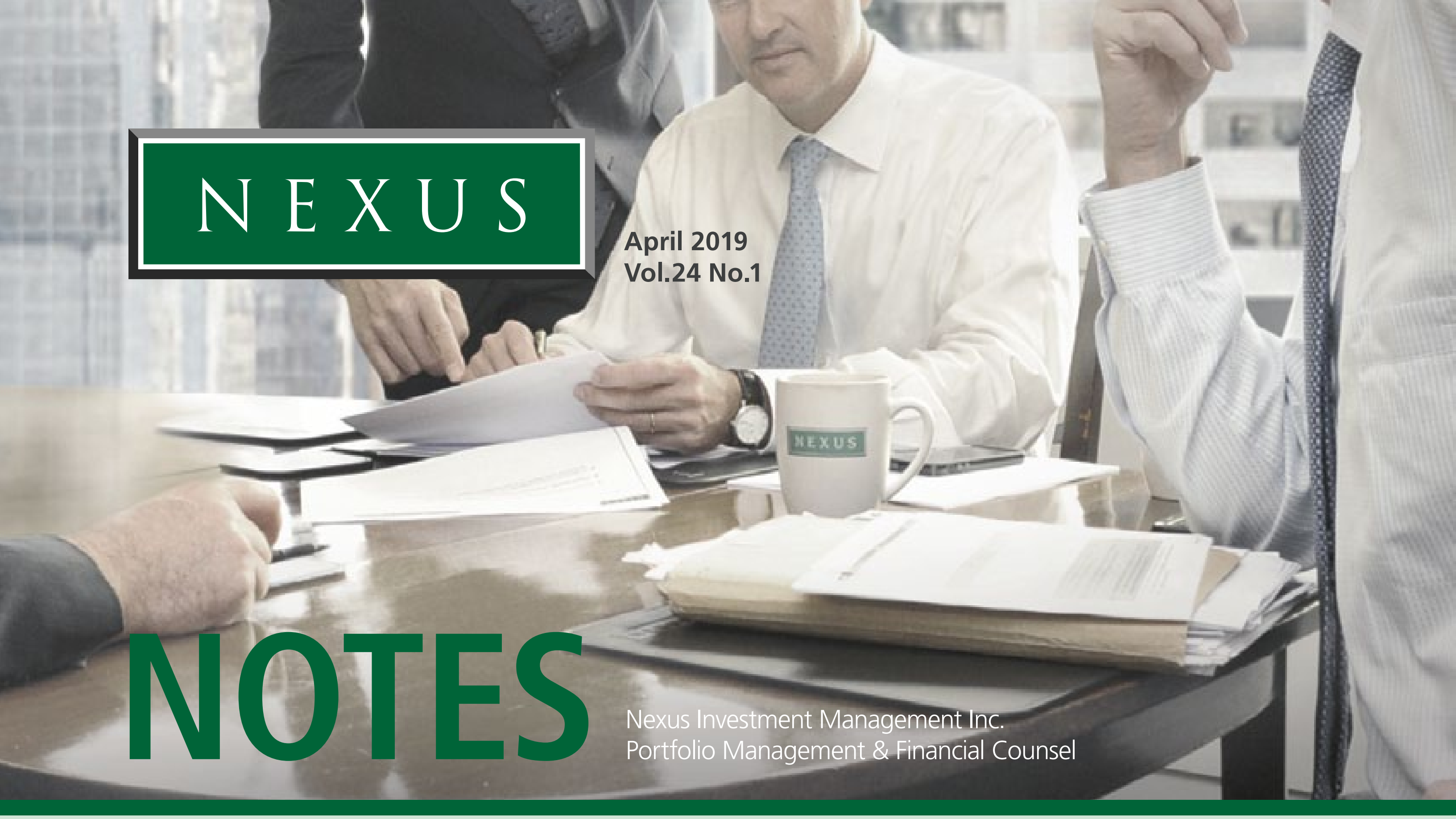

NEXUS

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NOTES

Nexus Investment Management Inc.
Portfolio Management & Financial Counsel

Inside Articles

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- When Less is More
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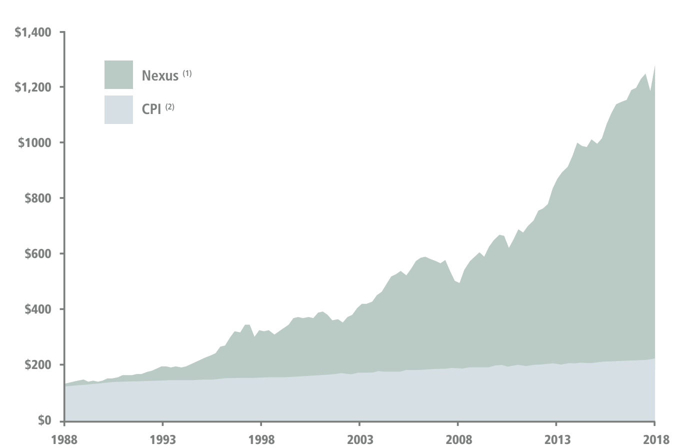
Building Value for Clients

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 $1,274 at March 31, 2019.

(1) "Nexus" reflects the performance of a composite of Nexus accounts managed to a balanced mandate (until September 30, 1997) and the Nexus North American Balanced Fund (thereafter). Returns shown prior to the deduction of investment management fees.

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

$100 Investment with Nexus in 1989



Live Long and Prosper?

The 2019 Federal Budget content was not particularly newsworthy from a tax perspective. There were no tax

rate reductions or any commitment to a comprehensive tax review or reform. However, one change worth some discussion is the introduction of the Advanced Life Deferred Annuity (ALDA) for registered plans. There has been pressure on the government in recent years to increase (from 71) the age required to start withdrawing funds from registered retirement savings plans. The reasoning is twofold: life expectancy has increased and interest rates have fallen. There is a concern that Canadians will outlive their retirement savings. The ALDA is an attempt to help retirees live long and prosper.

Starting in 2020, an ALDA will be an investment option available to anyone with a RRSP, RRIF or other similar deferred plans like a defined contribution pension plan (DCPP). Annuities are not a new investment for registered plan holders. Anyone with a registered plan can take a lump sum of cash from their registered account and purchase a monthly or annual annuity from an insurance company. The difference with the ALDA is that payments begin at the latest by the end of the year that you turn 85, instead of 72. The other catch with the ALDA is that you are only allowed to invest 25% of your registered accounts, up to a lifetime maximum of $150,000.

Annuities have not been a popular retirement vehicle in recent years for a few reasons, but most notably in the last few decades, because of the low interest rate environment (resulting in lower payments) and the absence of inflation protection. So why would anyone want to buy an annuity to defer an income stream starting at age 85? Especially considering there are also merits to making early withdrawals from your RRSP that I recently wrote about in my blog *Cashing in Before 71? When Early RRSP Withdrawals Make Sense* (http://www.nexusinvestments.com/cashing-in-before-71-when-early-rrsp-withdrawals-make-sense/).

The ALDA is likely to be a good vehicle for retirees who have a conservative investment portfolio or low risk tolerance. This means that they do not have the capacity to bear risk if they live a long life because they do not have sufficient retirement savings to cover shortfalls from unpredictable markets. It might also mean they don't like uncertainty and may sleep better at night knowing they have locked in a guaranteed income stream at age 85 with no volatility.

There is also a possible tax reduction or tax smoothing opportunity with an ALDA. If money is removed from an existing RRIF account and put into an ALDA, this could reduce the minimum RRIF withdrawal requirement between age 72 and age 85. This could be an attractive deferral opportunity for someone continuing to work in their 70's or having other retirement income sources and therefore paying a higher tax rate earlier than they expect to be paying in the future. It might also help reduce or prevent the OAS clawback for retirees with higher income in their early years of retirement.

It will be interesting to see how the ALDA gets used when it becomes available and how the insurance companies will price these investment products.

In this issue of *Nexus Notes* you will find an article about client communications and striking the right balance between doing right by clients and providing a high level of client service. It seems that less may, in fact, be more. We are also featuring a recent blog about investing in emerging markets and why we think there is opportunity despite the *Aguas Tormentosas* associated with these investments.

Happy Spring!

DCW

When Less is More

The Canadian Bankers Association's latest bi-annual survey [1] highlights how consumers' desire for choice and convenience is driving the adoption of new banking technologies.

One line in the CBA's summary resonated especially with me: "What they want is access to banking services 24 hours a day, in real-time, from anywhere in the world, on a reliable and secure network." Banks clearly have a big job to live up to their customers' demands!

This got me to thinking. What about the demands and needs of investment management clients generally, and Nexus's clients in particular? With the benefit of 2-years' experience with our own on-line reporting portal (clients.nexusinvestments.com), are the design principles underpinning it still valid? They included:

- Security
- Ease of access and flexibility
- Reliability
- Consistency with Nexus's existing (quarterly) reporting to clients
- Delivery of the custodian's monthly account statements and annual tax reporting
- Suitability for clients and/or their professional service providers (e.g., tax preparers)

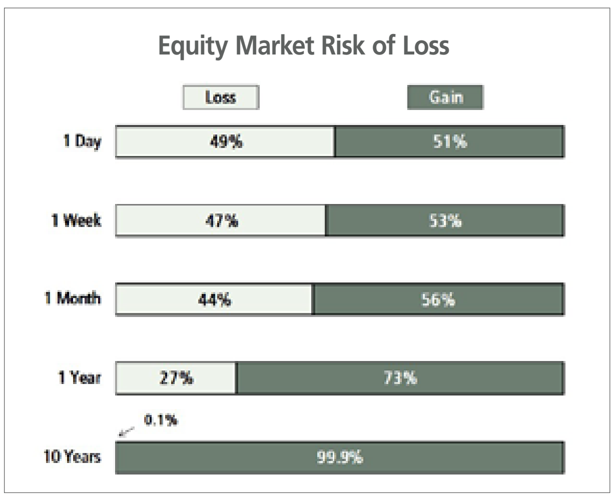
For now, the verdict is "all still valid". But a pass/fail scale (or, in this case, a "still valid"/"no longer valid" scale) isn't an especially tough standard to meet.

Financial services firms are in a technology arms race – with each other and against their clients' rising expectations. With this as backdrop, it's a legitimate question how a discretionary investment management firm like Nexus should be harnessing technology to provide more choice and convenience to clients.

One obvious – and tempting – answer is to capitalize on the ease of access principle noted above by providing more detailed and more frequent information. After all, banks provide fresh data daily, including customers' most recent deposits, withdrawals and credit card transactions, along with up-to-date account balances. Discount brokers and other trading businesses provide up-to-the-minute securities prices and portfolio values. Surely more information is better, no?

When it comes to managing portfolios for long-term success, "not necessarily" is the answer. Indeed, paraphrasing the modernist architect, Ludwig Mies van der Rohe, "less may be more".

Short-term fluctuations in securities prices are virtually random, depending on whether the news at any given moment is better or worse than it was a moment before. It follows, then, that a portfolio of stocks is equally likely to fall as to rise. Reproduced here is a chart from our November 2014 presentation showing the likelihood of an all-equities portfolio having increased in value after various periods of time. [2] Perhaps surprisingly, it's a virtual toss-up for periods of a month or shorter, but an extraordinarily high probability for periods of 10 years or more.



(Continued on page 6)

[1] The Canadian Bankers Association's latest bi-annual survey can be found at: cba.ca/technology-and-banking.
[2] Source: Michael J. Mauboussin, More Than You Know, Columbia University Press, 2006.

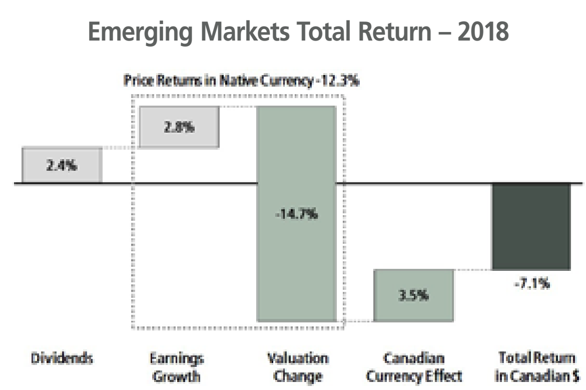
Emerging Markets: Aguas Tormentosas or Rio Tranquilo?

AGUAS TORMENTOSAS

2018 was a turbulent year for emerging markets (EM) investors. From its late January 2018 high to its October low, the emerging markets index [(1)] fell 27% when measured in US dollars. This reinforces the belief that emerging markets are exceedingly risky – the aguas tormentosas (stormy waters) that the intrepid Spanish sailors in the 1500s feared when they set out on long voyages to the New World.

But the above "high to low" return exaggerates reality. For the full 2018 calendar year, the total return from emerging markets, when measured in Canadian dollars, was a loss of 7.1%... still a meaningful loss, but not nearly as bad as the high to low measure. In part, this was thanks to a strong start for EM in January 2018 and a recovery at the tail end of 2018. Also, the Canadian dollar (C$) weakened in 2018. This C$ weakness had the effect of *improving* the return from EM when measured in C$.

What caused the EM loss of 7.1% in C$? The usual explanations tend to be very general: trade tensions, increasing interest rates, investors seeking safe havens, and so on. However, it is instructive to dig a little deeper and divide the 2018 loss into its underlying component parts, as shown in the chart. Any equity market return can be broken down into the components attributable to the companies' underlying performance (the two grey boxes on the left of the chart, that is dividends paid and corporate earnings growth) and the components attributable to the markets (the two green boxes in the chart, that is the valuation change and currency change). Let's start with how the companies performed in their local currencies. For the year, these companies collectively paid a dividend of 2.4% and increased their earnings over the course of the year by 2.8%. A 2.8% rise in earnings isn't great, but it was at least positive in a tough year. So far, so good – management of these companies "did their job". Now we turn to investors (who collectively make up the market). With all the stormy waters, heightened investor fears resulted in the share prices of EM stocks declining 12.3% in their native currencies. To properly separate out the underlying causes, the share price decline has two components – the aforementioned 2.8% *increase* in **earnings** by the underlying companies and a *decline* in the EM price to earnings **valuation multiple** of 14.7% attributable to investors' views changing, that together resulted in the 12.3% share price decline. [(2)] Finally, the weakening in the C$ improved the return by an additional 3.5%, resulting in the net total return loss of 7.1% in C$. So, the overall message becomes clear in the chart. In 2018, EM companies did what they are supposed to do – pay dividends and increase earnings. But the companies' good performance was overwhelmed by market effects – the valuation decline and the currency effect – which turned out to be the two biggest drivers of the poor 2018 total return.



Source: MSCI Emerging Markets Index, JPMorgan Asset Management, Bloomberg.

[(1)] The MSCI Emerging Markets Index is the overall emerging markets index. It includes the stock markets of 24 emerging market countries. The return is typically reported in US dollars, although this can be translated into any other currency, such as Canadian dollars.

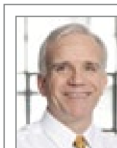
[(2)] Note that percentage returns must be combined by multiplying, not adding. As such, a 2.8% gain and a 14.7% loss are combined using (1 + 2.8%) x (1 - 14.7%) - 1 = -12.3%.

Emerging Markets: Aguas Tormentosas or Rio Tranquilo? *cont.'d*

RIO TRANQUILO

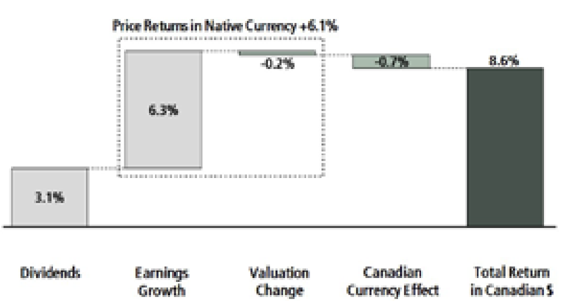
Over the longer term, a completely different picture of EM emerges. The second chart, which shows the annualized total return from EM over the 15-year period ending December 31, 2018, illustrates this. In the Rio Tranquilo, the waters appear tranquil, but there is nonetheless a powerful current in the river. The "current" is provided by the companies. The annual average return from dividends over the full 15 years was 3.1% per year and another 6.3% came from earnings growth. The "wild" short-term market effects (again, these are the valuation change and currency changes) became much smaller over long time periods. As the cycle of greed and fear repeats, up follows down and down follows up – forces that tend to cancel out over time. Over the full 15 years, the annualized valuation effect has been a tiny -0.2% per year and the overall currency effect shrank to a small -0.7%. This makes sense. There is little reason for a long-term change in the valuation multiple. Rather, the total return to the equity investor comes from companies doing what they do: paying dividends and growing earnings. Similarly, currencies go up and down in value against each other as short-term market forces and sentiment jostle them. Over the long term, however, the primary driver of the exchange rate of two currencies is simply the inflation rate differential between the two countries. [3] For the 24 emerging market countries as a whole, most, like Canada, have inflation under control, resulting in the relatively small currency effect.

Emerging markets look scary. But these countries develop over time and grow more quickly than developed markets. The actual companies in EM have also grown, exhibiting better stability and governance characteristics over time. Today, the average market capitalization of each company in the EM index is close to C$20 billion – not too shabby and bigger than many Canadian companies. Finally, EM companies collectively have a dividend yield of 2.8% and a forward valuation multiple of 11.7x, both more attractive than North American companies. So, the next time you look at EM, try and see the Rio Tranquilo rather than the Aguas Tormentosas.



FWG

Emerging Markets Annualized Total Return – 15 Years to December 31, 2018



Source: MSCI Emerging Markets Index, JPMorgan Asset Management, Bloomberg.

"You've got mail."

Image used with permission: Tom Cheney, The Cartoon Bank/The New Yorker Collection

[3] Putting aside any major event such as a war or revolution.

When Less is More *cont.'d*

The historical evidence suggests there is almost nothing to be gleaned from frequent checking of portfolio values. More importantly, however, there is a potential behavioural impact from the effect of the random fluctuations on an investor's state of mind.

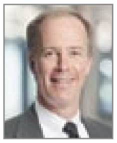
It's not hard to imagine how owners react to fluctuations in the value of their portfolios. Most would regret a decline, and delight in an increase. Given the probabilities described above, a portfolio owner who checked his or her portfolio value more often than monthly would be nearly equally likely to experience regret as happiness.

Now introduce into the mix the well documented psychological phenomenon that human beings feel the pain of loss approximately twice as strongly as the joy of gain. You can see where this might lead. Doesn't this combination – frequent portfolio checking, a 50/50 chance of loss, and a double-weighting of emotional impact – expose the portfolio owner to an *avoidable* risk of unwarranted overreaction to a decline in their portfolio? A risk that can be reduced simply by checking their portfolio value less frequently?

If this is true, it's fair to question how well an investment manager is meeting client needs by using technology to sharply increase the frequency of portfolio valuation information. Perhaps more is *not* more. Maybe Mies van der Rohe was right. Maybe "*less* is more".

"Hold on!", you say. "That just sounds like an investment manager rationalizing how to avoid hand-holding clients when times are tough. Moreover, carried to its logical conclusion, doesn't this line of reasoning justify no reporting of returns and portfolio values at all?" Unfettered, yes. But an investment manager, like any service provider, must serve clients – by delivering results, being accountable, and providing value for money.

So, it's a balancing act: between doing right by clients and serving them. In our view, monthly or quarterly reporting strikes that balance.



RDC

Spotlight on: The Nexus Report

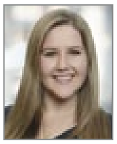
At Nexus, we are committed to regular and honest communication, something we feel is essential in our role as a trusted advisor.

With no lack of news headlines competing for attention, we regard straightforward communication as the most important factor for earning confidence – in us at Nexus, and in our approach.

We strive to provide updates, reporting and commentary that engages investors in the investment process. As a result, each quarter the investment team writes the *Nexus Report*, which is a comprehensive review of financial markets, our approach to the major asset classes, and our thoughts on the market outlook.

The *Nexus Report's* market and fund commentary offers our perspective for each quarter and can provide insights to investors on recent market moves, or context during bouts of volatility. By adding our colour commentary to market gyrations, we aim to provide an objective view in a world with no shortage of opinions.

Look for our next edition of the *Nexus Report* in our quarterly reporting package, or you can find it on our website: bit.ly/TheNexusReport



NMW

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

UPS AND DOWNS

At Nexus, part of our investment philosophy is to maintain a steadfast focus on the long term. However, tuning out the near-term market noise is not easy, particularly when markets are as volatile as they have been recently. We find it instructive to look back at market history to put the recent volatility in context. As an example of downside volatility, last year saw the worst December performance since 1931, with the S&P 500 dropping 9.2%. But the subsequent upside swing was equally impressive: the S&P delivered its best January performance since 1987, rising 7.9%. Despite these remarkable ups-and-downs, we try to keep in mind that short-term volatility is a normal characteristic of markets. And although the short-term volatility may capture all the attention, our view remains that successful investing requires a long-term perspective.

(Raymond James Weekly Market Guide, January 3, 2019.)

HOUSTON, WE HAVE LYFT-OFF!

Ride-share firm Lyft is in the news as it prepares for its initial public offering (IPO). The company's service is popular with its customers, as demonstrated by its rapid revenue growth. Revenue doubled last year to US$2.2 billion. However, profitability has not yet arrived, with the company posting a loss of $911 million last year. This has not stopped pre-IPO investors from assigning an impressive valuation of $15.1 billion in the most recent round of funding. Investors who buy shares in the public debut will be betting that Lyft is able to translate its revenue growth into profit. But that's not a sure thing, as Lyft will undoubtedly face stiff competition from Uber, the larger of the two companies, which was most recently valued at $76 billion. Uber will likely file its own IPO in April, in what is anticipated to be the biggest public offering of 2019.

(“Lyft Leading Wave of Startups That Will Make Debuts With Giant Losses”, *The Wall Street Journal,* March 25, 2019.)

ELECTRIC VEHICLE BATTERIES

One consequence of the rise of Lyft and Uber is that there will likely be more electric vehicles on the road in future. Both companies anticipate that electric vehicles will be an important and growing part of their vehicle fleets over time. These electric vehicles will require batteries, and lots of them. Herein lies the opportunity for the world's battery innovators who have been hard at work building better batteries at lower cost. According to a recent survey of battery prices, the price of an average battery pack fell 85% between 2010 and 2018. While lower prices will spur greater adoption and demand, these transitions take time. New, “solid-state” batteries are likely to revolutionize electric vehicles but, according to the authors of the survey at Bloomberg New Energy Finance, “We don’t expect solid-state batteries to make a meaningful contribution to the global EV [electric vehicle] market until the late 2020s at the earliest.”…Who said technology changes quickly?

(“A Behind the Scenes Take on Lithium-ion Battery Prices”, *Bloomberg New Energy Finance*, March 5, 2019.)

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.
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[1] The Nexus North American Balanced Fund has earned 10.5% per annum, pre-fees for 10 years. The return from a notional investment in market indices in the following weighting was 9.4% over the same period: T-Bill (5%), Bonds (30%), TSX (40%) and S&P 500 (25%).