NEXUS

Portfolio Management & Financial Counsel

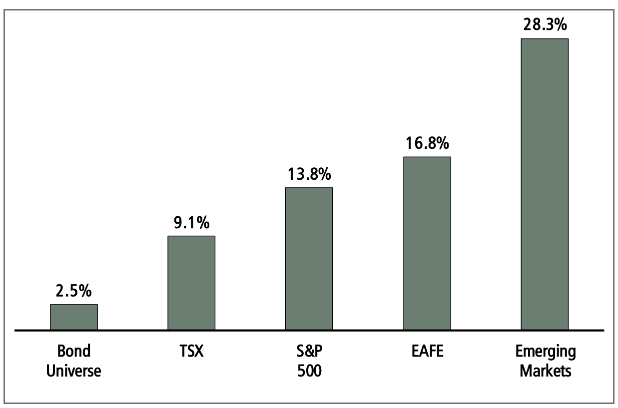
THE NEXUS REPORT

Fourth Quarter, 2017

Another Year of Progress

U.S. stock market returns were terrific in 2017. The S&P 500 generated a total return (in US dollars) of 21.8%, and has compounded at a rate of 20.8% per year since the bear market low on March 9, 2009 – quite an astounding pace of appreciation over almost nine years. A review of 2017 also yields a treasure-trove of arcane statistics. The S&P hit more new highs in 2017 than in any year before. On no day in 2017 did the Index ever close below the level of December 31, 2016. Perhaps most amazing is that the S&P 500 had 12 consecutive months of positive total returns for the first time ever.[1]

Going hand-in-hand with the strong and steady U.S. market returns was an incredibly low level of volatility. There was not a single day in 2017 when the S&P 500 fluctuated more than 2%, an environment of serenity last experienced in the 1960s.[2] And while we remarked last quarter how the VIX – the standard measure of volatility in U.S. markets – was at record low levels, it managed to go lower still in the last three months. On January 5, 2018, the VIX hit 9.31, the lowest level ever in the 25-year history of the data.



2017 Market Returns (1-yr Total Returns in C$)

Just as we described last quarter, however, the reality for Canadian investors is not quite so exciting as these U.S. statistics suggest. A strong rise in the Canadian dollar over 2017 had the effect of reducing U.S. dollar returns by eight percentage points. While the S&P 500 generated a 21.8% total return in U.S. dollars, this falls to 13.8% when measured in Canadian dollars. International stocks were even better than U.S. ones, but also faced the Canadian dollar headwind.

In Canada, the TSX Composite posted a total return of 9.1% over the course of 2017 – respectable, but significantly behind that of other markets. And while bond prices recovered somewhat in the last three months, the 2.5% total return of the Canadian Universe Bond Index over the year also had a moderating effect on many portfolio returns. Canadian investors enjoyed another year of progress, but not to the extent headlines might suggest.

Canadian Economy Strong

While the performance of the Canadian stock market has been more modest than many others, the performance of our economy has been surprisingly good. Many expected a slowdown in the second half of 2017 after a strong start to the year, but economic indicators have remained robust. In particular, Canadian labour market strength has been remarkable over the last few months. The November labour report – 79,000 new jobs added – was so strong it was thought to be an aberration that would be corrected in December. However, the December report was every bit as strong, with 78,600 new jobs added compared to expectations for 2,000. Moreover, the details of the report were strong across the board as new jobs were heavily full-time (vs. part-time), in the private sector (vs. public sector), and every province recorded gains. The unemployment rate fell sharply to 5.7%, which is the lowest recorded since 1974.[3]

Corroborating the strong labour market report, was the Bank of Canada's quarterly Business Outlook Survey released in early January. It depicts an economy facing labour shortages and the tightest capacity pressures since before the 2009 recession. Simply put, the economy is running nearly flat out.

Despite the strong statistical picture of our economy, we think it would be naive to ignore the challenges which may lie ahead. The re-negotiation of NAFTA is not going well and the accord could be headed toward dissolution. This is a complicated process that does not necessarily result in doom for the Canadian economy, but it adds a significant degree of uncertainty to the outlook. We also are concerned that the huge reduction in corporate taxes adopted in the U.S. late in 2017 could provide further challenges to the Canadian economy. For many years, Canada has been an attractive destination for U.S. corporate investment as a result of corporate tax rates that were lower here than in the U.S. This

1 *Barron's,* January 1, 2018.

2 *The New York Times*, January 5, 2018.

3 BMO Capital Markets.

competitive advantage is now gone. Finally, a topic that has resulted in much ink on the front page of Ontario newspapers is the sharp increase in the minimum wage. While there is a lot of political rhetoric around the minimum wage issue, the economic reality is that it will be difficult for many small businesses to digest such a large increase in the cost of doing business in such a short period of time.

Synchronized Global Growth

Not only was the Canadian economy strong, but 2017 was also a rare year in which all 45 OECD economies expanded.[4] It is entirely possible that 2018 could be another such year.

Most important to Canadians, however, is the health of the U.S. economy, and it remains in very good shape. Labour markets, which have been a key engine of the U.S. expansion, were strong throughout 2017 and the unemployment rate ended the year at 4.1%, a low level by any historic measure. On the surface, the December non-farm payroll report (148,000 new jobs) was disappointing compared to expectations (190,000), but even this was interpreted positively by many. The more modest report was evidence of a "Goldilocks" economy – strong enough to support the ongoing expansion, but not so strong as to encourage the U.S. Federal Reserve to raise interest rates more aggressively than expected.

As mentioned earlier, passage of a major tax cut in the U.S. in December came despite widespread skepticism. While one can reasonably worry about the impact of the tax cut on government finances over the long term, there is no doubt it will stimulate the economy in the short term. Some analysts believe that earnings of S&P 500 companies could rise as much as 10% in the next year.[5] Also significant, however, will be various corporate initiatives to deploy the tax windfall. For example, just as *Nexus Report* was going to press, Wal-Mart announced that it would raise the minimum wage of all U.S. employees to $11 an hour (from $10) and hand out one-time bonuses of up to $1,000 per employee.

Given the length of the current U.S. expansion it is reasonable to conclude that it is closer to the end than the beginning. However, most of the evidence suggests that there is more positive momentum to come in 2018. Even the retail sector, which has been the source of serial disappointment in recent years, produced its "merriest" holiday sales in 17 years.

Investment Outlook

Just as the U.S. economic expansion must surely be closer to its end than its beginning, so too must be the bull market in stocks. As we search the investment landscape for new ideas, we have rarely had a more challenging time finding companies that fit our criteria. But just because we are in the later stages of a bull market does not mean that a crisis is imminent. Most of the geopolitical risks we have discussed in the past – North Korea, Iran, Brexit – remain. Nevertheless, we continue to believe that the most likely outcome in the period ahead is for modest positive returns.

Another topic that is increasingly discussed as a risk to the happy mood in markets is inflation. Not since the 1970s has inflation been a factor in the investment landscape and the data continue to indicate that it remains subdued. Yet employment is at high levels on both sides of the border and monetary conditions remain extraordinarily stimulative. Interest rates and commodity prices are creeping higher, suggesting to some that the whiff of inflation may be in the air. While we don't see it as imminent, we will need to monitor it carefully.

The good news, as we have frequently stated, is that we don't have to buy "the market" and we don't particularly worry about the short term. Trying to make calls on what is likely to happen in the next several months and quarters is fraught with danger, and those trying to do so are rightly worried about all the risks we have discussed. Instead, we need only find some companies that have attractive businesses that we can buy at a fair price. When the inevitable correction occurs, their stocks may weaken. But their businesses will be fine, so long as we have chosen properly. And those whose businesses are sound will prosper over time regardless of the ebbs and flows of fear and greed in the short term.

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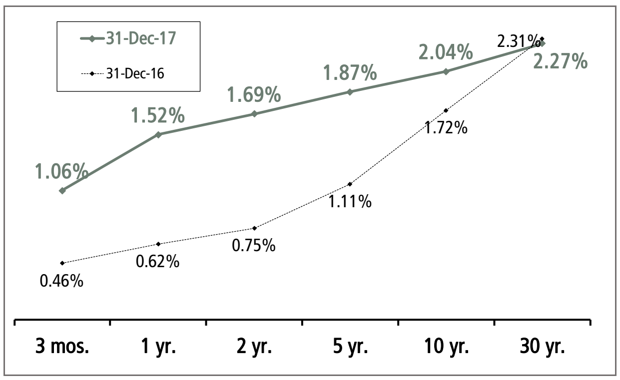
[4] *The Wall Street Journal*, January 2, 2018.

[5] Merrill Lynch raised it S&P earnings estimate from $139 to $153 solely due to the tax reduction.

Asset Class Investment Review

Fixed Income

There were three notable trends in the bond market over the course of 2017. The first was a continuation of an overall trend to higher interest rates. This trend began in Canada in mid-2016, after 10-year interest rates fell below 1.0%. This year, a change in Bank of Canada policy, evidenced by two Bank of Canada interest rate increases,[6] confirmed that the era of ultra-easy monetary policy is coming to an end.



Government of Canada Yield Curve

The second important trend has been the dramatic flattening of the yield curve (see above). At the beginning of the year the difference in yield between 2-year Canada bonds and 30-year Canada bonds was 1.56%. However, at the end of the year, that gap had narrowed to only 0.58%. Put another way, 2-year bonds in Canada weakened in price (rose in yield) and closed at their highest yields of the year. On the other hand, 30-year bonds rose in price (fell in yield). They were weakest in price in March and then strengthened through to the end of the year. This change in the shape of the curve can be explained by two related factors: shorter-maturity interest rates rising in response to increases in the Bank Rate, and rates for longer-maturity bonds benefitting from strong overseas demand.

The third trend that affected the bond market in 2017 was the unrelenting tightening of spreads between lower-quality and higher-quality credits. Over the course of 2017, an index of 10-year BBB corporate bonds narrowed in spread from 2.0% more than Canada bonds, to 1.61%, an improvement of 0.39%. An index of A-rated corporate bonds measured in the same manner tightened only 0.25%. Holding all other factors constant, tightening credit spreads improve the price performance of bonds. What makes this trend more surprising, was that it occurred in a period of record new corporate bond issuance.[7]

Our positioning in 2017 was less than ideal – we hold a shorter-maturity, higher-quality portfolio. So, while we may have anticipated the trend to higher rates properly, we have been invested in the area of the yield curve that has risen most in yield. In the same fashion, because we have eschewed long bonds, believing their potential returns were unattractive as compared to inflation, we did not benefit from their small decline in yield. Finally, our emphasis on quality has meant that we did not participate fully from the improvement in price that occurs when lower-quality bonds tighten in spread to Canada bonds. As a result, our performance was disappointing over the quarter and year. In the quarter our bond holdings returned 0.8%, while the FTSE TMX Bond Universe Index returned 2.0%. Over the year, our return was 0.9% against the index return of 2.5%.

As we enter 2018, the global economic expansion is gathering momentum[8] and consumer price inflation is showing signs of acceleration as well.[9] These are trends that do not augur well for the bond market. Accordingly, we will maintain our current approach in the expectation that rates of longer-maturity bonds will eventually rise and that our portfolio will avoid the substantial price erosion that will occur as a consequence.

Equities

The fourth quarter of 2017 was very strong for equities, as illustrated by the fourth quarter return for the Equity Fund market benchmark of 5.5%. The Equity Fund's actual return was up 4.3% and lagged the Fund's benchmark. Over the past twelve months, the Equity Fund returned 11.3% and was ahead of the benchmark's 10.9% return, concluding a successful year for our overall equity portfolios.[10] The

[6] The Bank of Canada increased the Bank Rate by 0.25% in each of July and September of 2017.

[7] In 2016, the Corporate bond market in Canada absorbed $98 billion of new supply. In 2017, $118 billion was issued. Source: BMO Capital Markets.

[8] The JP Morgan Global Manufacturing PMI was 55.6 in December, its highest level since February 2011.

[9] November Canadian CPI (yoy) was 2.1% up from 1.4% in October.

[10] All the return data in the Equities section are total returns for the Equity Fund. Equity returns within the Balanced Fund were

quarter was a continuation of a remarkable bull market that now stretches back 8 ¾ years (since April 2009). Despite the long streak, it looks like the bull market may well continue in 2018.

For the quarter, all asset classes held by the Fund generated positive returns. Our international equity holdings did remarkably well, with EQIT returning 6.4% and EMEC up 8.6%.[11] Our Canadian stocks returned 3.9% and our U.S. equities were up 4.7%.

While the Canadian dollar weakened slightly in the quarter, such that it slightly increased our U.S. equity returns when measured in Canadian dollars, the opposite occurred for the year. Over the full year, the materially stronger Canadian dollar had the effect of reducing our U.S. equity return by 8.0 percentage points.

Canadian Equities

Nexus's Canadian stocks were up 3.9% in the quarter and up 12.2% for the year. This slightly lagged the TSX Composite's return of 4.5% in the quarter and well exceeded the index's 9.1% return for the year.

For the quarter, the highlights of our Canadian portfolio were our telecom (up 7.2%) and industrial (up 5.2%) holdings. As an extension from the previous quarter, our industrial holdings continued to do well and were our strongest sector over the full year, followed by utilities (mainly Brookfield Infrastructure Partners).

In December, we added to our holding of Cenovus, which had traded down substantially on the back of its highly-levered $17.7 billion acquisition of ConocoPhillips's Canadian assets earlier in the year. After the change in CEO and the completion of the bulk of its post-acquisition deleveraging plans, we felt that sentiment was excessively pessimistic for Cenovus, creating an opportunity for longer-term shareholders.

U.S. Equities

Nexus's U.S. equities were up a strong 4.7% in the fourth quarter, but lagged the very strong S&P 500 return of 7.2%. For the year, our U.S. holdings are up 10.4% and were also behind the S&P 500's 13.8% return. Most of the annual lag occurred in the last quarter and stemmed from individual holdings that did relatively poorly. Notably, these stock holdings, GE, PRA Group, Gilead Sciences and CarMax have performed particularly well in January.

Our industrial holding, GE had a particularly bad year in 2018. Its energy and power businesses performed poorly and its pension shortfall was also a drag. After a dividend cut and a change in senior management, the incoming CEO announced a plan to focus on a narrower set of businesses – Aviation, Power and Healthcare – and to continue to reduce costs. We anticipate that better times are ahead.

Other Equity Investments

We continue to hold two non-North American equity investments within our Balanced and Equity Funds. These are externally-managed pooled funds called EQIT (international developed market equities) and EMEC (emerging market equities).[12]

Both funds had an excellent quarter, benefitting from synchronized global economic growth and more positive investor sentiment. Europe has gained momentum, with GDP growth estimated at about 2.3% for 2017. Similarly, Japan has completed seven quarters of consecutive GDP growth – its longest growth streak since the end of the 1990s. EQIT was up 6.4% in the quarter and up 22.6% for the year. EMEC was up 8.6% in the quarter and up an extraordinary 30.7% for the year. These holdings have added useful diversification to our core North American equity portfolio over the long term and have also been value-additive to returns in the quarter and the year. For more information on EQIT and EMEC, please see the Nexus International Equity Fund section of this report.

similar. For more specific performance, please refer to the Fund reports in this document or your client-specific report.

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

[12] 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 4.3% in the fourth quarter. This return compares to the 5.5% total return of the Fund's benchmark during the same period. In the last 12 months, the Fund has returned 11.3%, better than the benchmark return of 10.9%. From a longer-term perspective, our returns for the 3, 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 presented in the table below.

In Canada, the equity market rose 4.5% in the quarter. Our Canadian holdings gained 3.9%, modestly trailing the market. The main driver of the gains was the Financials sector and particularly the Canadian banks which, as a group, reported strong quarterly results.

In the U.S., the equity market advanced 7.2% in the quarter in Canadian dollar terms. Our U.S. holdings did not capture all this advance, but still generated a strong 4.7% return during the quarter. Our U.S. returns benefitted from owning Walmart, Microsoft, Dollar General and Cisco. However, these positives were partly offset by share price declines at GE, CarMax, Gilead Sciences and Western Digital.

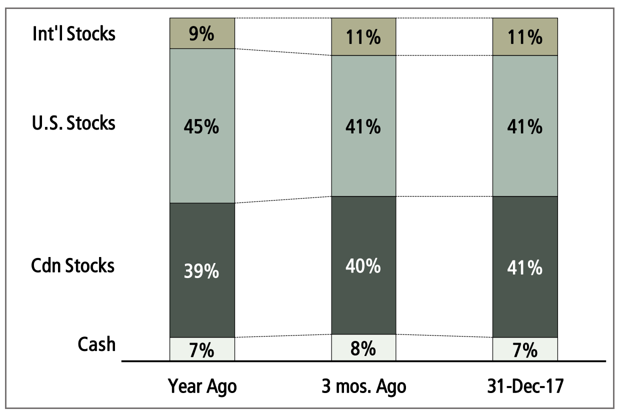
Our international holdings delivered positive returns in the quarter. The developed markets fund, EQIT, was up 6.4% this quarter and the emerging markets fund, EMEC, rose 8.6%.

At the end of the fourth quarter, the Fund's cash position was 7%. Our allocation to Canadian stocks was 41% and for U.S. stocks it was also 41%. We have maintained an allocation of 11% to markets outside North America and believe that this will provide important diversification to our North American investments.

	Equity Fund	Cdn Stocks	U.S. Stocks	Int'l Stocks
Quarter				
Fund	4.3%	3.9%	4.7%	7.3%
Benchmark	*5.5%*	*4.5%*	*7.2%*	
One Year				
Fund	11.3%	12.2%	10.4%	25.8%
Benchmark	*10.9%*	*9.1%*	*13.8%*	

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 December 31, 2017



Equity Fund Asset Mix

Nexus North American Balanced Fund

The Nexus North American Balanced Fund generated a total return of 3.4% in the fourth quarter. This return compares to the 4.2% total return of the Fund's benchmark during the same period. In the last 12 months, the Fund has returned 7.8%, in line with the benchmark return of 7.9%. From a longer-term perspective, our returns for the 3, 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.

Our bond holdings gained 0.8% in the quarter, trailing the return of the bond benchmark, which rose 2.0%. The duration of our fixed income portfolio remains shorter than the FTSE TMX Universe Bond Index. This positioning led to underperformance in the quarter, as our bonds were negatively impacted by rising short-term rates and we did not participate in the rally in longer-dated bonds.

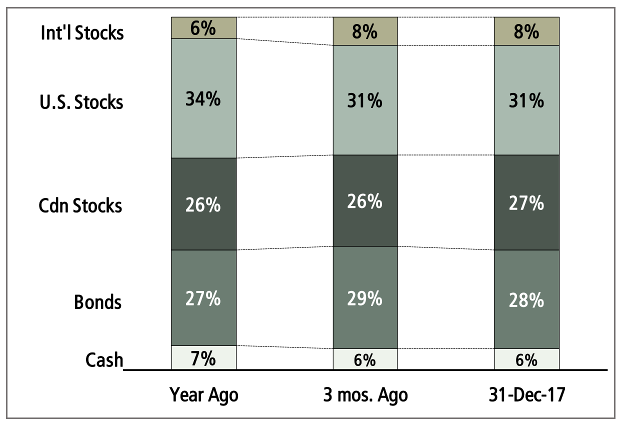
In equities, our Canadian stocks returned 4.0% in the quarter. Our U.S. equities also delivered positive returns, up 5.1%. Our international holdings had very strong performance in the quarter. The developed markets fund, EQIT, was up 6.4% and the emerging markets fund, EMEC, rose 8.6%.

At the end of the quarter, cash represented 6% of the Fund's asset mix, bonds were 28% 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	3.4%	0.8%	4.0%	5.1%	7.3%
Benchmark	*4.2%*	*2.0%*	*4.5%*	*7.2%*	
One Year					
Fund	7.8%	0.9%	11.2%	11.3%	25.3%
Benchmark	*7.9%*	*2.5%*	*9.1%*	*13.8%*	

Returns are presented before deduction of management fees. Benchmarks are (a) for the Fund: 5% FTSE TMX 91Day TBill, 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, 2017



Balanced Fund Asset Mix

Nexus North American Income Fund

The Nexus North American Income Fund produced a total return of 1.2% in the fourth quarter. This return compares to the 2.0% total return of the Fund's benchmark during the same period. In the last 12 months, the Fund has returned 2.3%, modestly trailing the benchmark return of 2.5%. From a longer-term perspective, our returns for the 3, 5 and 10-year periods remain above the benchmark and are very attractive on an outright basis.

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

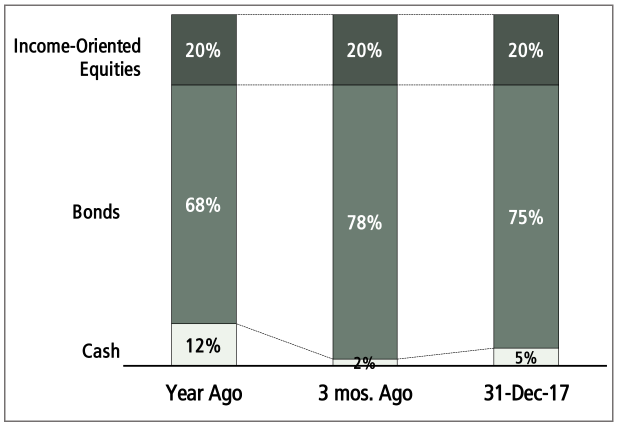
Our bond holdings rose by 0.8% in the quarter, underperforming the benchmark which rose 2.0%. This outcome is a result of our choice to maintain a bond portfolio comprised of shorter-maturity bonds, which turned out to be a drag on performance during a quarter in which short-term rates rose and long-term rates declined. The Fund continued to benefit from tailwinds provided by our Income-Oriented Equities in both Canada and the U.S.

At the end of the fourth quarter, the Fund's cash position was 5%, Income-Oriented Equities accounted for 19% and the balance, 76%, was in our core bond holdings.

	Income Fund	Bonds	Cdn Stocks	U.S. Stocks
Quarter				
Fund	1.2%	0.8%	3.4%	2.3%
Benchmark	*2.0%*	*2.0%*		
One Year				
Fund	2.3%	0.9%	12.2%	0.6%
Benchmark	*2.5%*	*2.5%*		

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 December 31, 2017



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).[13]

In the quarter just ended, NIEF delivered a total return of 7.3% which outpaced the 5.6% total return of its blended benchmark. Over the past year, the Fund returned a remarkable 25.7%, exceeding the benchmark return of 19.6%. Longer-term returns for both EQIT and EMEC remain solid, with EQIT up 12.3% per year and EMEC up 14.3% per year over the past three years.

Political developments continue to dominate the international stage. In Spain, questions surrounding the independence movement in Catalonia remain unresolved, despite regional elections in December. In Germany, contentious elections have left Chancellor Angela Merkel in a weakened position as she is now making a last-ditch effort to form a government by joining the country's two main parties in a "grand coalition". Elsewhere in Europe, there is evidence of positive progress on Brexit negotiations, as talks appear to be moving forward into a second phase focused on the future of trade between the UK and the European Union. For the UK, the balancing act will be to negotiate full trade access to EU markets while simultaneously maintaining national sovereignty – a key demand of Brexit supporters.

Through all this turmoil, most European stock markets produced solid single-digit gains in the last quarter. In addition to the stock market, economic fundamentals are also showing improvement with GDP growth in the eurozone poised to deliver the best annual results since the financial crisis.

In emerging markets, fourth quarter stock returns were among the best in the world. As measured by the MSCI Emerging Markets Index, price gains of 8.0% in the quarter were better than any other region, including Canada, Europe and the U.S. Within the emerging markets region, standouts include India's Sensex Index, which gained 12.2%, and Hong Kong's Hang Seng Index, which gained 9.5%.

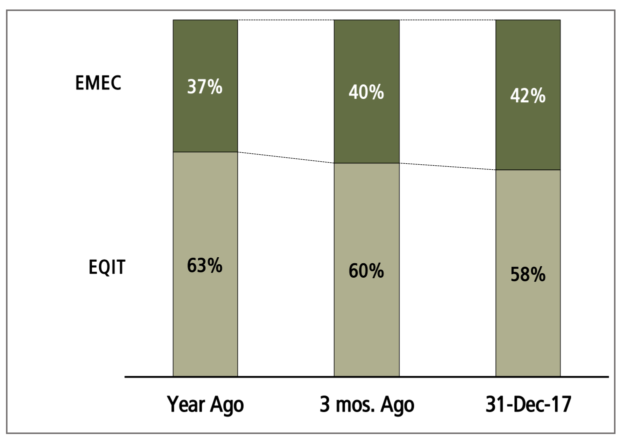
We continue to like the long-term outlook for both EQIT and EMEC given that international stocks remain attractively valued, provide unique diversification characteristics to the portfolio and offer solid prospects for long-term earnings growth.

The Nexus International Equity Fund's proportional exposure of developed markets to emerging markets is about 58:42, whereas the Fund's benchmark is 75:25.

	International Equity Fund	EQIT	EMEC
Quarter			
Fund	7.3%	6.4%	8.6%
Benchmark	*5.6%*	*4.8%*	*8.0%*
One Year			
Fund	25.7%	22.6%	30.7%
Benchmark	*19.6%*	*16.8%*	*28.3%*

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, 2017



International Equity Fund Asset Mix

[13] 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.