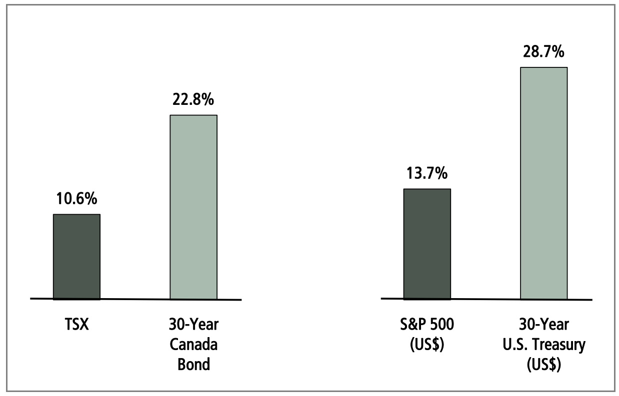
A Tale of Two Markets

2014 proved to be another excellent year in financial markets. Most stock markets around the world increased in value, although none quite so dramatically as in the United States. The principal U.S. benchmark, the S&P 500, provided a total return of 13.7% in U.S. dollar terms. This attractive return soars to 24.0% when converted to Canadian dollars. The strength of the U.S. dollar through the year was an added bonus for foreign investors (like Canadians) investing in U.S. assets. While the rise of the TSX Composite in Canada was modest in comparison, it still managed to provide a 10.6% total return despite the massive sell-off in energy stocks late in the year.

Perhaps even more significant than the returns over the past year, are the fabulous returns earned by equity investors over several years. Returns in the U.S. have been particularly stunning, with the S&P 500 generating a return of 25.8% per year over the past three years, and 17.9% per year over the last five years.[1] Largely as a result of the headwinds from poor natural resource stock returns, the TSX Composite has produced decidedly more modest results: 10.2% per year for three years, and 7.5% per year for five years. However, performance of many non-resource stocks in Canada was considerably better than the averages.

The biggest surprise in 2014 was the performance of fixed income markets. Virtually every investor in Canada and the U.S. (Nexus included!) predicted that 2014 would be a lackluster year for bonds as interest rates moved higher from unsustainably low levels. This forecast gained credibility as the U.S. Federal Reserve reduced, then eliminated, its Quantitative Easing (QE) program.[2] The Fed had pursued QE since 2009 as a means of suppressing longer-term interest rates and stimulating the economy. It seemed a given that rates would rise as QE declined. Perversely, interest rates continued to decline, and prices rose, throughout the year. In Canada, the FTSE TMX Universe Bond Index gained 8.8% in 2014. Those who bet on the longest maturity bonds reaped a bonanza: the 30-Year Government of Canada bond provided a total return of 22.8% as its yield fell almost a full percentage point, from 3.22% at the start of the year, to 2.33% at its conclusion. In the U.S., fixed income returns were even better. The 30-Year U.S. Treasury generated a total return of 28.7% over the year (in US$).



Total Return for Year Ended December 31, 2014

The conundrum presented by these market returns is that stock and bond investors seem to be anticipating very different economic environments. The U.S. equity market's strength reflects investor confidence with the steadily improving U.S. economy. Typically, a period of improving economic conditions also brings with it greater demand for labour and raw materials, both of which put upward pressure on inflation. Falling yields in the bond market are signaling quite the opposite. They reflect a decline in inflationary expectations more consistent with a period of stagnation and suggest that investors expect that the Fed may have to support the economy with monetary stimulus measures longer than many expect. Of course, conditions in fixed income markets in North America are also influenced by what is going on abroad. U.S. Treasuries yielding 2.6% are actually attractive compared to what is available in other parts of the world. Deflation in the Eurozone[3] and stagnation in Japan have resulted in even lower interest rates there. In Germany, for example, government bonds have negative yields all the way out to five years in maturity. This is not consistent with a rosy economic forecast. 2015 will be a year in which stock and bond investors are not likely to both be winners.

Oil

The collapse in oil prices in late 2014 and early 2015 has dominated the news headlines. From a July peak of US$108[4] to a recent trough of US$48, oil prices have fallen 55% to levels last seen in the depths of the 2008/2009 recession. Investors are scrambling to understand why this happened so they can forecast what the future may hold. As a global commodity, the oil market is complex with many economic and

[1] Returns are total returns in C$.

[2] The Fed was buying $85 billion per month in U.S. Treasury securities before the taper began.

[3] Prices dropped 0.2% on a year-over-year basis in December.

[4] Spot price of West Texas Intermediate at Cushing.

political forces influencing the price. Supply of non-OPEC crude has increased noticeably in recent years, primarily as a result of the boom in shale oil production in the U.S. Global demand is soft with growth slowing in China, Japan still stagnant, and Eurozone growth headed lower once again. Low oil prices may be simply a reflection of a glut in oil supply, and excess supply clearly can be seen in certain regions. However, it is less certain what the balance is between global demand and supply in aggregate[5]. Of course, OPEC does still play a role and Saudi Arabia boldly declared it would not cut production in the face of declining prices. One imagines this may be to send a message to others inside and outside the cartel, perhaps most notably, Iran. Also, given the stress that low oil prices imposes on Russia, some Western nations may have secretly signaled to the Saudis to keep pumping.

We have no ability to predict short-term oil price movements. All we can observe is that at current prices few regions produce oil profitably. $48 oil is lower than is needed for the oil sands in Canada to be successful, it is lower than is needed for shale oil in the U.S. to be successful, and it is lower than is needed for most countries within OPEC to be successful. Eventually, prices will head higher as less economic production is curtailed. Logic might suggest that this will happen soon, but we think it fruitless to predict.

Prosperity in North America

A popular perception is that Canada is an energy-exporting nation and that the collapse in oil prices will surely send our economy into a tailspin. For certain, many energy companies have slashed spending in the face of this tumult, and share prices have been hit hard. Energy-rich provinces like Alberta, Saskatchewan and Newfoundland are worried. However, there are benefits to cheap energy, and industrial regions, like Ontario and Quebec, have a new-found spring in their step. Low energy prices reduce the cost of manufacturing and put more spending power in consumer wallets. Our weaker loonie (a consequence of weak energy prices) improves the international competitive position of exporters. The strengthening U.S. economic recovery is creating increased demand for our products. If you make auto parts in Ontario, this is all fantastic news! There will be a shift in the location of prosperity within Canada, but it does not significantly alter the outlook for our economy in aggregate. The prospect for growth in Canada in 2015 may be less than in the U.S., but the growth outlook remains solid.

[5] Well-known economist Ed Yardeni contends demand exceeds supply in aggregate.

In the U.S., economic growth continues to improve, and the U.S. remains a bright light on the international stage. Low energy prices have acted like a tax cut to the consumer, which is powerful since consumer spending represents about 70% of U.S. GDP. U.S. strength is manifest in recent economic data: third quarter GDP growth spiked to 5.0%, the unemployment rate has fallen to 5.6%, consumer sentiment is at a seven-year high, and corporate profitability is at record levels. It is our expectation that 2015 will prove to be a year of solid economic growth in the U.S.

As we previously alluded, however, economic conditions elsewhere in the world are considerably less vibrant than they are in North America. Europe has faltered once again, and investors are anxiously awaiting the implementation of a QE program by the European Central Bank, expected in late January. Japan remains mired in stagnation. In China, economic growth has slowed and, while still formidable, it is not the growth driver it once was.

Investment Outlook

For 2015, we believe that the most likely outcome is for the equity bull market to stumble along at a positive, but more modest pace. Valuations in both the Canadian and U.S. stock markets are full, but not extreme – they could well end the year at quite similar levels to today's. Accordingly, it will be left to earnings growth to be the principal driver of stock prices. So long as the economic recovery in the U.S. remains intact, we are optimistic that companies should be able to achieve attractive results[6].

While this is the mostly likely scenario, we are mindful of significant downside risks. Certainly the performance of the bond market suggests great concern for global growth. Perhaps the most worrisome issue, however, is that low oil prices will hit many countries much harder than they hit Canada and the U.S. In particular, both Russia and Iran rely on the sale of oil to fund the vast majority of government spending. In these countries, and several others, there is the potential for political and economic crises that could spill beyond their borders. Simply put, the potential for civil unrest is a "clear and present danger" that we must watch carefully.

In this world of great uncertainty we remain focused on finding high-quality companies with resilient businesses in which to invest. They will reward us handsomely over time and offer some refuge in a time of turmoil.

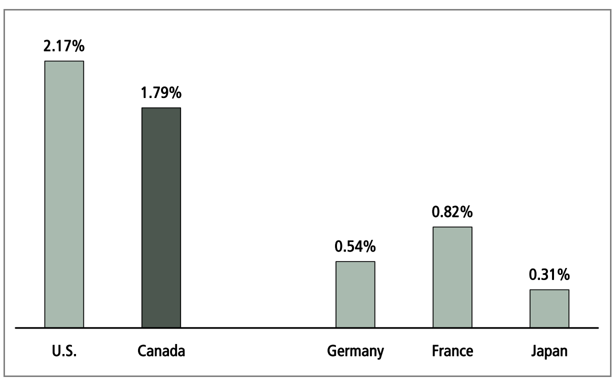
[6] Excluding energy companies, where we cannot predict the short term, but remain optimistic about the long term.

Asset Class Investment Review

Fixed Income

Bond market performance was extremely strong to close out the year, with yields declining to their lowest levels in many years. Ten-year Canada bonds ended the quarter at a yield of 1.79%, a drop of 39 basis points from the end of the third quarter and practically a 1% reduction from the 2.75% rate at which they started the year. The yields of shorter maturity bonds declined as well, reversing a small back-up in rates that occurred in the previous quarter. As a result, the FTSE TMX Bond Universe Index[7] (the "Bond Index") generated a strong 2.7% return in the fourth quarter. The returns of our fixed income holdings, using those in the Income Fund as a proxy, returned 1.9%, to finish the year having generated a 6.9% return. While this is well ahead of the expectations we held for this asset category at the beginning of the year, these results trailed the Bond Index, which returned 8.8% over the same period.

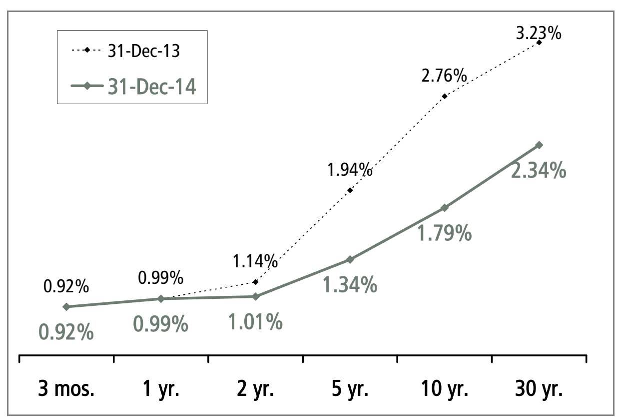
Considering these yields in an international context is helpful to better understand why they have fallen to such low levels. In places like Japan and Europe, economic growth remains moribund at best and inflationary pressures are non-existent.



Global 10-Year Government Bond Yields

For these countries and their central banks, official monetary policy is designed to reduce debt burdens, stimulate investment and spending, and to stave off a decline in inflation that might lead to deflation. The abrupt decline in energy prices since mid-year has temporarily aggravated this deflationary trend. As a result of these monetary policies, European and Japanese rates make Canadian and US interest rates look relatively attractive and it is this policy divergence with the rest of the world that is primarily responsible for an influx of capital to North America. It has lifted bond prices, even as the Federal Reserve was ending its own bond-buying program and caused an index of the U.S. dollar, known as the DXY[8], to rise to its highest level in more than ten years. Further exaggerating the demand for US$ assets has been the currency's safe-haven status in an unsettled world. There is no doubt that Russian and other petro-based pools of capital have contributed to the extra demand that has driven the DXY from 79.8 at mid-year to 90.2 at the end of the year.

Economically, Canada remains stuck somewhere between the weakness that characterizes Europe and Japan and the improving conditions in the U.S. We continue to expect that economic growth is on an improving trend here. But the pattern of recovery has been upended by the decline in energy prices, which has shifted the burden of recovery to the manufacturing and consumer dominated provinces of Ontario and Quebec and away from Alberta. In 2015, Canada's continued economic recovery will be based on two parts. First, export demand for intermediate and finished goods, rather than raw materials, will form the basis of our economic recovery. Second, consumer spending should get a lift due to lower energy costs. Both of these circumstances are a natural by-product of low interest rates and a weaker currency. So, we continue to suspect that the Bank of Canada is unlikely to raise interest rates in 2015, even as the U.S. Federal Reserve does so, as is the current consensus.



Government of Canada Yield Curve

Equities

7 Formerly the DEX Universe Bond Index.

8 The DXY is an index of the US dollar measured against the Euro, Yen, Pound, Canadian Dollar, Swedish Kroner and Swiss Franc.

The fourth quarter of 2014 was choppy overall and ended on a weak note, with December being a negative month. Most equity markets around the world, including the TSX Composite Index in Canada (down 1.5%), had a negative return for the quarter. The U.S. was the exception, with the S&P 500 returning 4.9% in US$ and a strong 8.6% measured in C$.[9]

Nonetheless, the fourth quarter as a whole added further to an excellent year for Nexus equity returns. As an indicator, the Equity Fund was up 5.4% in the quarter and 18.3% for the year, with both periods 2.3% points ahead of the benchmark return.[10]

Whilst we never profess to be market forecasters, the pace of equity market appreciation must surely slow down in North America after a torrid advance over the past six years. Looking ahead, our stock picks are not as attractively priced as they were at the start of the year, but we think they remain reasonably priced overall – especially in comparison to the very low yields available from bonds – and many are priced at a discount to the equity indices as a whole. As always, anything can derail the markets in the short term, but we think that a well-structured, quality equity portfolio is still a good hold over the longer term.

Canadian Equities

Nexus Canadian stocks were up 1.4% in the fourth quarter and up 11.2% over the year. This was ahead of the TSX Composite (down 1.5% in the quarter), and also ahead of the TSX's 10.6% gain for the year.

It was a mixed year for Canadian equity investors. The entire Energy and Materials sectors on the TSX had a negative return for the year and small capitalization stocks in Canada also performed poorly, as indicated by the TSX Smallcap Total Return Index's negative return of 2.3%. Nexus Energy holdings also suffered, but we hold no Materials or smallcap stocks. The strongest sector in the TSX Composite Index was Consumer Staples and our holdings – Alimentation Couche-Tard and Metro – were particularly strong in the quarter and for the year. Alimentation Couche-Tard continues to integrate its acquisition of Statoil Fuel and Retail and announced the acquisition of The Pantry during the last quarter. The Pantry operates over 1,500 convenience stores in the southeastern United States and is a good fit with Couche-Tard's U.S. footprint, but the completion of the deal is by no means a certainty. Over the course of the year, our Pipeline holdings (Enbridge and TransCanada), Progressive Waste Solutions and Thomson Reuters also did particularly well, each with a total return in excess of 20%. There were no major trades in the quarter. Progressive Waste Solutions was trimmed in some accounts where it had become a particularly large holding.

U.S. Equities

For the quarter, the S&P 500 was up 8.6% and a strong 24.0% for the year, helped by a significant weakening of the C$. Nexus U.S. holdings had a particularly strong quarter and year. Our U.S. equity portfolio returned 10.1% in the quarter and 31.4% for the year.

Our success for the year was broad-based, with strong performance from almost all of our Technology holdings (Hewlett-Packard, Apple, Microsoft, Western Digital, and Cisco; only Google had a slightly negative return for the year), CarMax, and our Healthcare holdings (especially Gilead Sciences and Sirona Dental).

General Electric, which we added to the portfolio in the third quarter is down slightly in US$ and about flat in C$ since we purchased it. We continue to believe that GE offers the key characteristics that Nexus looks for – growth in good times and quality and stability in difficult times, as well as being out of favour with investors at the moment.

Other Equity Investments

We continue to hold two non-North American equity investments within our Balanced and Equity Funds. Each is expected to add beneficial diversity and growth potential over the long term. These are two externally-managed pooled funds called EQIT (international developed market equities) and EMEC (international emerging market equities).[11]

With the recent economic weakness in Europe and emerging markets, along with considerable geo-political concerns, these holdings have held up relatively well. Both EQIT and EMEC were up slightly for the quarter (0.4% and 0.7%, respectively) and 3.8% and 8.4%, respectively for the year. Both were ahead of their respective benchmarks for the quarter and year. They both carry valuation multiples that are attractive compared to North-American equities.

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

[10] All the return data in the Equities section is 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.

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

Pooled Fund Reports

Nexus North American Equity Fund

The Nexus North American Equity Fund recorded another strong quarter, closing out a very strong year. Aided by a large allocation to equities outside of Canada during a period of Canadian dollar weakness, as well as some very good individual stock performances, the Equity Fund managed an advance of 5.4% in the final quarter of 2014. The Fund's benchmark advanced 3.1% over the same period.

In equity markets there continued to be a sharp divergence between the U.S. market and all others. In the fourth quarter the S&P 500 advanced 8.6% in C$ terms and our selections did even better, returning 10.7%. On the other hand, the TSX Composite Index, as well as the majority of other international indices generated either negative or very minimal returns. Thankfully, our Canadian holdings generated a positive return of 1.4% while the TSX Composite declined 1.5%. Our investments in EQIT (Developed Markets) and EMEC (Emerging Markets) each also generated a small positive return despite their respective benchmarks also being down over the quarter. A more detailed explanation of developments in equity markets appears earlier in the Asset Class Review section of this report.

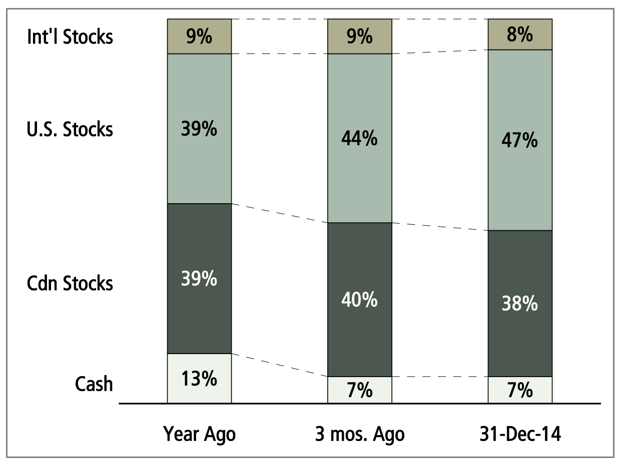
Our cash position remains at 7%, the same as it was at the end of the previous quarter. Our allocation to Canadian stocks is 38%, slightly less than it was previously, and our U.S. allocation has increased to 47%. The balance of 8% is invested outside of North America through our holdings of EQIT and EMEC.

Returns for longer periods continue to be excellent. The Fund returned 18.3% in 2014, nicely ahead of the 16.0% return of our benchmark. More importantly, the Fund continues to provide attractive relative and nominal returns for longer holding periods. Over the last ten years, the Fund has generated an annual average return of 9.0%, well above the 7.4% 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	5.4%	1.4%	10.7%	-0.6%
Benchmark	*3.1%*	*-1.5%*	*8.6%*	
One Year				
Fund	18.3%	11.2%	33.2%	4.8%
Benchmark	*16.0%*	*10.6%*	*24.0%*	

Returns are presented before deduction of management fees. Benchmarks are (a) for the Fund: 5% FTSE TMX 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 December 31, 2014



Equity Fund Asset Mix

Nexus North American Balanced Fund

The Nexus North American Balanced Fund had a strong final quarter, advancing 4.2%. All asset classes provided positive returns and these results were ahead of our benchmark, which advanced 2.3% over the same period. Returns for longer periods continue to exceed our benchmark and, most significantly for clients, are attractive on an absolute basis. The Fund has returned 14.7% in the last twelve months – exceeding the benchmark return of 12.8%. Our returns for 2, 3, 5 and 10 year periods also are higher than the benchmark and very attractive on an outright basis. More detail of the Fund's performance is laid out in the table below.

Beginning first with the bond market, this was a more eventful quarter for a number of reasons. It was marked by a busy new-issue calendar in the corporate and provincial markets, an investor preference for safety, and the countervailing effects of slowing growth outside North America and improving economic conditions in the U.S. Layered over all of this was the continued decline in energy prices which will both temporarily reduce inflation and act as extra stimulus to global consumer demand. The consequence of these developments is that interest rates finished at their lowest levels of the year and bond returns ended up being considerably better than even our most lofty expectations at the start of the year. In the most recent quarter, the Bond Index generated a 2.7% return, but the bond component of the Fund returned 1.9%. The unfavourable performance is a result of our holdings having a shorter maturity profile than the Bond Index during a period of sharply falling interest rates. A more detailed explanation of developments in bond markets appears earlier in the Asset Class Review section of this report.

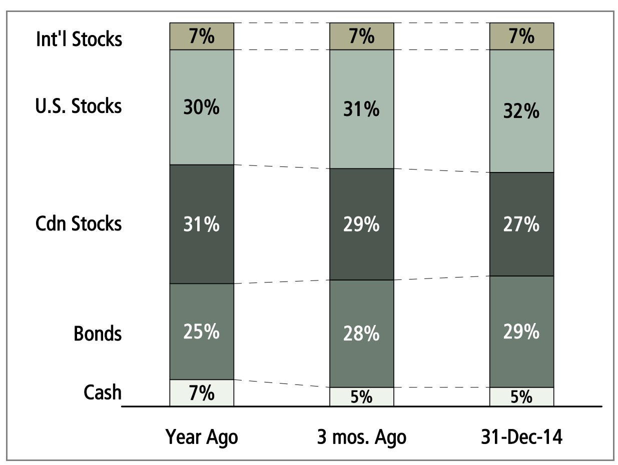
In equity markets there continued to be a sharp divergence between the U.S. market and all others. In the quarter the S&P 500 advanced 8.6% in C$ terms and our selections did even better, returning 10.1%. On the other hand, the TSX Composite Index, as well as the majority of other international indices generated either negative or very minimal returns. Thankfully, our Canadian holdings generated a positive return of 1.5%, while the TSX Composite declined 1.5%. Our investments in EQIT (Developed Markets) and EMEC (Emerging Markets) each also generated a small positive return, despite their respective benchmarks also being down over the quarter. A more detailed explanation of developments in equity markets appears earlier in the Asset Class Review section of this report.

Our overall asset mix was little changed from the prior quarter and the allocation between cash (5%), bonds (29%) and stocks (66%) remains very close to our long-term guidelines. Within equities, we continue to have more investments outside Canada, particularly in the U.S. Given the pressure of weak commodity prices on the Canadian dollar, this positioning helped our performance in the quarter.

	Balanced Fund	Bonds	Cdn Stocks	U.S. Stocks	Int'l Stocks
Quarter					
Fund	4.2%	1.9%	1.5%	10.1%	-0.4%
Benchmark	*2.3%*	*2.7%*	*-1.5%*	*8.6%*	
One Year					
Fund	14.7%	7.0%	11.9%	31.4%	4.5%
Benchmark	*12.8%*	*8.8%*	*10.6%*	*24.0%*	

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 December 31, 2014



Balanced Fund Asset Mix

Nexus North American Income Fund

The final quarter of the year closed on a high note for the Nexus North American Income Fund. It was an excellent quarter, generating a return of 2.7%, keeping pace with the Fund's benchmark, the FTSE TMX Canada Universe Bond Index (the "Bond Index") which also returned 2.7%. However, for the first time in many years, over the full year the Fund lagged its benchmark, managing a return of 8.1%, compared to the 8.8% return from the Bond Index over the same period. More detail of the Fund's performance is laid out in the table below.

Despite trailing the Bond Index in 2014, we remain pleased with the consistency of the returns and the low volatility of the Fund. We intend the Fund to be an excellent alternative to other savings products, and a superior alternative to traditional fixed income strategies. Returns over the last year and for longer periods continue to exceed inflation and, despite lagging slightly in 2014, our long-term returns exceed our benchmark over two, three, five and ten year periods.

This was a more eventful quarter for a number of reasons. It was marked by a busy new-issue calendar in the corporate and provincial markets, an investor preference for safety, and the countervailing effects of slowing growth outside North America and improving economic conditions in the U.S. Layered over all of this was the continued decline in energy prices which will both temporarily reduce inflation and act as extra stimulus to global consumer demand. The consequence of these developments is that interest rates finished at their lowest levels of the year and bond returns ended up being considerably better than even our most lofty expectations at the start of the year. A more detailed explanation of developments in bond markets appears earlier in the Asset Class Review section of this report.

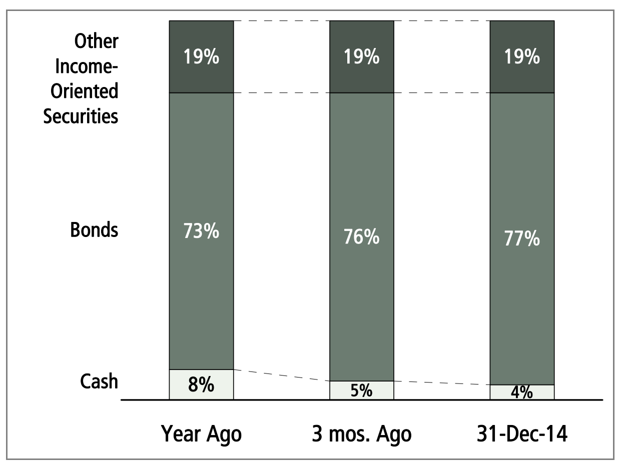
Our allocation to 'Other Income-Oriented Securities' provided much of the lift to Fund returns this quarter. We have 17 different holdings, with no single position bigger than 1.5% of the portfolio. Our holdings span seven different industry sectors and four of our positions are U.S. companies, where we benefited from both outright price appreciation as well as the foreign exchange effect arising from a weaker Canadian dollar. Perhaps most importantly, over the course of this past year, 14 of our holdings increased their dividend. A well diversified 'basket' of securities such as these should be thought of as providing some of the "duration" we are lacking in our bond holdings. While these securities will fluctuate in value more than bonds, over time, their growing distributions and lower correlation with the fund's core bond holdings, should mean that the Fund's returns and the underlying volatility of returns will be less than the Bond Index.

Looking at asset mix, we remain almost fully invested in the 'Other Income-Oriented' sector, with an allocation of 19.2%, effectively the same level as last quarter. We remain just below the Fund's limit of 20%. Our cash position (4.0%) is fractionally less than it was at the time of our last report.

	Income Fund	Bonds	Cdn Stocks	U.S. Stocks
Quarter				
Fund	2.7%	1.9%	5.7%	6.3%
Benchmark	*2.7%*	*2.7%*		
One Year				
Fund	8.1%	6.9%	13.8%	22.4%
Benchmark	*8.8%*	*8.8%*		

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

Investment Returns – As at December 31, 2014



Income Fund Asset Mix

Financial Market Summary

Market Levels

Canada	December 31, 2014	December 31, 2013
TSX Composite Index	14,632	13,622
91-Day T-Bill Yield	0.91%	0.91%
30-Year Government of Canada Bond Yield	2.33%	3.24%
Prime Rate	3.00%	3.00%
Exchange Rate (US$ per C$)	0.8620	0.9402

United States		
Dow Jones Industrial Average	17,823	16,577
Standard & Poor's 500 Index	2,059	1,848
30-Year U.S. Treasury Yield	2.75%	3.97%

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

	Last Quarter	Last 12 Months	Last 5 Years [2]	Last 10 Years [2]
FTSE TMX 91-Day T-Bill Index	0.2%	0.9%	0.9%	1.9%
FTSE TMX Universe Bond Index	2.7%	8.8%	5.4%	5.3%
TSX Composite Index	-1.5%	10.6%	7.5%	7.6%
S&P 500 Index (in C$)	8.6%	24.0%	17.9%	7.3%
MSCI EAFE Index (in C$)	-0.2%	3.7%	7.5%	4.0%
MSCI Emerging Markets Index (in C$)	-1.2%	6.7%	3.9%	8.0%

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.