NEXUS

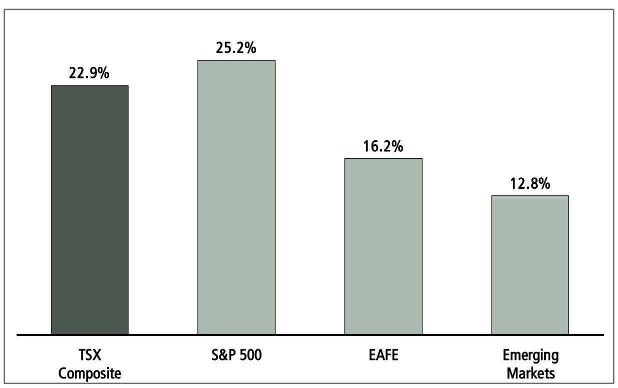
Portfolio Management & Financial Counsel

THE NEXUS REPORT

Fourth Quarter, 2019

Grand Finale to the Decade

A year ago, investors were licking their wounds following the worst December in U.S. stock markets since 1931. Many expected 2019 would be a difficult year, and pessimism abounded. Almost no one forecast that financial markets all over the world would soar, and those who stayed invested would prosper. In the U.S., the S&P 500 rose 29%; the NASDAQ rose 35%.[1] This was the best performance for the S&P 500 in six years, and one of the top years in decades. At the same time, interest rates fell, driving bonds prices higher, resulting in surprisingly handsome returns for fixed income investors. Other asset classes also boomed, with gold gaining 19% and even hog prices rising 17%! These strong gains were powered by the abrupt reversal of the U.S. Federal Reserve's monetary policy, and its subsequent three interest rate cuts. They also reflected, later in the year, a sense that economic growth in the U.S. and around the world was on a sounder footing, and that U.S.-China trade tensions were moderating.



2019 Stock Market Returns (Total Returns C$)

Gains were similarly strong elsewhere in the world as well. In Canada, the TSX Composite gained 19%; in Europe, the Stoxx Europe 600 rose 23%; and, in Asia, the Shanghai Composite was up 22%.[2]

Over the last decade, the U.S. was the clear winner in global stock markets. The S&P 500 had a total annual return of 16.0% in Canadian dollar terms,[3] vastly superior to the TSX return of 6.9% per year. Nonetheless, the past decade was only the fourth best in the last 100 years for U.S. stocks, and it comes after a truly terrible stretch from 2000 to 2009. In fact, the return on the TSX Composite remains slightly better than that of the S&P over the last 20 years, despite U.S. dominance over the last 10. The bottom line, as we will discuss below is that, despite the fabulous run for our U.S. investments over the last decade, the stock market south of the border has not reached a worrisome extreme.

Slow, but Steady, Growth

As the U.S. economy slowed through 2019, there was some debate whether it would slip into a recession. The current U.S. economic expansion is the longest on record and, eventually, all good things must come to an end. Over the last quarter, however, talk of an imminent recession seemed to fade and the U.S. economy ended the decade on a positive note. Interestingly, for the first time since the Civil War, a decade went by without the U.S. economy falling into a recession.[4]

From the outset, the U.S. labour market has been the engine of growth for the current expansion, and strong employment conditions remain in place. The December non-farm payroll report was slightly disappointing on its headline: 145,000 new jobs created compared to expectations for 160,000, and the growth of average hourly earnings softened to a 2.9% annual rate. However, the principal unemployment rate remained at 3.5% – a 50-year low – and U-6 fell to 6.7%, the lowest level since 1994. The U-6 is a broader measure of unemployment as it adds the underemployed to the unemployed. U-6 includes those who are working part-time because they can't find full-time work, and other marginally attached workers. Moreover, the December growth in payrolls caps a decade-long stretch of positive job growth, the longest such streak in the 80 years that the Bureau of Labor Statistics has been keeping data.

Strength in the consumer sector of the economy goes hand-in-hand with the strength in the labour market. As we've observed often in the past, consumer spending represents almost 70% of U.S. GDP. So long as Americans have jobs, they are likely to spend and economic growth is likely to continue. U.S. consumer confidence remains strong, and, over the last year, this confidence, combined with steady paycheques, has resulted in good auto and home sales, just to name two effects.

The great dichotomy in the U.S. economy is that corporate America does not appear nearly as sanguine

[1] Returns in this paragraph are price returns in U.S. dollars.

[2] These are price returns in local currency. In Canadian dollar terms, the Stoxx 600 and Shanghai Composite each gained 15%.

[3] The return in U.S. dollars was 13.6% per year.

[4] *Barron's*, December 20, 2019.

as the man in the street. In contrast with strong consumer confidence, CEO confidence is the lowest since 2009, likely undermined by trade tensions.[5] As well, the U.S. Institute of Supply Management's ("ISM") purchasing manager's survey reported early in the new year that the index fell to 47.2, compared to 48.1 in the prior month and expectations for 49.0. This survey has a long and credible record of providing useful insight into the likely path of future U.S. growth. Periods in which the survey result is above 50 are highly correlated with economic expansion. When the survey result falls below 50, it has historically been a reliable forecast of economic contraction. The ISM survey has hovered below 50 since August, reflecting clear concern in the corporate world about the prospects for growth. So far, this concern has not spread to the consumer and our optimism about U.S. economic growth depends on it staying that way.

U.S.-China trade tensions captured a lot of economic commentary over the last year, so the expectation that these two countries will sign a "phase 1" trade deal in mid-January is good news. The details of this deal remain somewhat vague, and we feel that skepticism around substantive resolution of big trade issues remains appropriate. However, even a little positive news is good news and, if continued progress can be made on the U.S.-China trade file and corporate confidence is improved, U.S. economic conditions could well turn out to be better than expected. At the moment, however, it seems like expectations for a tepid 1.5% increase in U.S. GDP for 2020 are sensible.

Canada Slowing Noticeably

In contrast with the robust first half of 2019, Canadian economic growth weakened considerably in the closing months of the year. The latest reports on GDP growth show it trending lower, and economists expect it may be below 1% in the fourth quarter – barely above stall speed.[6] Additionally, manufacturing is weak, and consumer confidence hit its lowest level of 2019 in December.

As in the U.S., the labour market remains supportive. December job gains were strong, with 35,000 new hires. Moreover, all the job gains were full-time and in the private sector (i.e., they were higher-quality jobs). The Canadian unemployment rate fell from 5.9% to 5.6%. Not quite at the low, but certainly at a level one would describe as "full employment". In total, 320,000 new jobs were created in 2019, making it one of the best years for job creation in a decade.

While the jobs report seems at odds with the weakness in other economic statistics, there are some underlying trends that are not quite as robust as the headline implies. To start, the 320,000 new Canadian jobs were highly concentrated in Ontario (243,000 of them) and, to a lesser extent, Quebec. Alberta and Newfoundland were notably weak, and most other provinces saw little improvement. Moreover, when one considers the December job gain next to the 71,000 employment decline in November (worst in a decade), and the weak report in October, the three month rolling employment trend has clearly weakened. Canada may well avoid recession, but growth is likely to be disappointing.

Investment Outlook

Our expectation is that modest economic growth will lead to corporate earnings being a bit better in 2020 than they were in 2019. This should support stock markets in Canada and the U.S. and drives a cautiously optimistic outlook. However, market valuations today are materially higher than they were a year ago. As we begin 2020, the S&P 500 trades at 18.3x forward earnings, as compared to 15.6x 12 months ago.[7] We've gone from a world where stocks were priced reasonably compared to long-term averages, to a world where they are a little expensive. S&P earnings in 2019 will likely be a little lower than they were in 2018, so all of the 2019 gain came from valuation multiple expansion. While current valuations are not extreme, it would be unreasonable to expect them to go higher. Stock gains will need to come entirely from earnings growth.

This does not preclude perfectly satisfactory investment returns in 2020. But it does mean that stocks are more exposed to negative surprises than they were before. There is less margin for error. Turmoil in the Middle East, a U.S. Presidential impeachment, or reignited trade tensions all could undermine capital markets. We can't possibly predict what will happen, but we have portfolios positioned for what could happen. We are invested in companies that should prosper when times are good, but also have the resilience to withstand the turbulence that impacts markets from time-to-time. We remain confident that this investment approach will serve clients well over the long term.

[5] *Barron's*, January 13, 2020.

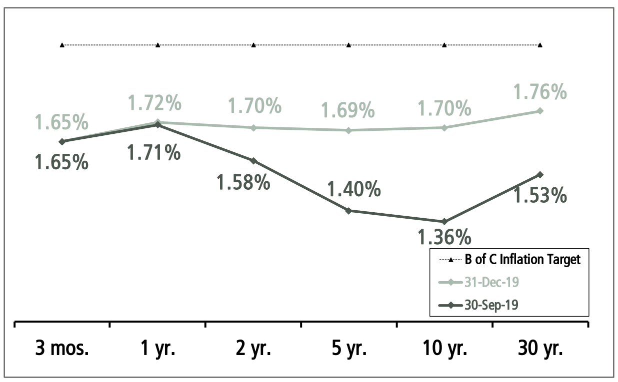
[6] Derek Holt, Scotiabank Economics, January 10, 2020.

[7] *Barron's*, December 30, 2019.

Asset Class Investment Review

Fixed Income

After falling in the previous quarter, interest rates reversed course and moved higher this quarter. Two-year yields inched up 12 basis points (from 1.58% to 1.70%), while 10-year yields rose 34 basis points (from 1.36% to 1.70%) – see chart. With government bond yields well below the rate of inflation, the continued demand for fixed income owes largely to its role as a safe haven in dangerous times. But in the last quarter, there was a modest improvement in sentiment about the geo-political outlook. As the trade war between China and the U.S. reached some form of interim resolution, and the British election generated a clear majority for the Conservatives, investor concerns faded, and the appeal of low-yielding, ultra-safe fixed income diminished.



Government of Canada Yield Curve

After a strong economic performance early in 2019, the Canadian economy seemed to decelerate in the second half, and this was especially so in the fourth quarter. The CFIB Business Barometer cooled throughout the year and closed at its weakest level in December. In aggregate, business investment has been very disappointing, but this masks a divide between a very gloomy environment in the West and a more positive outlook in Ontario and Quebec. And, while the employment picture has been broadly supportive of the consumer, the consumer has been burdened by high debt loads – owing mostly to housing-related debts. Despite having the highest policy rate in the G7, the Bank of Canada made no changes to the Bank Rate all year and has consistently delivered a message that interest rates at current levels are stimulative. Future cuts seem unlikely – due mostly to the worry that they could trigger an increase in housing prices and lead to even higher consumer borrowing. At its most recent rate setting meeting on December 4th, the Bank left rates unchanged and confirmed a wait-and-see approach to incoming data. As we think of what 2020 holds, we do not expect central banks, especially the Bank of Canada, to make major policy changes.

We made little change to our portfolio positioning in the fourth quarter. We remain concentrated in shorter-maturity securities and higher-quality issuers. The duration of our portfolio is 3.6 years as compared to the FTSE Canada Universe Bond Index of 8.0 years. On the credit front, 80% of our holdings are rated AA or better and only 2% of our holdings are in BBB-rated securities.[8]

Considering interest rate levels at the beginning of 2019 (2-year yields at 1.87% and 10-year yields at 1.97%), we have once again been surprised at the strong return from holding fixed income. The FTSE Canada Universe Bond Index returned 6.9% due to both a decline in the yields of longer-term bonds, and the tightening of spreads between Canada bonds and bonds issued by corporate and Provincial entities. We expect future returns to be much lower than those in 2019.

With bond yields rising last quarter, returns were negative for most fixed income securities. However, our shorter duration portfolio delivered excellent relative returns. The bond return in our Income Fund was minus 0.1% for the quarter while the FTSE Canada Universe Bond Index lost 0.8%. Over the year, our holdings returned 4.6%, which trailed the 6.9% return of FTSE Canada Universe Bond Index for the same period.

Equities

The fourth quarter was a good one for equity investors and capped a very strong year. The Equity Fund returned 4.3% in the quarter, a snick behind the 4.7% return for the market benchmark. For the past twelve months, the Equity Fund returned 23.0%, in line with the 22.8% return for its benchmark.[9]

[8] Returns and credit information are for the bond portion of the Nexus North American Income Fund, which acts as the model for all bond portfolios at the firm.

[9] 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.

The long-term average annual return from equities is in the high single digits, so equity investors in 2019 received more than two years' worth of "normal" returns. This is a pace which simply cannot continue. Recall that equity markets in 2018 had a negative return, so the Equity Fund's two-year trailing return of 9.8% per year puts it in the "normal" range.

Canadian Equities

Nexus's Canadian stocks returned 1.6% in the quarter, behind the 3.2% return from the TSX Composite. For the twelve months, our Canadian stocks returned 22.6%, largely in line with the TSX's 22.9% return.

The quarter turned out to be "pro-cyclical" in Canada. As our portfolio has a stronger representation in the less cyclical sectors, such as Real Estate, Utilities and Consumer Staples, and less in cyclical sectors, such as Materials and Energy, our sector positioning was the main driver of our Canadian equity underperformance. This same positioning has helped us over longer time periods. Our Industrial and Communication Services holdings did well. Toromont and Finning, two Caterpillar dealers, each returned about 10% in the quarter. TELUS returned 8%, in part due to news that it is buying a German business-services company that it will integrate with its own services division and intends to eventually spin-off as a separate entity.

The Canadian banks had a poor quarter, with our three holdings down between 3% and 6%. Investors are fretting about the banks' profit outlook, given low economic growth, squeezed net interest margins and Canadian consumers' high debt levels. Historically, the Canadian banks have managed their credit risks quite well and their current valuations are muted, so we remain comfortable with our holdings.

During the quarter, we sold our holding in Thomson Reuters. This had been a long-term position in our portfolios and, although we still like the company, we feel that it has become optimistically valued.

U.S. Equities

The fourth quarter performance of our U.S. equity portfolio was strong, returning 7.8%, ahead of the S&P 500's 7.0% return.[10] For the twelve months, our U.S. portfolio returned a blistering 31.4%, ahead of the S&P 500's 25.2%.

After an extended period of weakness, the Canadian dollar strengthened in 2019. For the year, his strength has reduced our U.S. equity returns by 6.3 percentage points from what they would have been if measured in U.S. dollars (but over most longer periods, the Canadian dollar has weakened and added to our non-Canadian equity returns).

In the quarter, our strongest performing sectors relative to the S&P 500 were our Financial and Industrial holdings. Detractors from performance in the quarter were our Healthcare and Consumer Discretionary holdings.

The strongest individual contributors were Apple, with a 31% return, GE with 25%, and then JPMorgan and Citigroup, each with high-teen returns (these individual stock returns are in US dollars). Facebook, a holding that was added in early 2019, returned 15% in the quarter.

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).[11]

Some of the global headwinds for our international holdings appear to have peaked, specifically trade tensions and Brexit – at least until next week's tweets, anyway! Recent negative events in the Middle East have not, as yet, flowed through to the equity markets, but this remains a risk. EQIT was up 6.9% in the quarter and a very strong 22.0% for the year. EMEC returned 9.4% in the quarter and 18.1% for the year. Their combined 2019 return of 20.3% was a bit behind the overall North American equity market, but substantially ahead of the combined international benchmark of 15.3%. Notwithstanding the strong returns, the valuations of these holdings remain attractive. For more information on EQIT and EMEC, please see the Nexus International Equity Fund section of this report.

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

[11] Both funds are managed by teams from J.P. Morgan Asset Management in London, England.

Pooled Fund Reports

Nexus North American Equity Fund

The Nexus North American Equity Fund generated a total return of 4.3% in the fourth quarter. This compares to the 4.7% total return of the Fund's benchmark during the same period. For 2019, the Fund has returned 23.0%, in line with the benchmark return of 22.8%. From a longer-term perspective, our returns remain attractive on an absolute basis and above the benchmark in most measurement periods.

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

In Canada, the equity market gained 3.2% in the quarter. Our Canadian holdings underperformed, delivering a 1.6% return. The quarter was a "pro-cyclical" one that favoured the more cyclical sectors. Our portfolio emphasizes more stable sectors such as Real Estate, Utilities and Consumer Staples, which were relative underperformers in the quarter. We note that this same positioning has helped out returns over most longer periods.

In the U.S., the equity market gained 7.0% (in Canadian dollar terms) in the quarter. Our U.S. holdings outperformed, generating a 7.8% return. Many of our stocks did well, with six producing double digit returns (especially Apple, JPMorgan, Citibank and Facebook). These outweighed the few that declined (Cisco, General Motors, and Dollar General).

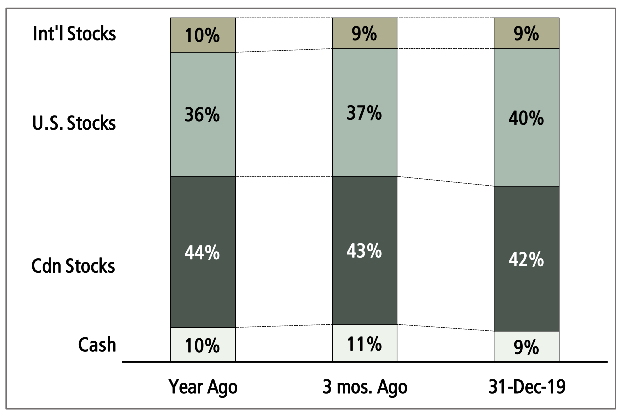
Our international holdings experienced strong performance in the quarter. The developed markets fund, EQIT, gained 6.9% and the emerging markets fund, EMEC, gained 9.4%.

At the end of the quarter, the Fund's cash position was 9%. Our allocation to Canadian stocks was 42%, while U.S. stocks represented 40% of the mix. The remaining 9% is allocated to geographies outside of North America, which expresses our view that exposure to international markets will provide long-term diversification benefits to the Equity Fund.

	Equity Fund	Cdn Stocks	U.S. Stocks	Int'l Stocks
Quarter				
Fund	4.3%	1.6%	7.8%	8.0%
Benchmark	*4.7%*	*3.2%*	*7.0%*	
One Year				
Fund	23.0%	22.6%	31.4%	20.3%
Benchmark	*22.8%*	*22.9%*	*25.2%*	

Returns are presented before deduction of management fees. Benchmarks are (a) for the Fund: 5% FTSE Canada 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 December 31, 2019



Equity Fund Asset Mix

Nexus North American Balanced Fund

The Nexus North American Balanced Fund generated a total return of 3.1% in the third quarter. This return compares to the 2.8% total return of the Fund's benchmark during the same period. For 2019, the Fund has returned 17.3%, in line with the benchmark return of 17.5%. From a longer-term perspective, our returns remain attractive on an absolute basis and above the benchmark in most measurement periods.

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

Fixed income markets declined during the quarter, with the bond benchmark declining 0.8%. Our bonds declined by 0.1% in the period, outperforming the benchmark. Nexus's bond holdings continue to have an average maturity date that is well below that of the benchmark. This positioning resulted in the outperformance seen this quarter.

In equities, we recorded a small gain in Canada (1.2%) and strong gains in the U.S.(8.1%) during the quarter. It was a "pro-cyclical" quarter in Canada, so our higher-quality emphasis, which has benefitted us over longer periods, lagged the TSX composite in the quarter. Our U.S. equity portfolio outperformed the S&P 500, with the majority of our U.S. holdings, especially Apple and General Electric, doing well.

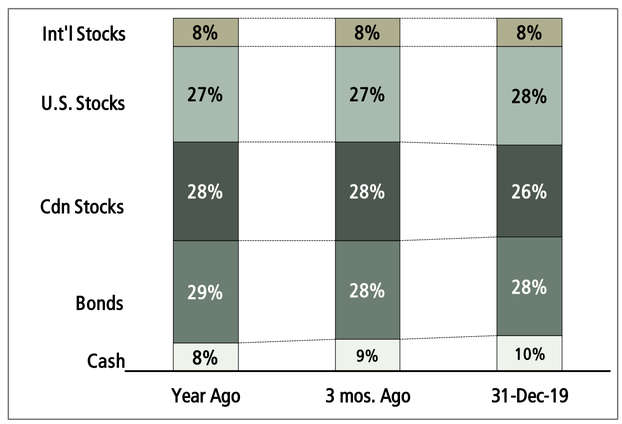
Our international holdings provided a tailwind to performance in the quarter. The developed markets fund, EQIT, gained 6.9% and the emerging markets fund, EMEC, gained 9.4%.

At the end of the quarter, cash represented 10% of the Fund's asset mix, bonds were 28% and stocks accounted for the remaining 62%. 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	3.1%	-0.1%	1.2%	8.1%	8.0%
Benchmark	*2.8%*	*-0.8%*	*3.2%*	*7.0%*	
One Year					
Fund	17.3%	4.6%	23.0%	31.0%	20.3%
Benchmark	*17.5%*	*6.9%*	*22.9%*	*25.2%*	

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

Investment Returns – As at December 31, 2019



Balanced Fund Asset Mix

Nexus North American Income Fund

The Nexus North American Income Fund produced a total return of 0.6% in the fourth quarter. This return compares to the 0.8% decline of the Fund's benchmark during the same period. For 2019, the Fund has returned 7.8%, surpassing the benchmark return of 6.9%. From a longer-term perspective, our returns remain attractive on an absolute basis and above the benchmark in most measurement periods.

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

Fixed income markets suffered on account of rising interest rates, with the bond benchmark declining 0.8% in the quarter. Our bonds declined 0.1% in the period, outperforming the benchmark. Nexus's bond holdings continue to have an average maturity that is well below that of the benchmark. This positioning resulted in the outperformance seen this quarter.

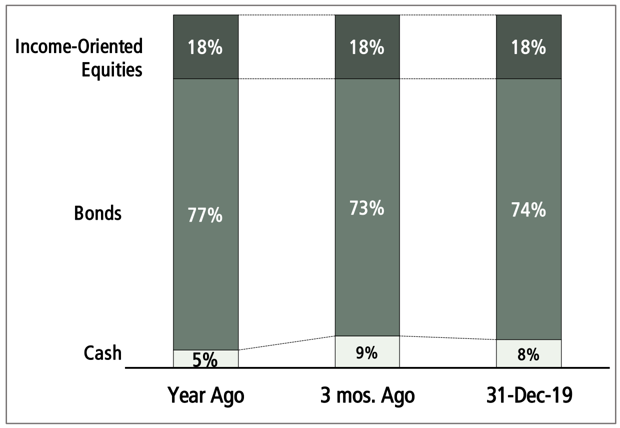
Our holdings of income-oriented Canadian equities provided slightly positive returns this quarter, gaining 0.6%, while our U.S. equities were a major tailwind, with returns of 11.9% (in Canadian dollars).

At the end of the fourth quarter, the Fund's cash position was 8%, income-oriented equities accounted for 18% and the balance, 74%, was in our core bond holdings.

	Income Fund	Bonds	Cdn Stocks	U.S. Stocks
Quarter				
Fund	0.6%	-0.1%	0.6%	11.9%
Benchmark	*-0.8%*	*-0.8%*		
One Year				
Fund	7.8%	4.6%	25.3%	24.9%
Benchmark	*6.9%*	*6.9%*		

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

Investment Returns – As at December 31, 2019



Income Fund Asset Mix

Nexus International Equity Fund

The Nexus International Equity Fund ("NIEF") holds two underlying funds: EQIT (invested in international developed market equities) and EMEC (invested in emerging market equities).[12]

In the fourth quarter, NIEF gained 7.9% compared to the 7.0% gain of the Fund's blended benchmark. Over the past year, the Fund has returned 20.3%, significantly outpacing the benchmark return of 15.3%. Longer-term returns for both EQIT and EMEC have also been attractive, with EQIT up 10.0% per year and EMEC up 14.3% per year over the past three years.

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

The strong performance in international developed markets was driven by the partial resolution of two significant overhangs. First, the U.K. election delivered some welcome clarity around Britain's plans to leave the European Union. Boris Johnson's pledge for a swift Brexit was welcomed by voters and the financial markets alike. Second, there was positive anecdotal evidence that the U.S.-China trade dispute is thawing. If the two nations can achieve a trade détente, markets expect this to grease the gears of global commerce and help lift economic growth.

Emerging market (EM) equities also benefitted in the quarter from the apparent easing of global trade tensions. As progress is made on reducing the strains between the global trade behemoths, smaller emerging economies should see a commensurate benefit to their trade activity. However, selectivity remains critical to successful investing in these markets. The manager of the fund focuses on companies with clear competitive advantages, strong balance sheets and growth opportunities in their end markets, which we see as a compelling long-term approach to EM investing.

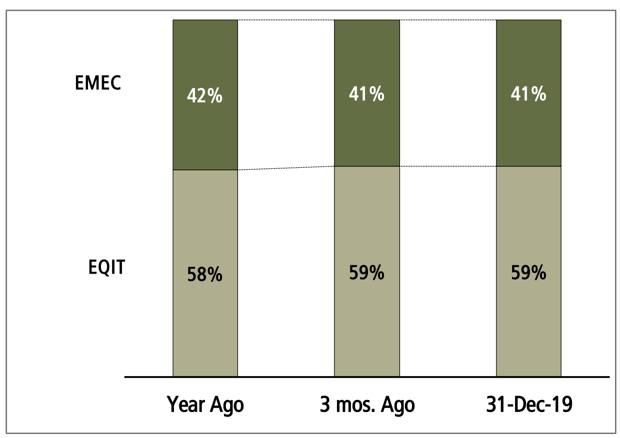
Over the long term, we expect that our international investments will generate attractive returns. By investing outside of North America, we gain access to companies operating in fast-growing economies — particularly in emerging markets — that offer the prospect of above-average profit growth. In addition, our investments in both international developed markets and emerging markets are available at discounted valuations and provide important diversification benefits to our portfolios.

At the close of the fourth quarter, the International Equity Fund's investment in EQIT accounted for 59%, while EMEC accounted for 41%.

	International Equity Fund	EQIT	EMEC
Quarter			
Fund	7.9%	6.9%	9.4%
Benchmark	*7.0%*	*6.1%*	*9.7%*
One Year			
Fund	20.3%	22.0%	18.1%
Benchmark	*15.3%*	*16.2%*	*12.8%*

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 December 31, 2019



International Equity Fund Asset Mix

[12] International developed markets or "EAFE" includes Europe, Australasia and the Far East. Emerging markets include 26 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.