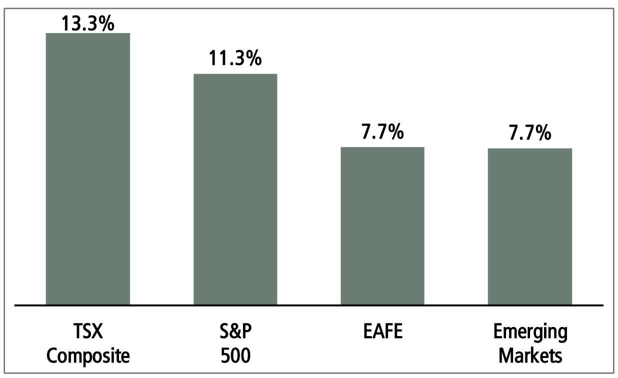
Happy Days are Here Again

Smiles have returned to investors' faces. 2018 was a tough year, punctuated by the worst December performance by the S&P 500 in the U.S. since 1931. However, memories of these tumultuous times seem distant as stock markets around the world have soared over the last three months. In fact, the recovery started on Boxing Day as the Dow Jones posted its biggest one-day point gain ever, bouncing off of the Christmas Eve lows. Since then, it has been onward and upward. In the first three months of 2019, the S&P 500 posted a total return of 11.3% in Canadian dollar terms, its largest first quarter gain since 1998.[1] Canada was even better, as the TSX Composite generated a total return of 13.3%. Stock markets overseas also moved sharply higher, although most were not quite as strong as Canada and the U.S. At the current pace of gains, global equities are on track to beat 1933 as the best ever year for stocks.[2] Of course, it's silly to extrapolate the first three months of the year, but it does underscore the exuberance.



First Quarter 2019 Stock Market Returns (C$ Total Returns)

Why the sudden change in sentiment? In late December, the bounce off of the lows was likely nothing more than a technical recovery from oversold conditions at a time when there was little liquidity. The real news came in the first few days of January when U.S. Federal Reserve Chair, Jerome Powell, suddenly changed his tone on interest rates. After raising short-term interest rates on December 19 – the fourth such increase in 2018 – the Fed Chair signaled in a speech on January 4 that the Fed would be "patient" and further interest rate increases were on hold. At the same time, optimism began to grow that progress was being made in U.S. trade talks with China. Suddenly, the two darkest clouds that hung over markets in 2018 – rising interest rates and severe trade tensions – began to dissipate. Stocks were off to the races.

U.S. is Slowing, but Growing

At the same time that stocks moved higher, U.S. economic growth was clearly decelerating. In March, the final revision to fourth quarter (2018) U.S. GDP showed that economic growth slowed to a 2.2% annual rate. While a decent rate of growth in an absolute sense, it was a sharp slowdown from the 3.4% rate in the third quarter and the 4.2% rate in the second quarter. Tax cuts late in 2017 had a powerfully positive impact on the U.S. economy through much of 2018, but the fading effects of this fiscal stimulus were clearly visible by year-end. For the first quarter of 2019, most economists expect economic growth below 2%.

As economic growth slowed, other economic statistics sent mixed messages. Loyal readers of the Nexus Report will know that labour market strength has been one of the engines of the remarkable U.S. expansion. After a string of very strong reports, suddenly it appeared that employment growth had stalled in February as the U.S. economy added a meagre 20,000[3] jobs compared to expectations for 180,000. Together with other weak economic data, this report worried investors that a sharp slowdown was under way.

Relief on the labour market front came a month later, however, as the March employment report was slightly better than expected: 196,000 new jobs were created, the work week lengthened slightly, and although average hourly earnings growth declined modestly, wage gains remained encouraging. The February report seems to have been a blip, but it was not the only confusing economic data in the quarter. Measures of consumer confidence in March also delivered ambiguous messages. The Conference Board reported an "unnerving pullback" at the same time that the University of Michigan reported that sentiment hit a 5-month high.[4]

In hindsight, economic trends were undoubtedly influenced by the longest U.S. government shutdown in history. Skipped paychecks weighed on economic activity, and the shutdown also prevented a number of economic statistics from being released on a timely basis. Add in severe winter weather in certain parts of

1 Also the best return in *any* quarter since 2009.

2 Michael Hartnett, Bank of America Merrill Lynch, quoted in *Barron's*, April 6, 2019.

3 The initial report of 20,000 jobs was later revised to 33,000.

4 Doug Porter, "Talking Points", BMO Capital Markets, March 29, 2019.

the country and it shouldn't be surprising that economic trends were murky.

Perhaps the climax of all this uncertainty occurred in the last week of March when the U.S. yield curve briefly "inverted". A yield curve inversion occurs when the 10-year treasury bond yield falls below that of the 3-month T-bill, rather than the normal state of affairs the other way around. Historically, there is a reasonable correlation between an inversion and a subsequent recession, so many pundits saw this as a disturbing omen. Our own view is more sanguine, partly because the inversion was short lived, but mainly because we believe the underlying strength of the U.S. economy remains intact. We expect growth to be modest, but positive, in the period ahead.

Canada's Persistent Resilience

For several quarters we have marveled at the resilience of the Canadian economy in the face of many daunting challenges. While November and December each delivered small declines in GDP, January surprised on the upside. Even though oil sands production was down 4% in January as a result of mandated cutbacks in Alberta, Canadian GDP increased 0.4% over December. Construction and manufacturing were both particularly strong. Overall 2019 GDP growth is estimated at approximately 1.5%, not especially robust, but a far cry from recession.

Canadian labour market conditions also remain good. There was a modest loss of 7,200 jobs in March, but this was unsurprising after the remarkable 123,000 aggregate gain in January and February. The unemployment rate, at 5.8%, hovers near a 40-year low, and wage gains are starting to accelerate.

Despite this encouraging data the outlook for the Canadian economy remains uncertain. Our trade deficit has spiked in recent months, the housing market has weakened considerably, and consumer indebtedness remains at worrisome levels. Trade tensions with China are high as a result of the Huawei situation, and ratification of the USMCA (a.k.a. the new NAFTA) has stalled. Of course, Canada could also be caught in the fallout from Brexit or other geopolitical events. While our expectation is for modest economic growth to continue, any one of these issues could undermine this view.

Investment Outlook

Financial markets are forward-looking and their performance is an expression of investors' expectations for the future. The stock market rally over the last three months clearly reflects optimism among equity investors about the economy and corporate earnings growth. On the other hand, the strong rally in bonds reflects very different expectations among fixed income investors. Government bond yields plunged during the quarter, suggesting monetary conditions will remain extraordinarily easy, a necessity to support an ailing economy. One commentator described this dichotomy as "fascinatingly counterintuitive".[5]

These two different visions of the period ahead can't both be right, and time will tell which camp is most prescient. What is certain, however, is that the lower level of interest rates means fixed income securities will provide little opportunity for real return over the long term. By comparison, stocks are more attractive. Even after the impressive rally in the first quarter, overall equity valuations have recovered only to "normal" levels. Stocks are obviously more expensive than they were three months ago, but many attractive investments remain.

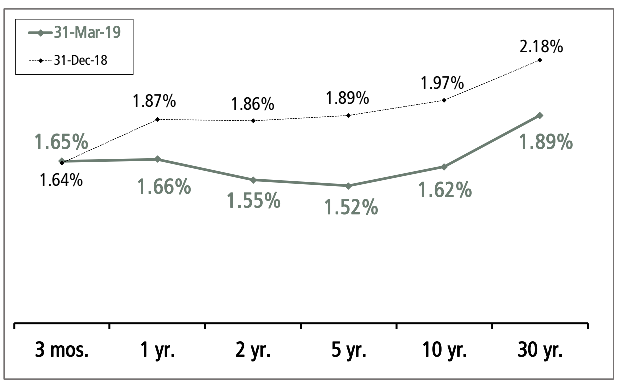
The summary offered three months ago remains equally relevant today. Given the roller coaster ride investors have endured in recent months, and the mixed signals about future economic growth, it is understandable that many are cautious about the future. An unavoidable truth in investing is that there is no way to predict when times will be good and when they will be more challenging. However, if one maintains an appropriate asset mix and a well-diversified portfolio of quality companies, we remain certain that investment success will be achieved.

[5] Michael Arnone, quoted in *Barron's*, March 29, 2019.

Asset Class Investment Review

Fixed Income

After moving sharply lower to end 2018, interest rates continued to fall in the first quarter of the new year. The decline was led by policy changes at the Bank of Canada (the Bank) and the U.S. Federal Reserve (the Fed). Previously, both had been pursuing a program of gradual interest rate increases and monetary policy normalization, backed up by "forward guidance" of where they expected interest rates to rise to. After spending much of 2018 preparing capital markets to expect higher interest rates and less stimulative monetary conditions, the heads of both central banks moved early in 2019 to spread the message that rate increases were on hold and further increases were highly unlikely for some time.[6] Bond prices, which had anticipated further interest rate tightening, moved higher in response and yields all along the yield curve fell substantially from where they started the year.



Government of Canada Yield Curve

Over the quarter, 2-year yields fell 0.31% to 1.55% and 10-year yields fell 0.35% to 1.62%. The sharp decline in rates generated surprisingly strong fixed income returns. The bond return in our Income Fund was 2.7% for the quarter, and 4.4% for the last 12 months. These results trailed the FTSE TMX Canada Universe Bond Index, which returned 3.9% and 5.3% for the same periods.

Both central banks have admitted to a high degree of uncertainty with respect to their economic forecasts. In Canada in particular, first quarter economic releases provided evidence for both skeptics and optimists. On the worrying side, the economy is having to deal with deteriorating trade relations with China, the uncertain outlook for the USMCA and a housing market that has slowed to stall speed. In early February, the merchandise trade account recorded its largest ever deficit ($4.8 billion) and the release in early March ($4.2 billion) was the second highest recorded. Yet, in other respects, the economy has showed surprising strength, and most notably regarding employment, where the economy has created an average of 38,000 new jobs per month over the last 6 months, wage gains are accelerating, and the 5.8% unemployment rate is near a 40-year low.[7]

The decline in yields of longer-term bonds, without a corresponding reduction of central bank policy rates, meant that the yield curve, when measured as the difference between 3-month yields and 10-year yields "inverted" briefly at the end of March. Yield curve inversions are often associated with economic contractions. But the linkage is greatly exaggerated, and while it is unclear just how strong the economy really is in both Canada and the U.S., fears of recession are overstated. The issues that have darkened business and consumer sentiment –U.S. / China trade negotiations, Brexit, and U.S. political dysfunction – will need time to be resolved. Until then, we expect slower growth.

The present level of interest rates offers little long-term investment opportunity. Canadian Government yields are below the targeted rate of inflation, and 5-year interest rates are lower than money market rates (See chart). While bond yields may fluctuate, we still believe the next significant move for interest rates is higher and therefore continue to keep a short duration portfolio (3.9 years). In fact, in March, when interest rates were at lower levels, we sold 5-year bonds and bough money market instruments, where we earn higher returns. We will re-invest those funds when bond prices fall (rates rise).

The other notable aspect of our positioning is the emphasis we have put on better credit-quality securities. Only 3% of our holdings are rated BBB, and 79% are rated AA or higher. This quarter, credit spreads compressed. While we benefitted from the increase in price that occurs when spreads decline, it is the lower quality credits, not the higher quality, that typically benefit the most. As we have stated before, high-quality gives the portfolio superior liquidity, which is useful in the event of a sudden shift in risk

[6] In remarks accompanying the release of the Bank's Monetary Policy Report on January 9th, the Bank downgraded its assessment of Canadian economic conditions and Governor Poloz indicated that he was in no rush to resume monetary tightening.

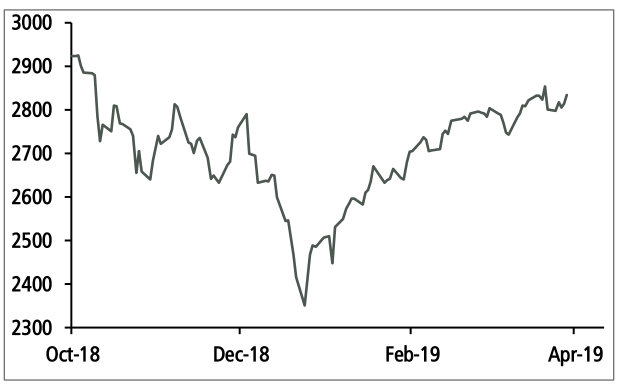
[7] The December 2018 and January 2019 unemployment rates were each 5.6%.

sentiment, and a shorter-maturity profile moderates capital volatility as interest rates fluctuate.

Equities

After a poor end to 2018, equity markets staged a tremendous recovery in the first quarter. The Equity Fund returned 10.4% in the quarter, slightly behind the 11.8% return for the market benchmark. For the past 12 months, the Fund returned 7.1% and lagged its benchmark's 10.3% return.[8] This difference stems from lower-than-benchmark U.S. equity returns and an unfavourable period for international equities.

The first quarter was strong around the world. In North America the TSX Composite returned 13.3% and the U.S. S&P 500 returned 13.6% in U.S. dollars (11.3% in Canadian dollars). In the rest of the world, equity returns were also good, with each of the principal international developed markets' and emerging markets' indices returning 7.7%.[9] The reasons for the strong returns were simply the opposite of the quarter before, with market sentiment reversing its dramatic deterioration of that quarter, accompanied by the market's view that the U.S. Federal Reserve is done with raising interest rates for now. The exhibit below illustrates the quarter to quarter "round-trip" for the S&P 500. (The TSX graph looks almost identical.)



S&P 500 Index

Canadian Equities

Nexus's Canadian stocks returned 13.4% in the quarter, roughly in line with the 13.3% return from the TSX Composite. For the twelve months, our Canadian stocks returned 10.0% outperforming the TSX, which returned 8.1%.

All Canadian sectors had strong returns, with the "worst", Materials, returning 9.0%. Our portfolio did well across the board, with particular strength in our Energy and Industrial holdings.

U.S. Equities

Our U.S. stocks returned 10.6%, slightly trailing the S&P 500's 11.3% return in the quarter. For the twelve months, we have lagged the S&P 500, with our U.S. portfolio returning 7.2% relative to the benchmark's 13.5%. Our equity approach and portfolio differ significantly from the indices. With just 16 U.S. stocks, our shorter-term returns will naturally differ from the S&P 500. We aim to hold a sub-set of higher quality names trading at reasonable valuations that we believe offer attractive long-term performance characteristics.

There is one new name in the U.S. portfolio – Facebook. Facebook obtains almost all its revenue from targeted advertisements placed on its social media and messaging platforms. The company has grown quickly, is very profitable and has a strong balance sheet. It has also been dogged by controversy over security and privacy issues, which the company is addressing. These issues created what we feel is an attractive valuation relative to the company's prospects.

Other Equity Investments

We remain invested in two non-North American equity holdings within our Balanced and Equity Funds. These are externally-managed pooled funds called EQIT (international developed market equities) and EMEC (emerging market equities).[10]

Headwinds continue in both international developed markets (Brexit and slowing growth) and in emerging markets (trade tensions). Nonetheless, EQIT returned 9.9% in the quarter and EMEC was up 7.9%. Combined, their 12-month return was a 1.6% loss and detracted from the Fund's performance. Longer-term returns remain strong, up 11.8% per year over the last three years. We continue to like the role that international equities play as an "add-on" to our North American portfolio. International equities currently trade at a 20% lower valuation relative to North American equities. For more information on EQIT and EMEC, please see the Nexus International Equity Fund section of this report.

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[8] All the return data in the Equities section are total returns for the Equity Fund. Equity returns within the Balanced Fund were similar. For more specific performance, please refer to the Fund reports in this document or your client-specific report.

[9] Except where indicated, all U.S. and international returns are measured in Canadian dollars.

[10] Both funds are managed by teams from JPMorgan Asset Management in London, England.

Pooled Fund Reports

Nexus North American Equity Fund

The Nexus North American Equity Fund generated a total return of 10.4% in the first quarter. This return compares to the 11.8% total return of the Fund's benchmark during the same period. In the last 12 months, the Fund has returned 7.1%, but trailed the benchmark return of 10.3%. From a longer-term perspective, our returns for the 2, 5 and 10-year periods remain near or above the benchmark and are very attractive on an outright basis.

More detail on the Fund's performance is presented in the table below.

In Canada, the equity market gained a remarkable 13.3% in the quarter. Our Canadian holdings kept pace with these gains, delivering a 13.4% return. All sectors in Canada were up in the period with the "worst" performing sector (Materials) rising 9%. We had multiple stocks that rose more than 20%, including Cenovus, Encana, Thomson Reuters, Toromont and TransCanada.

In the U.S., the market also rebounded strongly, up 11.3% in the quarter. Our U.S. holdings participated in the rebound, rising 10.6%, but trailed the benchmark. Like Canada, every sector in the U.S. produced a gain in the period, with the "worst" sector performer being Healthcare, which produced a 7% gain. Several of our holdings rose in excess of 20%, including Cisco, Citigroup, GE and Western Digital.

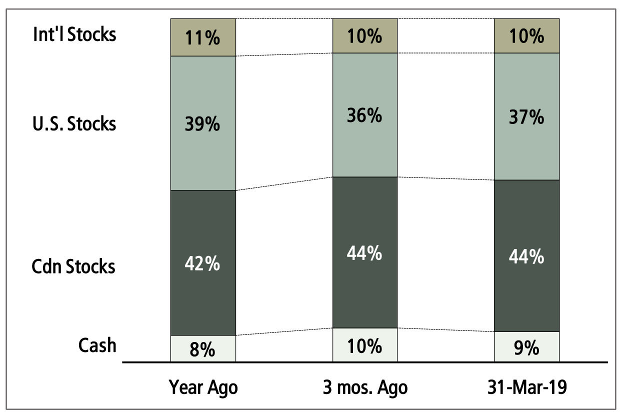
Our international holdings also participated in the first quarter rally, although to a somewhat lesser extent. The developed markets fund, EQIT, rose 9.9% this quarter and the emerging markets fund, EMEC, gained 7.9%.

At the end of the first quarter, the Fund's cash position was 9%. Our allocation to Canadian stocks was 44%, while U.S. stocks represented 37% of the mix. Our allocation to markets outside of North America remains at 10% reflecting our view that maintaining non-North American exposure will provide valuable diversification benefits to the Fund.

	Equity Fund	Cdn Stocks	U.S. Stocks	Int'l Stocks
Quarter				
Fund	10.4%	13.4%	10.6%	9.0%
Benchmark	*11.8%*	*13.3%*	*11.3%*	
One Year				
Fund	7.1%	10.0%	7.2%	-1.5%
Benchmark	*10.3%*	*8.1%*	*13.5%*	

Returns are presented before deduction of management fees. Benchmarks are (a) for the Fund: 5% FTSE TMX 91Day TBill, 50% TSX, and 45% S&P 500 (in C$) (rebalanced monthly); (b) for Cdn Stocks: TSX; and (c) for U.S. Stocks: S&P 500 (in C$).

Investment Returns – As at March 31, 2019



Equity Fund Asset Mix

Nexus North American Balanced Fund

The Nexus North American Balanced Fund generated a total return of 8.0% in the first quarter, trailing the 9.3% total return of the Fund's benchmark. In the last 12 months, the Fund has returned 6.9%, but lagged the benchmark return of 8.4%. From a longer-term perspective, our returns for the 2, 5 and 10-year periods remain at or above the benchmark and are very attractive on an outright basis.

More detail on the Fund's performance is shown in the table below.

Fixed income delivered surprisingly strong returns in the quarter with interest rates declining significantly in both the U.S. and Canada. The bond benchmark returned 3.9% in the quarter which surpassed the 2.7% return of the bonds in our portfolio. The top performing bonds in the quarter were longer-dated maturities and lower-quality credits. Nexus's bonds are underweight both of these categories, which led to the underperformance this quarter.

In equities, our Canadian stocks provided a significant tailwind with gains of 13.7%. Similarly, our U.S. holdings rebounded 10.6%. Returns were strong across the board, with every sector producing strong gains during the period. Many of our holdings were up more than 20% including Cenovus, Cisco, Citigroup, Encana, GE, Thomson Reuters, Toromont, TransCanada and Western Digital.

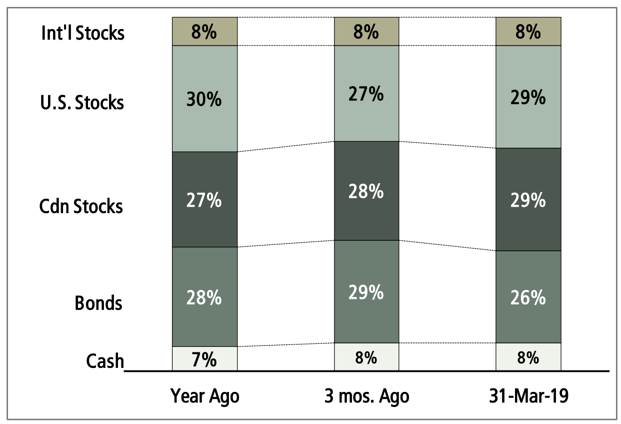
Our international holdings also participated in the first quarter rally, although to a somewhat lesser extent. The developed markets fund, EQIT, rose 9.9% this quarter and the emerging markets fund, EMEC, gained 7.9%.

At the end of the quarter, cash represented 8% of the Fund's asset mix, bonds were 26% and stocks accounted for the remaining 66%. These asset allocations continue to remain close to the Fund's long-term guideline.

	Balanced Fund	Bonds	Cdn Stocks	U.S. Stocks	Int'l Stocks
Quarter					
Fund	8.0%	2.7%	13.7%	10.6%	9.0%
Benchmark	*9.3%*	*3.9%*	*13.3%*	*11.3%*	
One Year					
Fund	6.9%	4.4%	11.0%	9.3%	-1.5%
Benchmark	*8.4%*	*5.3%*	*8.1%*	*13.5%*	

Returns are presented before deduction of management fees. Benchmarks are (a) for the Fund: 5% FTSE TMX 91 Day T Bill, 30% FTSE TMX Universe Bond, 40% TSX, and 25% S&P 500 (in C$) (rebalanced monthly); (b) for Bonds: FTSE TMX Universe Bond; (c) for Cdn Stocks: TSX; and (d) for U.S. Stocks: S&P 500 (in C$).

Investment Returns – As at March 31, 2019



Balanced Fund Asset Mix

Nexus North American Income Fund

The Nexus North American Income Fund produced a total return of 4.2% in the first quarter. This return compares to the 3.9% total return of the Fund's benchmark during the same period. In the last 12 months, the Fund has returned 6.2%, outperforming the benchmark return of 5.3%. From a longer-term perspective, our returns for the 2, 5 and 10-year periods remain near or above the benchmark and are very attractive on an outright basis.

More detail on the Fund's performance is displayed in the table below.

Our bond holdings produced a return of 2.7% in the quarter, underperforming the benchmark which returned 3.9%. Interest rates declined significantly in the period and the spread on corporate bond yields over government bonds of the same term narrowed significantly. These factors were responsible for the surprisingly strong absolute performance and the relative underperformance of the Fund's bond holdings.

We continue to structure the Fund's bond holdings with a high-quality and short-maturity emphasis. Despite causing underperformance in the quarter, this positioning reflects our outlook on interest rates and the current risk/reward profile of the fixed income market. Following the significant decline in interest rates (increase in bond prices) we sold some of our bond holdings. We intend to keep the proceeds invested in money market (cash) in anticipation of an opportunity to reinvest those funds at more attractive yield levels.

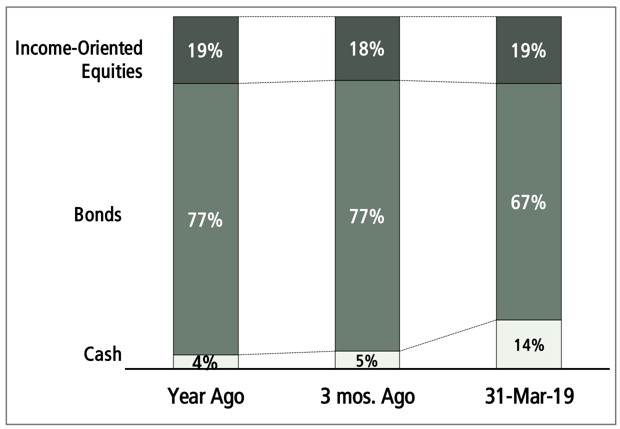
Our holdings of Income-Oriented Equities in Canada and the U.S. provided a tailwind to the Fund's performance this quarter. Specifically, our Canadian stocks were up 14.4% and our U.S. equities produced a 4.9% gain, both adding to the Fund's overall return.

At the end of the third quarter, the Fund's cash position was 14%, Income-Oriented Equities accounted for 19% and the balance, 67%, was in our core bond holdings.

	Income Fund	Bonds	Cdn Stocks	U.S. Stocks
Quarter				
Fund	4.2%	2.7%	14.4%	4.9%
Benchmark	*3.9%*	*3.9%*		
One Year				
Fund	6.2%	4.4%	16.2%	13.4%
Benchmark	*5.3%*	*5.3%*		

Returns are presented before deduction of management fees. Benchmarks are (a) for Fund: FTSE TMX Universe Bond; (b) for Bonds: FTSE TMX Universe Bond. In addition to bonds, up to 20% of the Fund's portfolio may be invested in equities.

Investment Returns – As at March 31, 2019



Income Fund Asset Mix

Nexus International Equity Fund

The Nexus International Equity Fund holds two underlying funds: EQIT (invested in international developed market equities) and EMEC (invested in emerging market equities).[11]

The Nexus International Equity Fund delivered a total return of 9.1% in the first quarter. This return compares to the 7.7% total return of the Fund's blended benchmark during the same period. Over the past year, the Fund declined 1.6%, trailing the benchmark which declined 1.0%. Longer-term returns for both EQIT and EMEC have been strong, with EQIT up 9.7% per year and EMEC up 14.7% per year over the past three years. More detail on the Fund's performance is presented in the table below.

International markets participated in the first quarter rally, although not to the extent seen in North American markets. While sentiment improved during the period, there were specific issues in international markets that constrained the rally.

The main issue was growing uncertainty about Brexit. There seems to be no easy way out for the UK; Prime Minister May was unable to gain consensus on her proposed Brexit deals which were roundly defeated several times. The paths forward now include "Exit" with a deal passing Parliament by May 22, a "Long Extension" to allow time to work out the details with the EU, or a "No Deal Exit".

Whatever the outcome, for now, European markets are wrapped in a tangled web of Brexit uncertainty.

Another key issues, and more pertinent to emerging markets, is the ongoing trade dispute between the U.S. and China. The on-again, off-again nature of the trade discussions have left markets in limbo as to whether a satisfactory deal can be reached. In the meantime, China's exports showed a remarkable drop of 21% in February compared with the same month last year. This was worse than what was expected by most economists and indicative of the potential disruption inherent in any major global trade spat.

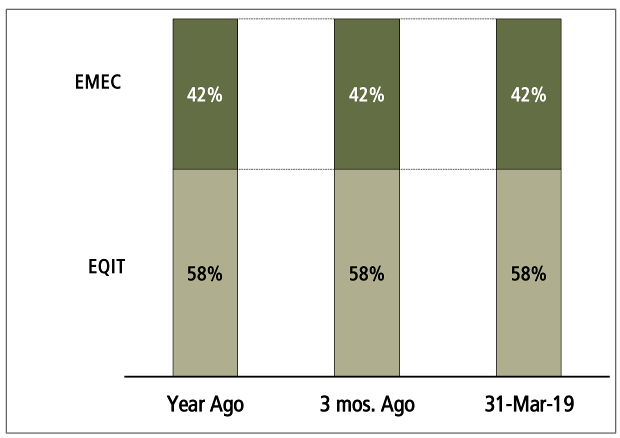
Despite the prevailing uncertainty around trade – whether between the UK and the EU or China and the U.S. – we continue to hold a positive view on the long-term prospects for our investments in EQIT and EMEC. Both funds are constructed with a bias towards quality, which we believe will reward investors over the long term, despite the near-term uncertainties around trade relationships. We continue to believe that, over time, the funds will deliver valuable diversification and growth benefits that are not available in North American markets.

At the close of the third quarter, the International Equity Fund's investment in EQIT accounted for 58% of the Fund's assets, while EMEC accounted for 42%.

	International Equity Fund	EQIT	EMEC
Quarter			
Fund	9.1%	9.9%	7.9%
Benchmark	*7.7%*	*7.7%*	*7.7%*
One Year			
Fund	-1.6%	-3.0%	0.0%
Benchmark	*-1.0%*	*0.0%*	*-3.9%*

Returns are presented before deduction of management fees. Benchmarks are (a) for Fund: 75% MSCI EAFE (in C$) and 25% MSCI Emerging Mkts (in C$) (rebalanced monthly); (b) for EQIT: MSCI EAFE (in C$); and (c) for EMEC: MSCI Emerging Mkts (in C$).

Investment Returns – As at March 31, 2019



International Equity Fund Asset Mix

[11] International developed markets or "EAFE" includes Europe, Australasia and the Far East. Emerging markets include 23 developing countries. EQIT and EMEC are managed by JPMorgan Asset Management in the UK. The Nexus Balanced and Equity Funds have held EQIT and EMEC for some time and continue to do so.