated by hiking existing tariffs on Chinese goods (~US\$550b) by a further 5% effective from October.

This resulted in a global market sell-off on rising recession fears.

10yr US Treasury yields fell to 1.5%, the lowest level since 2016, and the US yield curve inverted (10yr-2yr yields turned negative) for the first time this cycle - now pointing to a recession. See Chart 1 below.

The risk of yield inversion was discussed in [October 2018](#), identifying it as one of our key 'bear market' risk indicators. Over the past seven economic cycles, every recession has been preceded by an inversion of the yield curve by a median 18.5 months. Despite yield curve inversion, markets have tended to peak many months later for a median gain of 21% (see table in Chart 1), implying a lag effect before credit markets move towards stress and bank lending shuts down.

Chart 1. US 10yr-2yr yield curve turns negative for the first time this cycle



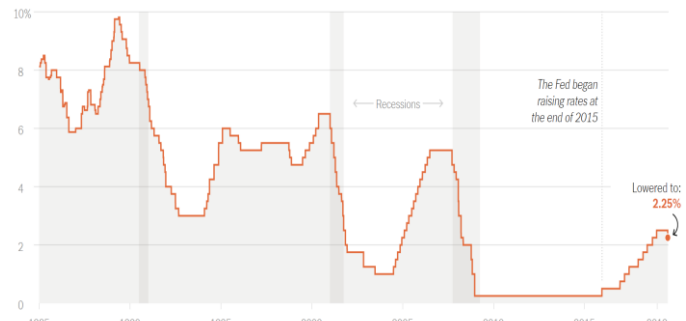
Source: Bloomberg, Canaccord Genuity

With both 10yr and 2yr US Treasury yields ~50bps below the Fed's cash rate of 2%, the Fed is behind the curve. Markets are pricing in a further 100bps of Fed cash-rate cuts by June 2020. So much for the Fed's 25bps rate cut in July - the first of this cycle - simply being a 'mid-cycle insurance cut'!

These key factors continue to provide a strong tailwind for our gold thesis, with US\$ gold up 7.5% to US\$1,520/oz in August and A\$ gold continuing to break all-time highs, currently A\$2,265/oz.

US markets have just encountered the longest global growth cycle ever. **Markets are now presenting a 1-in-10-year opportunity of a Fed cash rate-cutting cycle.** Compared to the last two rate cuts cycles, the Fed has less than half the rate cut scope (<250bps) as illustrated in Chart 2 below. The impending rate cut cycle is likely to see the Fed cut rates more than the market is currently pricing in. Note that less than a year ago futures markets were pricing in rate hikes!

Chart 2. US Fed target cash rate – 1-in-10-year cutting cycle underway



Note: Rate is Fed funds target rate until 15Dec2008, then upper limit of the Fed funds target rate range. Source: Federal Reserve, New York Times

In the last two rate cut cycles:

- 1) the cash rate fell to 0.75%, following 550bps of cuts post-2000 tech-bust, with gold rising 180% between April 2001 – May 2006; and
- 2) the cash rate fell to 0%, following 525bps of cuts post GFC-crash, with gold rising 167% between Nov 2008 – Sep 2011.

Whilst we expect to do well if gold simply holds at current levels, our view is that gold is very well placed to continue breaking higher. Weight of money and liquidity will flow into the gold sector, and favourably impact our gold holdings. High-yielding stocks including interest rate sensitive sectors like AREITs and Infrastructure, as well as defensive consumer staples, should also continue to be beneficiaries and perform well, however we expect gold to materially outperform these other sectors.

Portfolio positioning

To quote pertinent words of wisdom from the great Peter Lynch: "You get recessions, you have stock market declines. If you don't understand that's going to happen, then you're not ready, you won't do well in markets."

With this in mind, the portfolio positioning today comprises of longs in what we view as the best stock picks leveraged to long-term structural growth (including technology, med-tech, fintech) and select resource exposures to under-supplied markets (underpinned by strategic world-class projects), well placed to keep growing through the cycle; plus selective hedges and shorts exhibiting earnings risk; and continuing exposure to gold stocks.

The Fund's beta adjusted net exposure is currently ~50% - moderately hedged via shorts and our gold longs (negative beta) less Kidman (which we consider as cash or better being under a binding takeover offer from Wesfarmers). Note, our gold exposure whilst core to the portfolio, also serves as a hedge to structural growth stocks in the portfolio. The time to get defensive (say bringing the Fund's beta adjusted net exposure closer to 0%) will be when corporate credit starts to act poorly. For now, however, there is little sign of above-average credit stress, and to date, credit markets remain supportive.

Risks to our positioning are resolution of the US-China trade war (becoming increasingly unlikely) and/or material fiscal stimulus by China, the US and Europe. To date, China has opted away from announcing 'big bazooka' stimulus (like early 2016) and have implemented measured and modest reform packages instead. The US has used its major fiscal stimulus already (2017 tax cuts), and with a Republican Senate and a Democratic House, Trump will find passing similar initiatives much more difficult this time around. Any major monetary stimulus already flagged by the ECB will only be good for gold.

Whilst we remain confident in the Fund's positioning and performance through this cycle, we will continue to watch macro-economic developments closely, and remain active, making any necessary adjustments to the portfolio accordingly.

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