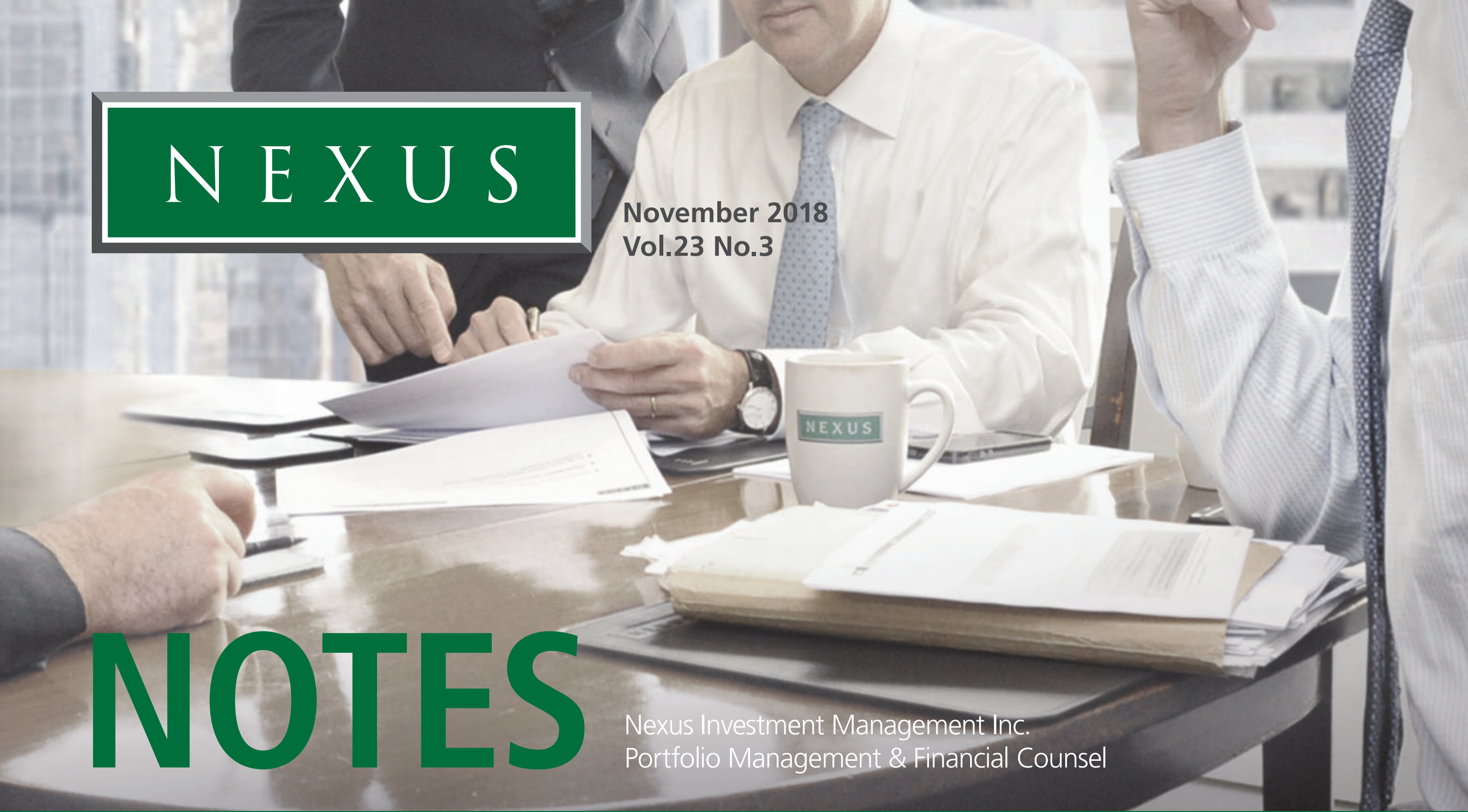

NEXUS

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NOTES

Nexus Investment Management Inc.
Portfolio Management & Financial Counsel

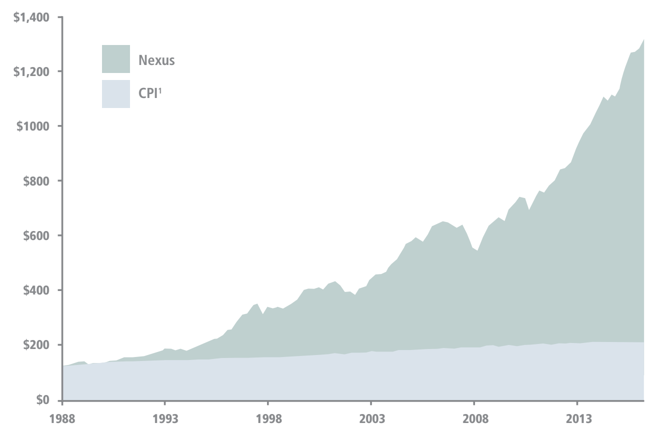
Inside Articles

Building Value for Clients

Since its establishment in 1988, Nexus has pursued an investment approach which concentrates on real growth in client wealth over the long term. The chart illustrates the impact of this long-term investment thinking – a $100 investment in a balanced portfolio in 1989 has grown to $1,338 at December 31, 2017.

(1) CPI is the "all-items" Consumer Price Index for Canada, not seasonally adjusted.

$100 Investment with Nexus in 1989



Don’t Jump without a Parachute

The month of October seems to have a bad reputation for being scary and this has nothing to do with Halloween.

The crash of 1929 was an October event and many investors still remember 1987 and even 2008. According to data assembled by Bespoke Investment Group, when we look at the last one hundred years of the worst performing months, October is much less frightening than its reputation. So what causes this irrational fear about October? Don’t underestimate the power of anecdotal evidence or even a full moon. But in all seriousness, October earns its reputation because it has provided some of the most challenging months in history. However, the reality is that most often performance in the 10th month of the year is not that different from that of the other 11 months.

Looking back at October, it was the worst month we have experienced in a while. After a long hiatus, volatility has returned to the markets. Instead of blaming the month of October, it is important to accept volatility as the price of admission when you are an investor. Investors can temper the volatility associated with equities by ensuring they don’t jump without a parachute.

Bonds act as a buffer in a portfolio, smoothing out the inevitable peaks and valleys in portfolio performance. They provide “ballast in the boat”. However, bonds have had a rough time of late. Interest rates and inflation have been low for many years now. This means that bonds have provided relatively poor returns in the eyes of those searching for more lucrative yields. To make matters worse, interest rates have started to go up which means negative returns for bonds. Despite uninspiring returns, bonds are an important component of Canadian investors’ portfolios. In July, John Stevenson penned an article entitled “The Fixed Income Conundrum” and explained why bonds still provide a safety net for investors. In this issue of Nexus Notes, Alana Buckley examines, in more detail, the impact of rising interest rates on bond returns. She also explains how the Nexus Income Fund is positioned for this period.

Also in this issue, Alex Jemetz highlights the many reasons that private clients should consider a boutique firm like Nexus over a big financial institution. Bigger is not always better. There is external evidence that private clients receive a superior experience at a smaller investment firm, stemming from factors such as performance, accessibility, safety, simplicity and conviction, when combined with tax and personal financial planning expertise.

Finally, just a reminder to clients that we will be hosting our annual client events over two evenings and a lunch session in November. Don’t forget to RSVP to Jorjan at mead@nexusinvestments.com. We look forward to seeing you there!

DCW

"Not you, too, Larry. Pumpkin-flavored?"

Image used with permission: John Caldwell, The Cartoon Bank/The New Yorker Collection

Bigger is Not Always Better

"The asset management sector in Canada is in a consolidation phase with privately held firms being snapped up amid heightened competition." [1]

The acquisition of independent investment management firms by banks is a trend evidenced by this year's purchases of Jarislowsky Fraser and MD Management by Scotiabank, and more recently, Greystone by TD.

The concentration of assets in the largest-of-the-large firms is making "boutique" firms like Nexus members of a very exclusive club. Many of the marquee names in the business started out as private wealth managers. However, in order to increase assets under management and revenue, they branched out to take on institutional investors, to make acquisitions of their own, or were acquired.

But just because they have buckets of assets or manage sophisticated pension funds, does it mean they are in the best position to manage a private client portfolio? We would argue not, and we are not alone in this opinion.

Aside from obvious tax and personal financial counselling expertise that Nexus offers, there are other reasons that a client should prefer a smaller firm that caters to private individuals. Studies conducted on this topic by firms such as Northern Trust, Alberta Investment Management and Ontario Municipal Employee Retirement System (OMERS) all come to the same conclusion: there are definite advantages that come from having a "small" firm manage your money. [2] (Nexus has $1.9 billion in assets under management.)

Northern Trust began analyzing this phenomenon in 1995, and has followed with more recent updates. Their findings were that small firms enjoy a consistent advantage over industry leaders in a multitude of areas. Some of the specific conclusions are below.

PERFORMANCE

"Clients searching for superior performance potential and defensive characteristics are more likely to find them in smaller firms." [3]

Institutional investors evaluate performance over shorter-term cycles – typically 3-5 years – and always relative to a market benchmark. This short-sightedness can lead to managers misdirecting their focus and taking undue risk. Nexus has a long-term, absolute return focus, which is aligned with our clients' interests. Nexus's philosophy is founded on quality: selecting investments that have both growth potential in good times and defensive characteristics for times when markets are not favourable. These quality attributes include low leverage and cyclicality, profit margin stability and the ability and willingness to pay dividends.

Global Management Research-Institutional Performance Report

For the Periods Ending August 31, 2018

Balanced Universe Category - 111 Funds	1 Yr.	2 Yrs	3 Yrs.	4 Yrs.	5 Yrs.	7 Yrs.	10 Yrs.
Nexus North American Balanced Fund	**10.6%**	**9.1%**	**8.4%**	**8.3%**	**10.7%**	**10.5%**	**8.4%**
Median	8.7%	7.0%	7.0%	6.6%	9.1%	8.7%	7.0%
Quartile	1st	1st	1st	1st	1st	1st	1st

Note: All returns are annualized and presented prior to the deduction of investment management fees. Past performance is not indicative of future results.

(1) Armina Ligaya, "TD Bank becomes Canada's biggest money manager with $792-million deal to buy Greystone Managed Investments", Financial Post, July 10, 2018.

(2) Northern Trust defines "small" and "emerging" managers generally as those who have less than USD$2 billion in assets under management.

(3) "Potential Benefits of Investing with Emerging Managers: Can Elephants Dance?" Journal of Investing (Spring 2007).

Bigger is not Always Better *cont.'d*

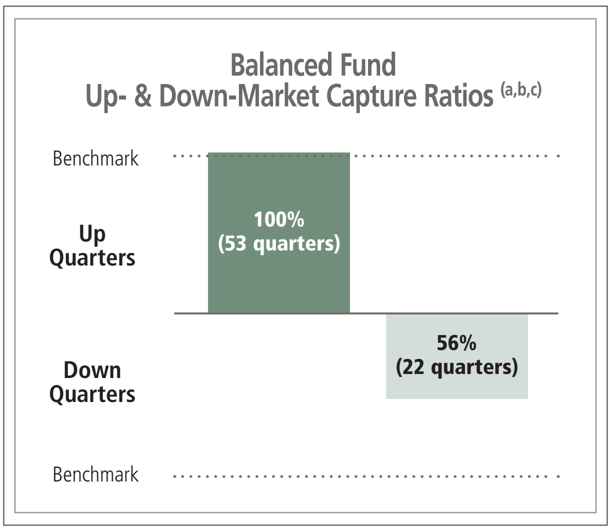
"Small firms outperformed the elephantine household names at the median, as well as top and bottom quartile levels." [3]

In the latest Institutional Performance Report from Global Manager Research©, (results on the previous page) the Nexus Balanced Fund was top quartile in every period shown in the table below. The Fund's ranking is significant, as it is representative of a typical Nexus balanced client, and its composition is comparable to the peer group benchmark.

"Small firms delivered dramatically better performance in down markets. [3]

Nexus's clients typically share one common attribute – the need for capital preservation. Our business, philosophy and process have been built around creating portfolios with downside protection.

It is one thing to say as much, and another to prove it. One of the most common measures of capital preservation is an analysis often referred to as up/down market capture. The chart below shows that since 2000 (when our current portfolio managers started working as a team) in periods when its benchmark was up, the Nexus Balanced Fund, on average, was up the same amount. However, when the benchmark was down, the Fund, on average, was down only 56% of the decline of the benchmark. This shows that Nexus's Balanced Fund, as a proxy for a typical balanced client, has exhibited superior downside capital preservation over the long term.



ACCESSIBILITY

"Investors who insist on only hiring large firms probably are not protecting themselves, and possibly are missing out on most of the best talent in the marketplace." [3]

Members of Nexus's investment team have worked at some of the world's most reputable companies – JPMorgan, Credit Suisse, McKinsey & Co. and Rothschilds – to name just a few. Alma maters include Harvard, Princeton, Wharton, Yale, Columbia, McGill and Queen's. Teams of this calibre are rare and fewer are directly accessible to individual clients.

Nexus offers a variety of ways clients can access the investment team: through face-to-face meetings, quarterly investment review luncheons and our annual client presentations. Our managers pick up their own phones and are happy to answer client questions as they arise.

SAFETY

"We hear over and over again that institutional clients hire the largest firms because they view them as safer than emerging firms. In reality, this is just another over-crowded trade that may expose clients to excess volatility and nasty surprises, without adequate compensation in terms of full-cycle performance." [4]

We believe that large firms are no "safer" than Nexus. We use a third-party custodian that holds our clients' assets and we have been in business for 30 years. There is something to be said about the focus of a small group of people – undistracted by sales or revenue quotas or arbitrary performance targets – concentrating solely on prudently choosing investments, a compliance and operations department that is not overwhelmed with millions of accounts, and client service team members who know their clients on a personal level and are more likely to detect if something is amiss.

SIMPLICITY

"The most obvious ways for large firms to grow have been to create new products or undertake mergers and acquisitions with mid-

[a] Each quarter since January 1, 2000 to September 30, 2018 is defined as an "up" or "down" quarter based on whether the benchmark return for the quarter was positive or negative. For up (down) quarters, the capture ratio is the ratio of compound average rates of return for the Fund and its benchmark for such quarters.

[b] Nexus returns are presented prior to the deduction of investment management fees. Past performance is not indicative of future results.

[c] Balanced Fund benchmark is 5% FTSE TMX 91 Day TBill Index, 30% FTSE TMX Universe Bond Index, 40% TSX, and 25% S&P 500 (in C$); rebalanced monthly.

Bigger is not Always Better *cont.'d*

size firms. Unfortunately, these initiatives... are very costly, distract management attention away from client portfolios, and frequently lead to staff turnover or other unwelcome organizational changes." [3]

It is not hard to determine who is benefiting from large firms' proliferation of products. At Nexus, we do not believe investors need a plethora of investment product choice. We have written previously about this in our *In Search of Simplicity* blog, illustrating how straight-forward investment solutions can outperform complex ones.

CONVICTION

"There's something to be said about viscerally understanding the risk profile of a fund when you have invested in it." [5]

Research from Morningstar concludes that there is a "strong link" between manager investment in a fund and a fund's performance [6]. Managers investing alongside clients aligns the interests of both, and is a powerful signal that the portfolio managers have a strong conviction in their investment decision-making. Nexus portfolio managers and other professionals invest significantly alongside our clients in our pooled funds or in segregated portfolios managed the same way. We are long-term shareholders, not just employees, and in this sense we "eat our own cooking".

CONCLUSION

Short-term attention on markets and performance means that institutional clients change the focus and behaviour of their investment managers. Given our long-term-oriented client base, Nexus does not have to contend with these distractions.

Dedication to clients, better performance (particularly in down markets), less bureaucracy, crisper decision-making, more motivation and less complacency are all factors quoted in the research, and Nexus categorically checks all of those boxes. The result is that we have more time to spend on selecting the best long-term investments and ensuring our clients are being attended to properly.


AOJ

Movin' On Up: What Rising Rates Could Mean for Your Fixed Income Returns

Since 2016, interest rates have been rising gradually.

The increase in the pace and consistency of the move has resulted in frequent conversations with clients about the role of fixed income in portfolios. During these conversations, two questions come up regularly:

1. Will I lose money on my investments if interest rates move higher?; and
2. How is the Nexus Income Fund positioned?

To address Question 1, I first remind readers of the article that John Stevenson penned which appeared in the July 2018 edition of *Nexus Notes* called the *"Fixed Income Conundrum".* His article addresses why, despite relatively uninspiring income and return prospects, fixed income continues to play a key role in many investors' portfolios. Building on John's article, we explore further the idea that recent negative fixed income returns do not mean a negative total return for investors over longer periods of time.

Because fixed income-related conversations tend to be frustratingly technical and math-heavy, we've summarized the key points below.

Recently, investors have experienced periods of negative total return on bonds because of rising interest rates. *Bonds experience negative returns when the capital loss from falling prices exceeds the interest income earned over a given period.* This trend of negative total returns could continue as interest rates rise, but it does not necessarily mean a permanent loss of capital.

[4] "Emerging managers hold their edge versus elephants", Northern Trust white paper, 2009.
[5] Jon Lukomnik, executive director of the Investor Responsibility Research Center Institute.
[6] "Why You Should Invest With Managers Who Eat Their Own Cooking", Russel Kinnel, Morningstar, March 31, 2015.

Movin' On Up *cont.'d*

Why doesn't it mean a *permanent* loss of capital? As the saying goes, bond investments don't lose money. But for the sake of completeness, we need to add the following caveat: *when held until maturity*, investors in a bond will earn a positive return (the yield of the bond) over that period.

Things can get more complicated in between the purchase of a bond and its maturity date. When interest rates increase (and bond prices fall), it is possible that investors experience a negative period return, as we have seen lately. To reconcile the competing concepts of *bond investments don't lose money* and *as interest rates rise, bond prices fall,* we must consider the time horizon. If a bond has a positive yield (as all of ours do!), any short-term losses will be reversed as the bond approaches its maturity date. Losses can be incurred, however, when a bond is sold before its maturity date and the funds are not re-invested in the bond market.

It is possible that we are still in the early stages of a long journey to higher rates. During this period, the pace and degree of shifts in interest rates will have a significant impact on the size of capital gains/losses incurred by investors. But, based on our expectation for a slow and uneven climb higher, we remain comfortable with our positioning in the Income Fund. We anticipate modest, but positive, returns over the medium term, and that the portfolio should continue to deliver stability, liquidity and a natural offset to equity volatility. While it likely won't be a completely smooth ride, we expect that any short-term negative returns will be neither large nor long-lived.

Moving on to the second question "how is the Nexus Income Fund positioned?", the positioning in the Fund aligns with our expectation that rates will be moving higher, as cited in our quarterly publications. We have constructed and continue to manage a conservatively positioned income-oriented portfolio. Unlike many traditional bond funds, we are not shy to position the Fund in a way that differs materially from the Fund's benchmark (the Canada Universe Bond Index). For example:

• The Income Fund currently has a duration of about 4.0 years vs. about 7.5 years for the bond universe, and it has no bonds with maturity dates more than 10-years away. Simply put, *the Income Fund has a much lower sensitivity to a move in interest rates compared to typical bond funds that track the Universe.*

• The Income Fund can hold up to 20% equities at any given time. We believe that high-quality, income-focused stocks can act as a substitute for bond duration over the long term and in certain economic environments. The Income Fund currently holds its maximum allocation of 20% equities.

• We don't mind waiting. Recently the Income Fund has had as much as 8% of its assets in short-term money market securities. This limits the need to sell securities for liquidity and allows us the flexibility to use the funds when we feel the time is right.

It's also important to keep in mind that we have already seen a move in interest rates. The yield on the bonds in the Income Fund has increased from 1.6% in mid-2016 to 3% today without a significant shift to the maturity profile. On the positive side, as the yield on fixed income increases, the cushion against capital loss that would cause a negative total return increases and, as we re-invest cash from interest payments and maturities, we are re-investing at higher yields. This should result in better future returns. The other side to this is that investors have had to endure underwhelming returns on their fixed income portfolios for some time already.

Thankfully, the Nexus Income Fund continues to deliver performance that we can be proud of. Over 1, 3, 5, and 10-year periods the fund has earned returns [1] that are consistently better than the Canada Universe Bond Index. (For the 1- and 10-year periods ended July 31, 2018, the Nexus Income Fund returned 2.6% and 5.8% vs the Bond Universe returns of 2% and 4.3%, respectively). While the Fund's benchmark is all bonds, and indeed a different maturity profile when compared

[1] Returns for periods greater than one year are annualized and presented prior to the deduction of investment management fees.

Movin' On Up *cont.'d*

to the Income Fund, Nexus's relative positioning represents our view and strategy. As the numbers show, this has served us quite well over both the short and long term.

In practice, managing a fixed income portfolio involves balancing considerations such as credit quality, overall portfolio exposures and duration. In the current environment, we think Nexus's approach of investing in high-quality credits and shorter-maturity bonds provides the appropriate blend of price volatility, conservative income, and liquidity. We remain positioned for higher interest rates and look forward to a more normalized central bank policy and higher yields.

I'd like to leave you with the message that not all income funds are built equally, and we continue to think this one serves a role in many investor portfolios. Please feel free to reach out to your Nexus contact if you'd like to discuss any of this in more detail.

AB

Pearls of Wisdom

Reading is one of the principal occupations in our profession. As we digest a wide range of material, interesting ideas and surprising facts – some serious and some light-hearted – rise to the surface. We attempt to share a few of those with you in each of our issues of Nexus Notes.

DMC

JOBS FOR ALL!

As a representation of the tightness of the U.S. labour market, there are more jobs available than people looking for work. Currently there are 7.1 million job openings in the U.S. compared to only 6.2 million unemployed persons. This is the first time since 2001 that this circumstance has arisen. Given the shortage of labour, it is perhaps unsurprising that employers might look to atypical pools of talent to find the employees they so desperately need. We read with interest comments from the head of the local Economic Development Corp. in Elkhart County, Indiana. He states, "Employers are asking, 'Do we know when the next batch of ex-offenders will be released? Can we get their résumés? Can we do a job fair down at the local correctional facility?'" It may just be that everyone deserves a second chance, particularly if redemption can be found on a factory floor.

(The Globe and Mail, "The U.S. Economy is on a tear. How long can it last?", July 27, 2018)

Nexus Investment Management Inc. provides discretionary investment management and financial counselling services to private clients, trusts, estates and foundations.

- **Exceptional client service and objective advice:** tailored to the client's individual needs.
- **Superior investment performance [1]:** long-term record of superior after-tax returns and capital preservation.
- **Disciplined investment approach:** *"Growth at a Reasonable Price"* philosophy, using research and patience.
- **Alignment with clients' interests:** as the Firm is wholly owned by its principals, we are committed to your financial success.
- **Cost-effective management:** our services are accessible directly, without the costs of branding and distribution.

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Publication Mail Agreement 40033917.

[1] A composite of Nexus accounts, managed to a balanced mandate, has earned 7.8% per annum, pre-fees for 10 years ended December 31, 2017. A composite of notional returns from a weighted average of the following indices: T-Bill (5%), Bonds (35%), TSX (35%) and S&P 500 (25%) earned a return of 6.3% over the same period.