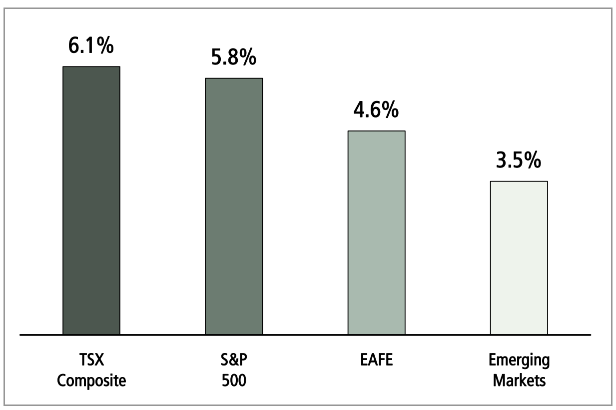
Good Times Keep Rolling

After such great returns in 2013, many investors worried they were due for more challenging times in 2014. Such has not been the case!

During the past three months the TSX Composite Index climbed 6.1% (on a total return basis) as Canadian investors factored in the positive benefits to earnings from a weaker loonie and better growth in the U.S. While the S&P 500's 5.8% total return (in Canadian dollars) was almost as good, the majority of this return came from currency as the U.S. dollar strengthened another 3.8% against the Canadian dollar.[1] Moreover, the S&P 500 return was volatile – it started the year with the index declining 5.8%, but subsequently rallied 7.1% to finish the quarter in the black.[2]

Returns in international equity markets also were generally strong. As in the U.S., emerging markets started the quarter with a decidedly negative tone, but recovered strongly in February and March.



Total Returns (C$) for 3 Months Ended March 31, 2014

Since quarter end, uncertainty again returned to the equity market, although the greatest drama has been reserved for those stocks that soared the most through 2013. Companies like Facebook and Twitter (and other high-flying technology and biotech names), whose stock prices rose to levels that are difficult to understand in the context of conventional economics, have experienced a sharp pull-back as a more realistic outlook seems to have taken hold. Higher quality, more sensibly valued companies (such as Nexus favours) have exhibited greater stability.

[1] In U.S. dollar terms the S&P 500 generated a total return of 1.8%.

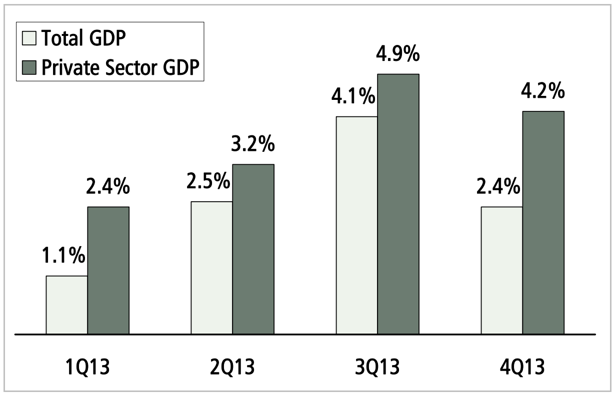
[2] Index price only returns in US$.

A Winter of Discontent

No one denies that the winter of 2014 was epic. Large parts of the eastern U.S., all the way down to Atlanta, experienced cold weather and storms that closed schools and businesses repeatedly through January and February. It was very disruptive to economic activity. The result was a series of soft reports on the U.S. economy, with disappointments in the ISM Purchasing Managers Index, retail sales, and employment. Three months ago we outlined our belief that the U.S. economic recovery had accelerated, and our expectation that economic conditions would be solid in 2014. The key question for investors is whether the soft reports in the first quarter were simply the result of weather, or if the long-awaited improvement has come off the rails?

We believe that the weakness observed in January and February was due to the weather and that the better economic performance we expect has simply been delayed. The U.S. labour market report for March lends some support to this view. The addition of 192,000 jobs in March was roughly in-line with expectations, consistent with a more robust outlook, and the data for January and February were revised higher. March also marked the first time since early 2008 that the U.S. reached a new high-water mark for total employment. During the recession 8.8 million jobs were lost, and it wasn't until last month that they all were replaced. There is still work to be done as the work force has since expanded by 2 million. But crossing this threshold is symbolic of progress. As well, the "participation rate" improved in March, suggesting that some people who had previously given up searching for a job have now gained enough enthusiasm about their prospects to re-enter the work force.

A careful analysis of U.S. economic growth in 2013 provides further cause for optimism. We believe the fundamental trends are more positive than the headlines suggest. Recall that during 2013 the U.S. government stumbled from one crisis to the next. First, there was the "Fiscal Cliff", then "sequestration" that resulted in across the board spending cuts, and finally the federal government shutdown in October. Each of these events had a significant negative impact on economic growth. If one looks strictly at private sector growth, it actually was quite a strong year. The chart on the following page depicts the difference between headline GDP growth and private sector GDP growth, the difference being the headwind from government turmoil.



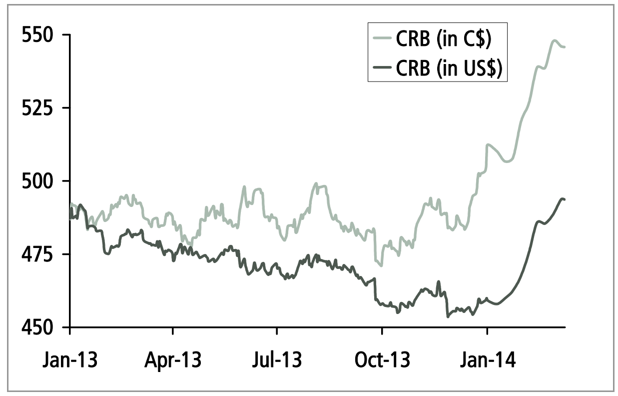
Private vs. Total U.S. GDP Growth [3]

Hope for Canada

Notwithstanding the Canadian stock market's strong showing in the first quarter, economic growth remains more subdued than that south of the border. We have described the Canadian economy as "muddling along" in the past, and that remains an accurate characterization. Job growth is weak, with only 100,000 new full-time jobs created since 2012. The March labour market report released in early April stirred a moment of hope, but the headline figure of 42,900 new jobs proved to be not quite what it seemed. A measly 3,000 jobs were high-quality full-time jobs in the private sector, while 30,000 of the jobs were part-time. Moreover, the vast majority of all jobs created in the last year were in Alberta. Most other provinces are losing jobs. In short, GDP is growing fast enough to keep unemployment from rising, but not fast enough to cause it to improve. Perhaps that is the definition of muddling along.

As we think about the balance of 2014, however, several factors suggest Canadian economic performance may be set to improve. Most important of these is the impact from the decline in our dollar. Canada is an export-oriented economy, so a weaker currency means that the goods we sell abroad in foreign currencies translate into more Canadian dollars at home. The chart to the right above is meant simply to show the powerful impact of the change in foreign exchange rates. The dark line is an index of commodity prices tracked by the Commodity Research Bureau in U.S. dollars. The lighter-coloured line is the same index denominated in Canadian dollars. If you are a Canadian company producing oil or coal, or other exports, the benefit is obvious.

While it will be less immediate and less dramatic, we also expect improving conditions in the U.S. economy – our largest trading partner – will help. Stronger demand from south of the border, coupled with a weaker loonie, could be just the tonic we've been waiting for.



CRB Commodity Price Index [4]

The Road Ahead

Three months ago we outlined our positive outlook for continued upward momentum in markets. We still hold the same optimism about corporate earnings going forward. Specifically, as economic conditions improve in both Canada and the U.S. we think the positive impact this will have on earnings may be underestimated by many investors. While the fundamentals remain solid, however, it would not be reasonable to expect that stock prices will continue to rise at the same pace. We, and most investors, were surprised by how vigorously markets continued to climb in the first quarter. Mean reversion is perhaps the most powerful force in the investment world. We are optimistic that markets could be higher at year end, but extrapolating their current path is almost certainly too optimistic.

We also are mindful that there are many unquantifiable risks that could be disruptive to investors. Not long ago, we worried about the "Arab Spring", Iran, and North Korea. Today, the situation in Crimea dominates the headlines. A month ago, Canadians were anxious about the prospect of a Quebec referendum. Thanks to the spectacular implosion of the Parti Québécois, however, that is now off the table.

In the uncertain world in which we live, investment success derives from an approach that contemplates the range of outcomes that *could* happen rather than making a heavy bet on the outcome that *should* happen. By focusing on quality and insisting on a margin of safety in everything we buy, we are confident that the success Nexus has enjoyed in the past should continue long into the future.

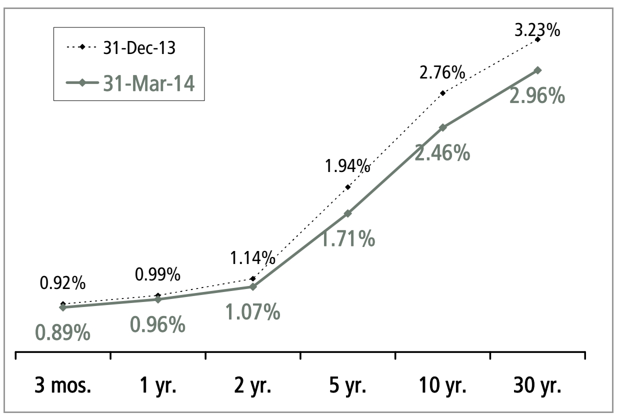
[3] Source: Bureau of Labor Statistics, RBC.

[4] Source: Bloomberg.

Asset Class Investment Review

Fixed Income

In the first quarter of 2014, the bond market staged a rebound from where it had closed 2013. The general level of interest rates declined modestly, as indicated in the chart below, and spreads of both corporate and provincial securities continued to contract. As a result of this combination of further spread tightening and modest interest rate declines, the DEX Universe Bond Index (DEX) produced a positive return of 2.8% in the quarter. Our bond returns, using the bonds in our Nexus North American Income Fund as a proxy, lagged the DEX return slightly with a return of 2.5%. For the last 12 months, our bond holdings fared better, with a return of 2.0%, compared to an increase of only 0.8% for the DEX.



Government of Canada Yield Curve

Compared to many other periods, this was an uneventful quarter in the bond markets. As much as any, fixed income markets are reasonably complex and lend themselves to in-depth analysis. However, of late, it seems that investors in the bond market have been preoccupied with just two main concerns.

The first concern, believe it or not, was the weather. The issue for bond investors was the degree to which the softening of construction activity and new hiring, as well as the weakness in many measures of consumer and business sentiment and activity was weather-related, and thus temporary, or was, instead, the result of more fundamental factors. We are firm believers that the weaker readings of economic activity are entirely attributable to a harsh winter. As spring arrives, we expect a substantial pick-up in economic activity in both the U.S. and Canada. In our estimation, stronger economic activity will eventually lead to a normalization of interest rates. Accordingly, the duration of our portfolio is 5.0 years, which is considerably shorter than the 6.9 year duration of the DEX.

One of the new unconventional tools that central bankers use for management of the financial system has been "forward guidance" – the sharing of how central bankers expect they'll react to future economic developments. Accordingly, the second area of investor focus this quarter has been on the new leadership of the U.S. Federal Reserve and, to a slightly lesser degree, at the Bank of Canada.

Under the leadership of Ben Bernanke, the Federal Reserve had instituted extraordinarily aggressive monetary policies which have been the foundation on which much of the global economic recovery has been built. In December, prior to stepping down after eight years as Chair, Governor Bernanke had begun the process of reducing the amount of quantitative easing that the Fed was supplying to the market. Investors spent much of this last quarter musing about whether his successor, Janet Yellen, would continue the policy of gradually reducing monetary stimulus and eventually normalizing rates.

In Canada, while Governor Poloz has been on the job longer (since June 2013), investors have detected that he is less concerned with a weakening of the Canadian dollar, more concerned with inflation below the Bank's target level and thus more "dovish" than his predecessor, Governor Carney. In our opinion, this "take" on Governor Poloz is accurate. The Bank of Canada has explicitly adopted a more neutral interest rate policy from its previous bias toward an eventual tightening of the monetary system.

On the other hand, while Governor Yellen has often been described as a "dove" on interest rates, should the recovery gain traction, we think that she will be quite comfortable steering interest rates back to more normal levels. As a result, our opinion for the direction of rates has not changed. Eventually, a stronger U.S. economy will lead to an acceleration of economic activity in Canada and result in higher Canadian and U.S. interest rates.

Equities

The year has started well for equity investors, with all the markets we invest in having a positive return for the first quarter. As an indicator, our Equity Fund was up 5.0% for the quarter and 20.1% over the past twelve months.[5]

Market valuation levels in North America are no longer cheap. But we don't think they are unduly expensive either. While anything can happen in the short term, we remain confident in the long-term prospects for our quality-oriented portfolio.

We added to a range of our existing equity holdings during the quarter, but there were no outright sales or new buys.

Canadian Equities

The Canadian equity market has continued its recent hot streak. Our Canadian stocks were up 5.4% over the quarter and 17.9% for the past twelve months. This was slightly behind the TSX Index for the quarter and outperformed the TSX Index's 16.0% return over the twelve months.

Energy was the strongest performing sector of our Canadian portfolio over the quarter. All our Canadian energy holdings were up, but Encana stood out – up 23%. Doug Suttles, the new CEO at Encana, is having a positive impact with a more focussed strategy. This has included a downsizing of the workforce, a dividend cut, non-core asset sales and strengthening the balance sheet. Collectively, we think this puts the company on a better footing.

Another notable performer in the quarter was Finning International, the Caterpillar dealer for Western Canada, the U.K. and the southern cone of South America. It, too, has had a recent change in management. While Scott Thomson took over as CEO in mid-2013, his plans to improve Finning's return on invested capital have been communicated to investors more recently and have been well received. The improvements are operationally focussed, including supply chain improvements, more efficient use of Finning's assets and more effective servicing of customers' equipment.

U.S. Equities

Our U.S. equity portfolio returned 6.6%[6] in the quarter and 30.7% for the twelve months, slightly ahead of the S&P 500 in the quarter, and slightly behind the index's very strong 32.6% return for the twelve months. For the quarter, the bulk of the return resulted from a weakening of the Canadian dollar. In US dollars, price performance was mixed, with 8 of our 16 stocks trading down and 8 trading up. In microcosm, this reflects what has been going on in the U.S. Mixed economic data and higher valuation levels for U.S. stocks were a general dampener, while some of our holdings, especially in healthcare and the lower-valuation technology stocks did well.

As a carryover of a theme from 2013, our U.S. technology and healthcare holdings performed especially well in the quarter. "Value-tech", that is the larger, more attractively priced technology stocks in the U.S. have done well. Hewlett-Packard, Microsoft and Western Digital each returned more than 10% in the quarter. These holdings, along with Cisco and Apple, remain attractively valued. Amongst our healthcare holdings, four out of five traded up in the quarter, as these stocks continue to benefit from varying combinations of an aging population, new products, reasonable valuations and the implementation of Obamacare.

Other Equity Investments

We continue to carry two non-North American holdings within our Balanced and Equity Funds, which add beneficial diversity and potentially higher growth. These are two externally-managed pooled funds called EQIT (international developed market equities) and EMEC (international emerging market equities). Returns from both of these holdings have been assisted over the course of the past year by the weakening of the Canadian dollar.

EQIT was up 2.9% for the quarter and 23.5% for the twelve months. For the twelve months, EQIT's strength was broad based across most European countries and Japan.

It was another recovery quarter for EMEC, which returned 4.4% for the period, but was up just 5.5% for the twelve months. We remain confident in EMEC's high quality-orientation within emerging markets and its long-term prospects. Despite higher growth, the emerging markets index trades at just 10.5x forward earnings and carries a dividend yield of 2.7%. For context, the S&P 500 trades at 15.3x forward earnings and has a dividend yield of 2.0%.

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

[6] All U.S. and International returns are measured in Canadian dollars.

Pooled Fund Reports

Nexus North American Equity Fund

2014 began strongly for investors in our Nexus North American Equity Fund. All areas of the portfolio performed well, although some of the strength in returns owed to a depreciation of the Canadian dollar which had the effect of amplifying the returns of investments in U.S. and other foreign markets. In the quarter the Equity Fund managed an advance of 5.0%, which trailed the 5.6% advance of the Fund's benchmark.

Geographically, all markets contributed in a reasonably balanced fashion. In Canada, our holdings increased 5.4%, but trailed the TSX Index which rose 6.1%. In the U.S., our holdings advanced 6.6%, bettering the 5.8% generated by the S&P 500 in Canadian dollars. The allocation outside North America produced positive, but less favourable results. The EQIT Fund, which invests internationally in developed markets such as Europe and Japan, returned 2.9%, suffering from the shadow cast over markets by the situation in the Ukraine as well as apprehension about the economic effect of a pending sales tax hike in Japan. After beginning the year with a significant negative return, our position in the EMEC Fund, which invests in emerging markets, came roaring back in February and March, generating a 4.4% return for the quarter. EMEC is a small position (4.2% of the Fund's portfolio) and the long-term rationale for holding it remains intact. A more detailed explanation of developments in equity markets appears earlier in the Asset Class Review – Equity section of this report.

As we look ahead, it is clear that equity markets have come a long way in the past few years and that valuations are not as cheap as they were. However, we believe that the U.S. recovery is gaining steam and that investors will be surprised by the earnings power of companies exposed to a cyclical economic recovery. There is a lot of "smart talk" from commentators about the likelihood of a correction – suggesting that being reasonably fully invested as the Fund is, is actually somewhat contrarian at this point.

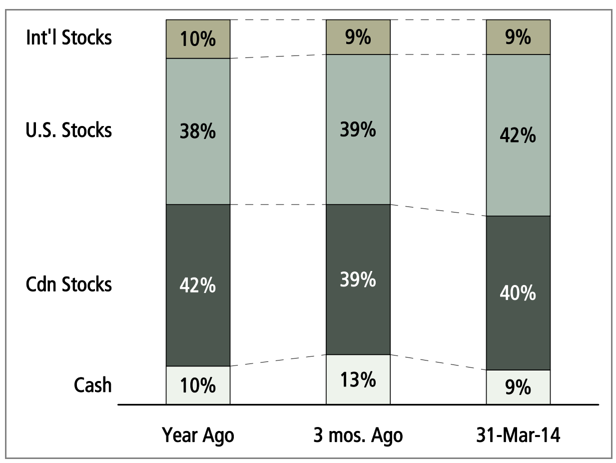
Reflecting this underlying confidence and the investment appeal of many of our present holdings, we reduced our cash position early in the quarter – taking it from 13% to 9%. It still is higher than target and we are willing to put it to work as we find new investments that we feel have long-term appeal. Our allocation to Canadian stocks (40%) and U.S. stocks (42%) remains roughly equal and we have slightly more than 9% invested outside of North America through our holdings of EQIT and EMEC.

Returns for longer periods continue to be excellent. The Fund has returned 20.1% in the last twelve months, which almost kept pace with the blistering 22.5% return of our benchmark. More importantly, the Fund has provided an annual average return of 8.6% for the last 10 years, a substantial increment above the 6.9% return from the benchmark. More detail of the Fund's performance is laid out in the table below.

	Equity Fund	Cdn Stocks	U.S. Stocks	Int'l Stocks
Quarter				
Fund	5.0%	5.4%	6.6%	3.8%
Benchmark	*5.6%*	*6.1%*	*5.8%*	
One Year				
Fund	20.1%	17.9%	30.7%	15.9%
Benchmark	*22.5%*	*16.0%*	*32.6%*	

Returns are presented before deduction of management fees. Benchmarks are (a) for the Fund: 5% DEX 91-Day T-Bill, 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, 2014



Equity Fund Asset Mix

Nexus North American Balanced Fund

2014 began strongly for investors in the Nexus North American Balanced Fund. All asset classes contributed positively with equities providing most of the gains, although the bond market made a nice recovery as well. In the first quarter the Balanced Fund managed an advance of 4.4%, which slightly trailed the 4.7% advance of the Fund's benchmark.

Turning first to equities, and looking at the Fund by geography, all markets contributed in a reasonably balanced fashion. In Canada, our holdings increased 5.6%, but trailed the TSX Index which rose 6.1%. In the U.S., our holdings advanced 6.3%, bettering the 5.8% generated by the S&P 500 in Canadian dollars. The allocation outside North America produced positive, but less favourable results. The EQIT Fund, which invests internationally in developed markets, such as Europe and Japan, returned 2.9%, suffering from the shadow cast over markets by the situation in the Ukraine as well as apprehension about the economic effect of a pending sales tax hike in Japan. After beginning the year with a significant negative return, our position in the EMEC Fund, which invests in emerging markets, came roaring back in February and March, generating a 4.4% return for the quarter. EMEC is a small position (2.5% of the Fund's portfolio) and the long-term rationale for holding it remains intact.

In the first quarter of 2014, the bond market staged a rebound from where it had closed 2013. The general level of yields declined modestly and spreads for both corporate and provincial securities continued to contract. As a result of this combination of further "spread tightening" and modest interest rate declines, the DEX Universe Bond Index (DEX) produced a positive return of 2.8%. Our returns lagged the DEX return slightly, up 2.6%. A more detailed explanation of developments in equity and bond markets appears earlier in the Asset Class Review section of this report.

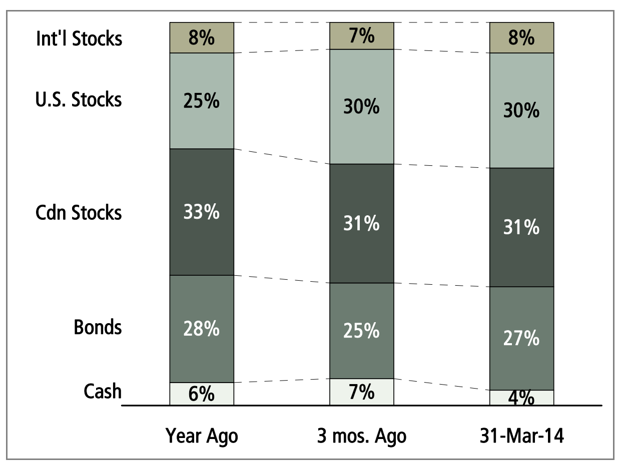
Asset mix decisions added to relative returns as we continued to overweight equities and underweight fixed income. This quarter we lowered our cash position from 7.5% to 4.3% by adding to both equities and bonds. We still remain underweighted in bonds, with an allocation of only 27%. Our total allocation to equities remains above target (69% vs. 65%) with most of the overweight in our U.S. and non-North American holdings.

Returns for longer periods continue to exceed our benchmark and, most importantly, are attractive on an outright basis. The Fund has returned 15.8% in the last twelve months – ahead of the benchmark return of 14.4% and has provided an annual average return of 8.1% for the last 10 years, which comfortably exceeds the benchmark return over this period of 6.6%. More detail of the Fund's performance is laid out in the table below.

	Balanced Fund	Bonds	Cdn Stocks	U.S. Stocks	Int'l Stocks
Quarter					
Fund	4.4%	2.6%	5.6%	6.3%	3.5%
Benchmark	*4.7%*	*2.8%*	*6.1%*	*5.8%*	
One Year					
Fund	15.8%	2.2%	18.9%	30.8%	17.9%
Benchmark	*14.4%*	*0.8%*	*16.0%*	*32.6%*	

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

Investment Returns – As at March 31, 2014



Balanced Fund Asset Mix

Nexus North American Income Fund

The first quarter of 2014 was another exceptionally strong quarter for the Nexus North American Income Fund. The Fund produced a return of 2.9% while the Fund's benchmark, the DEX Universe Bond Index (DEX), returned 2.8%. Over the last year, the Fund has managed a return of 5.1%, compared to a 0.8% return from the DEX. More detail of the Fund's performance is laid out in the table below.

In the first quarter of 2014, the bond market staged a rebound from where it had closed 2013. The general level of yields declined modestly and spreads of both corporate and provincial securities continued to contract. As a result of this combination of further spread tightening and modest interest rate declines, bonds provided solid returns for the three month period. Our bond performance, at 2.5%, lagged the DEX return slightly. A more detailed explanation of developments in the bond market appears earlier in the Asset Class Review – Fixed Income section of this report.

Adding to the return from bonds was our allocation to "Other Income-Oriented" securities, which performed well, contributing a 3.9% return. We continue to expect very moderate returns from our bond investments and better returns, albeit with greater volatility, from our allocation to "Other Income-Oriented" securities.

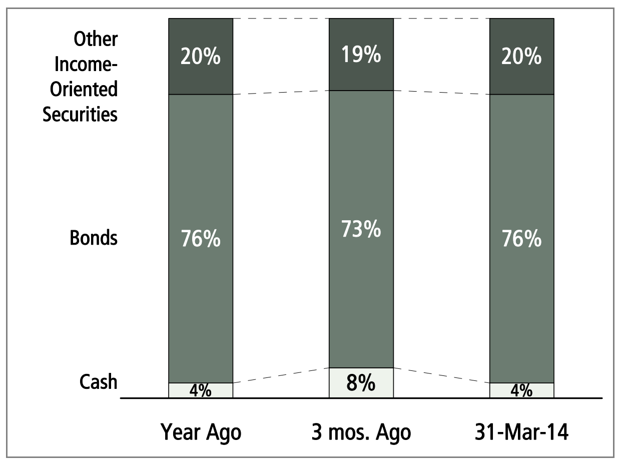
Looking at asset mix, we remain fully invested in the 'Other Income-Oriented' sector, with an allocation of 19.9%. In fact, during the quarter we were obliged to trim some of these holdings so as to remain below the Fund's limit of 20%. Our cash position (4%) has been reduced somewhat from the end of the last quarter.

We continue to be pleased with the consistency of the returns and the relative lack of volatility in the Fund. We intend the Fund to be an excellent alternative to other savings products and a superior alternative to other fixed income strategies. Returns over the last year and for longer periods continue to exceed our benchmark and the returns are substantially greater than inflation. Over the last 10 years, the Fund has provided an average return of 6.3% per annum.

	Income Fund	Bonds	Cdn Stocks	U.S. Stocks
Quarter				
Fund	2.9%	2.5%	3.9%	9.3%
Benchmark	*2.8%*	*2.8%*		
One Year				
Fund	5.1%	2.0%	14.9%	38.0%
Benchmark	*0.8%*	*0.8%*		

Returns are presented before deduction of management fees. Benchmarks are (a) for Fund: DEX Universe Bond; (b) for Bonds: DEX Universe Bond.

Investment Returns – As at March 31, 2014



Income Fund Asset Mix

Financial Market Summary

Market Levels

	March 31, 2014	December 31, 2013
Canada		
TSX Composite Index	14,335	13,622
91-Day T-Bill Yield	0.90%	0.91%
30-Year Government of Canada Bond Yield	2.96%	3.24%
Prime Rate	3.00%	3.00%
Exchange Rate (US$ per C$)	0.9046	0.9402
United States		
Dow Jones Industrial Average	16,458	16,577
Standard & Poor's 500 Index	1,872	1,848
30-Year U.S. Treasury Yield	3.56%	3.97%

Market Returns for Periods Ended March 31, 2014 [1]

	Last Quarter	Last 12 Months	Last 5 Years [2]	Last 10 Years [2]
DEX 91-Day T-Bill Index	0.2%	1.0%	0.8%	2.0%
DEX Universe Bond Index	2.8%	0.8%	5.0%	5.1%
TSX Composite Index	6.1%	16.0%	13.7%	8.1%
S&P 500 Index (in C$)	5.8%	32.6%	18.0%	5.6%
MSCI EAFE Index (in C$)	4.6%	27.9%	13.0%	4.7%
MSCI Emerging Markets Index (in C$)	3.5%	7.5%	11.5%	8.2%

Notes:

[1] Market returns represent total returns, including income and capital appreciation (or depreciation).
[2] Market returns are compound annual rates for periods of more than 1 year, but are not annualized for shorter periods.