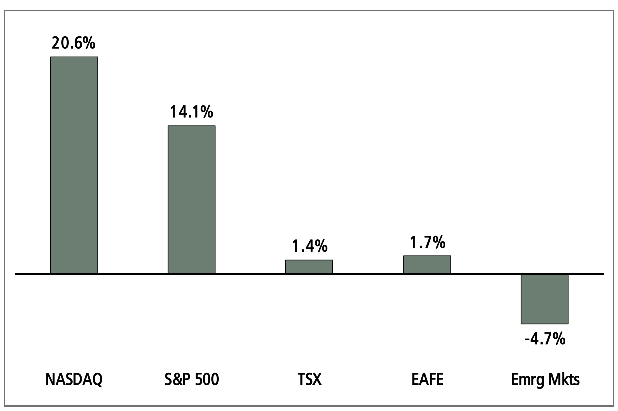
Diverging Paths

In 2017 investors enjoyed a synchronized global stock market rally. Over the first nine months of 2018, however, the paths of equity markets have diverged significantly. U.S. stock markets have continued to rise, led by the technology sector. In August, accompanied by great media fanfare, Apple became the first company in history to reach a US$1 trillion market capitalization. A few weeks later, Amazon became the second. More generally, U.S. market strength has been supported by continued economic growth as well as a surge in corporate earnings, thanks to the tax cuts enacted in late 2017. Market volatility, after a sharp but brief spike in February, has reverted to levels far below long-term averages. The mood in U.S. markets seems to reflect a high degree of optimism.

In contrast, returns in Canada and most international equity markets have been lacklustre. Many countries are experiencing decelerating economic growth and investor sentiment has been negatively affected by the great uncertainty around international trade. Certain country-specific issues, such as Brexit in the U.K., also have weighed. In emerging markets the potential for contagion from the economic crises in Turkey and Argentina has made investors anxious. It's a very different mood from the confidence implied by U.S. stock market strength.



2018 Stock Market Returns[1]

A Sigh of Relief

Throughout 2018, no issue was of greater importance for the Canadian economy than the difficult re-negotiation of the NAFTA trade deal with Mexico and the U.S. Reports on its progress overshadowed the usual flow of updates on the country's economic health. In 2016, President Trump's campaign rhetoric described NAFTA as the worst trade deal ever created, and he relentlessly criticized the economic relationship between Canada and the U.S. after he took office. In June, tensions rose further as tariffs were imposed on steel and aluminum imported from Canada (and elsewhere). Then, through the summer, the threat of the "nuclear option" – tariffs on autos and auto parts – was brandished with apparent glee. It came as a huge relief, therefore, when a new NAFTA – now called the U.S., Mexico, Canada Agreement (USMCA) – was announced on September 30. While there is a myriad of changes in the new agreement, our analysis suggests that there will not be substantial economic impact one way or the other. Much will be made of the increased access to our dairy market, but Canada had already agreed to most of this in the Trans-Pacific Partnership trade deal. Given that many feared a substantially worse deal than we have under NAFTA, the USMCA can be considered a success.

Now that trade worries have subsided, investors can focus again on economic fundamentals in Canada, which have remained surprisingly strong. For example, Statistics Canada reported that 63,000 new jobs were created in September, significantly better than expectations. The unemployment rate dropped to 5.9%, nearly matching the 5.8% rate set earlier in the year, which was the lowest in many decades. While many of the new jobs were part-time, and wage growth moderated, there is no denying the strength of the Canadian labour market. As well, Canada recently reported its first trade surplus in two years, and the approval of the $40 billion LNG Canada project in B.C. is both a benefit to the Canadian economy and a positive signal to foreign investors.

Despite the resilience of the Canadian economy, many of the challenges we have outlined in recent months persist. Following U.S. tax reform, Canada has lost its position as a favourable tax jurisdiction for corporations. In the oil sector, the discount for Canadian crude relative to the U.S. benchmark has reached alarming levels. The lack of pipeline capacity and other means to take product to market has widened the discount for Canadian crude to more than US$40 per barrel. Perhaps most worrying is the rising level of interest rates in a country whose citizens and governments carry unprecedented levels of debt. While economic conditions are currently

[1] Year-to-date total returns, including dividends, in Canadian dollars.

favourable, caution about the period ahead seems warranted.

U.S. Economy Remarkably Positive

"Remarkably positive" is the phrase that U.S. Federal Reserve Chair, Jerome Powell, used to describe the U.S. economic outlook in a recent speech to the National Association for Business Economics. In September, for example, the U.S. unemployment rate dropped to 3.7%, the lowest level since 1969. While the headline number of new jobs created in September was a bit lower than expected, it nonetheless confirms the U.S. labour market is extraordinarily strong. Weekly jobless claims are also at a level last seen almost 50 years ago. GDP growth in the second quarter of 2018 was 4.2%, the fastest rate of growth in four years. While growth is almost certain to moderate in the second half of the year, we expect it to remain at a very healthy pace, thanks to robust business and consumer sentiment and the lingering positive effects of U.S. tax reform.

As we have often observed, however, trees don't grow to the sky. It's reasonable to assume that the second longest U.S. expansion on record is closer to the end than to the beginning. The fact that activity in both the housing and auto sectors has moderated in recent months may be the first sign that U.S. economic strength has peaked. The timing of a downturn is uncertain and the catalyst unknown; however, many view the ongoing risk of a trade war and excessive levels of debt as reasons for significant concern.

While trade peace seems to have been achieved with Mexico and Canada, and constructive talks are ongoing with the European Union and Japan, relations with China have become increasingly belligerent. The U.S. has instituted 10% tariffs on a wide range of Chinese imports and these are scheduled to increase to 25% in January. The issues at hand are complex and resolution does not seem imminent. There is no doubt the tariffs are bad for China, but they are also bad for the U.S. Together with the ongoing steel and aluminum tariffs, trade wars pose a real threat to the current U.S. expansion.

Concerns about growing levels of debt in the U.S. are not new to these pages. U.S. federal government debt is at record levels and interest payments total $276 billion annually, or 6.8% of all government outlays.[2] Moreover, debt levels continue to rise as the U.S. forecasts a $1 trillion budget deficit for 2019. For a decade the debt burden of the U.S. government has benefited from extraordinarily low interest rates. But rates are now rising and the consequences of this burden are worrisome. Additionally, corporations are now refinancing maturing debts at higher interest rates and eroding profit margins in the process. There is no way to predict if, or when, a debt crisis could happen. But a necessary ingredient is the rising trend of interest rates that now seems to be taking hold.

Investment Outlook

As is so often the case, the future path of financial markets is remarkably uncertain. There are many reasons to be optimistic for continued good returns in portfolios. There also are sobering risks that could translate into difficult markets ahead. It is certain there will be a recession sometime in the future as well as an ugly bear market. There is just no way to know when either will happen. They may be many months, or many years, away.

We often discuss how we tackle this uncertainty by investing in high-quality companies – companies that will prosper when times are good and prove resilient when times are tough. These companies typically have reasonable valuations that offer a "margin of safety" and strong balance sheets that provide stability in economic downturns. We talk less often about an equally important portfolio attribute: diversification.

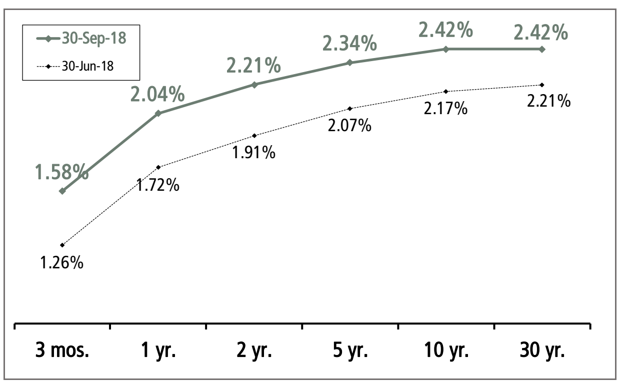
Diversification across industry sectors is important. We don't want to have too many eggs in one basket. It is also important across regions. Virtually all client returns in 2018 have come from U.S. equities. Who would have predicted the dramatically different market returns depicted in the graph on page 1? In the period ahead there will be an ebb and flow as to which sectors and regions are strong and which are weak. By sensibly diversifying our investments across them we expect to achieve good long-term returns while smoothing out the inevitable ups and downs that are part of the investment landscape.

[2] From Pew Research Center. Interest payments cited are to third parties, netting out the interest paid to other arms of government such as the Social Security fund.

Asset Class Investment Review

Fixed Income

In the third quarter, there was a change of tone in the bond market from the first half of the year. For the first 6 months of 2018, rates moved higher, but followed a "sawtooth" pattern that alternated periods of yield increases with temporary and partial recoveries. In the last 3 months rates moved steadily higher, without many periods of recovery: 2-year yields rose 0.30%, from 1.91% to 2.21%; and 10-year yields rose 0.25%, from 2.17% to 2.42% (see chart). It is worth remembering that it was precisely two years ago that 10-year yields traded at their record low level of 0.95%. As rates moved higher in the last quarter, returns were negative. The bond return of our Income Fund was a modest negative return of 0.2% for the quarter, and up only 0.2% for the year-to-date. The FTSE TMX Canada Universe Bond Index fared worse. It fell 1.0% this quarter and has declined 0.3% for the year-to-date.



Government of Canada Yield Curve

NAFTA and tariff headlines dominated the news this quarter, introducing much uncertainty to a trade-oriented economy such as Canada's. Exacerbating the unease, for much of the period Canada was on the outside of the negotiations while bilateral discussions between the Americans and the Mexicans took place without Canadian involvement. It was unclear if the two countries could pursue a deal on their own. It was unclear how forceful President Trump would be in applying tariffs to pressure Canada. Understandably, the uncertainty dominated any assessment of the outlook for the economy and it created a set of conditions which justified a very cautious approach to business investment on this side of the border.

As mentioned earlier, economic conditions in the U.S. are tremendously positive and are dragging the Canadian economy forward. U.S. unemployment is at a record low level, surveys of business and consumer confidence are elevated, and corporate profitability is high. Measures of GDP growth announced recently for the second quarter showed that GDP grew at a 4.2% rate – the fastest rate of quarterly growth in 4 years. There is a lot of forward momentum in the U.S. economy presently.

Early in the quarter (July 11th) the Bank of Canada increased the Bank Rate to 1.50%. The subsequent commentary from Governor Poloz was consistent – until the results of trade negotiations were known, further rate increases were unlikely. While it remains to be seen how businesses will respond to the new trade agreement, a definitive deal all but guarantees that the Bank of Canada raises the Bank Rate to 1.75% when it meets on October 24th. Casting forward, further interest rate increases will be determined by signs of accelerating inflation, which we think is on the horizon. In Canada, headline inflation is at the upper end of the Bank's 1% to 3% target range and in the last year, all three core inflation measures have accelerated from about 1.50% to a bit more than 2%.

Over the course of the quarter, we did make some minor trades to better position the portfolio and take advantage of opportunities in the market. Most noticeably, after much anticipation, we saw the inaugural bank "bail-in" bond issue from Royal Bank of Canada in September. This new structure has been created to comply with new regulatory requirements and will replace traditional deposit notes going forward for all the large banks. Unlike traditional deposit notes, the new structure has a bail-in mechanism which means the bonds can be converted into common shares if the issuing bank becomes financially "non-viable", at a time determined by OSFI. The yield of these new bonds should be higher than deposit notes, and currently this differential for a 5-year term is about 0.18%. Given Nexus's large exposure to traditional deposit notes, watching where this structure trades will be important, as we will likely transition into the new bail-in bonds as they replace the traditional deposit note market. For now, the new structure has resulted in strong performance in the existing deposit notes as investors know that there will be no more supply.

Although we made some changes to the portfolio, our core positioning remains unchanged. We have a high-quality bias and shorter-maturity profile. High-quality gives the portfolio superior liquidity, which will be useful in the event of a sudden shift in risk sentiment, and the shorter-maturity profile will protect capital as interest rates rise.

Equities

The third quarter was a mixed one for equities – strong in the U.S. and weak elsewhere. The Equity Fund returned 1.9%, slightly lagging the market benchmark's return of 2.4%. Over the past twelve months, the Equity Fund returned 11.1%, also behind the benchmark's 12.8% return.[3]

The main driver of returns in the quarter were our U.S. equities, which were up 4.9%. Our Canadian equities had a low return of just 0.7%, but this was better than the TSX Composite, which had a negative return. The main source of weakness was our international equities, which traded down 2.6% in the last 3 months.[4]

The Canadian dollar has yo-yoed. It strengthened in the third quarter, such that it *reduced* our U.S. equity returns measured in Canadian dollars by 1.8 percentage points. For the last 12 months, it weakened, *adding* 4.4 percentage points to our return.

Overall, equity market volatility has been well below its long-term average and returns have been higher than average. We know this will not continue indefinitely and we continue to believe that our well-diversified, quality-oriented investment approach will stand us in good stead in trying times.

Canadian Equities

Nexus's Canadian stocks were up 0.7% in the quarter and up 6.8% over the last twelve months. Despite the low return, this was ahead of the TSX Composite's loss of 0.6% in the quarter and gain of 5.9% for the twelve months.

The Canadian market last quarter was "split" – 5 of the index sectors had negative returns, while 6 had positive returns. The biggest benefit for us this quarter was our defensive, high-quality positioning, as we hold no Materials stocks (which declined 13%). Other sources of our outperformance were our Energy holdings and a strong showing from Thomson Reuters, which completed the partial spinoff of 55% of its Financial and Risk business (now renamed Refinitiv). Thomson Reuters retains its Legal, Tax and Accounting Information business units.

U.S. Equities

Nexus's U.S. equities were up 4.9% in the third quarter, trailing the S&P 500's 5.9% return. For the twelve months, our U.S. holdings are up 19.4%, also behind the S&P 500's very strong return of 22.3%.

Our strongest U.S. sector was Healthcare, which returned 14.3% (Pfizer and Gilead), in a quarter that was also strong for most Healthcare stocks.

While four of our Information Technology holdings were up double digits (Apple, Cisco, HP and Microsoft), one, Western Digital, fell substantially amidst concerns of excess memory capacity and lower pricing. Western Digital has always been a volatile stock, but we like it for its solid longer-term potential.

One other source of weakness last quarter was GE. The stock has since had a bounce, erasing its third quarter decline. The main news on GE is a change in CEO, with Larry Culp, a GE board member and the ex-CEO of Danaher, taking the helm.

Other Equity Investments

We are 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).[5]

As investors continue to view the U.S. as an island of stability amidst a world rocked by trade issues and weaker currencies, the weakness for international equities that we saw in the second quarter extended into the third. EQIT fell 2.4% and is up 2.7% for the last twelve months. EMEC fell 2.8% in the third quarter and is up 4.6% over the last twelve months. Longer-term returns for both holdings remain good (the 2-, 3- and 5-year returns are all around 10% per year), and we continue to value their long-term attributes. For more information on EQIT and EMEC, please see the Nexus International Equity Fund section of this report.

[3] 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.

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

[5] 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 1.9% in the third quarter. This compares to the 2.4% total return of the Fund's benchmark during the same period. In the last 12 months the Fund lagged its benchmark, but still produced a strong return of 11.1%. From a longer-term perspective, our returns for the 2, 5 and 10-year periods remain at or above the benchmark and are very attractive on an outright basis.

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

In Canada, the equity market declined 0.6% in the quarter. Our Canadian holdings did better, rising 0.7%. The Materials sector had a difficult quarter (particularly gold stocks) and, since we have no stocks in that sector, we avoided the losses in that area of the market. Several of our stocks performed strongly, including Toromont, Alimentation Couche-Tard and Thomson Reuters.

In the U.S., our holdings rose substantially, up 4.9% in the quarter, although this trailed the benchmark, which rose 5.9%. The key drivers of this rise were the Healthcare and Information Technology sectors, which were up 13% and 11%, respectively. We participated in this strength via our positions in Pfizer, Apple and other stocks. But we also had some negative offsets among our U.S. holdings, including Western Digital and General Electric.

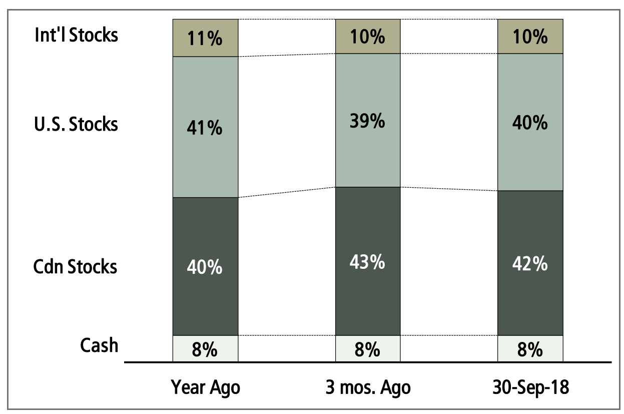
Our international holdings continued to face headwinds from rising global trade tensions. The developed markets fund, EQIT, declined 2.4% this quarter and the emerging markets fund, EMEC, declined 2.8%.

At the end of the third quarter, the Fund's cash position was 8%. Our allocation to Canadian stocks was 42%, while U.S. stocks represented 40% of the mix. We have maintained an allocation of 10% to markets outside North America and remain confident, despite the recent bouts of volatility, that this will provide important diversification to our North American investments.

	Equity Fund	Cdn Stocks	U.S. Stocks	Int'l Stocks
Quarter				
Fund	1.9%	0.7%	4.9%	-2.6%
Benchmark	*2.4%*	*-0.6%*	*5.9%*	
One Year				
Fund	11.1%	6.8%	19.4%	3.7%
Benchmark	*12.8%*	*5.9%*	*22.3%*	

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 September 30, 2018



Equity Fund Asset Mix

Nexus North American Balanced Fund

The Nexus North American Balanced Fund generated a total return of 1.6% in the third quarter. This compares to the 1.0% total return of the Fund's benchmark during the same period. In the last 12 months, the Fund has returned 8.5%, modestly exceeding the benchmark return of 8.3%. From a longer-term perspective, our returns for the 2, 5 and 10-year periods remain at or above the benchmark and are very attractive on an outright basis.

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

Our bond holdings declined 0.2% in the quarter, outperforming the bond benchmark which lost 1.0%. Portfolio composition was little changed quarter over quarter. We participated in some new issues of corporate bonds and sold our provincial bonds because of strong recent performance and relatively skinny credit spreads. We maintain our high-quality and short-maturity emphasis, which served us well in the quarter, as longer-maturity bonds underperformed those with shorter maturities. This positioning resulted in our bond portfolio outperforming the index, although our quality bias created a small drag on the portfolio as credit spreads continued to tighten.

In equities, our U.S. stocks delivered strong gains of 5.7% and our Canadian stocks were also up, albeit a more modest 0.9%. The US returns benefitted from strength in the Healthcare and Information Technology sectors, with two of our holdings (Pfizer and Apple) up over 20% this quarter. However, there were negative offsets, such as Western Digital and General Electric, which both declined in the period.

In Canada, the Materials sector had a difficult quarter (particularly gold stocks) and, since we have no stocks in that sector, we avoided the losses in that area of the market. Several of our stocks performed strongly, including Toromont, Alimentation Couche-Tard and Thomson Reuters.

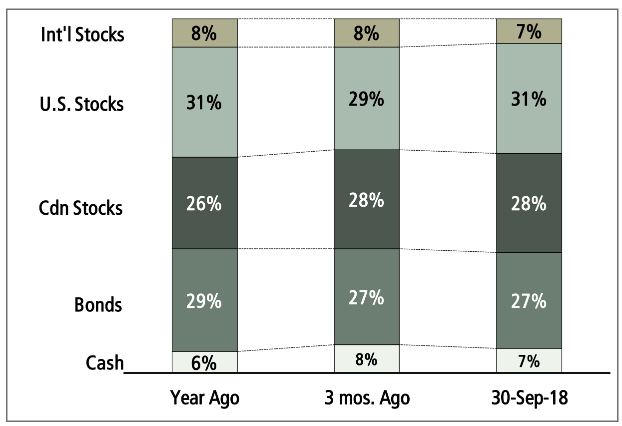
Our international holdings continued to face headwinds from rising global trade tensions. The developed markets fund, EQIT, declined 2.4% this quarter and the emerging markets fund, EMEC, declined 2.8%.

At the end of the quarter, cash represented 7% of the Fund's asset mix, bonds were 27% 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	1.6%	-0.2%	0.9%	5.7%	-2.6%
Benchmark	*1.0%*	*-1.0%*	*-0.6%*	*5.9%*	
One Year					
Fund	8.5%	1.0%	6.0%	20.7%	3.7%
Benchmark	*8.3%*	*1.7%*	*5.9%*	*22.3%*	

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 September 30, 2018



Balanced Fund Asset Mix

Nexus North American Income Fund

The Nexus North American Income Fund produced a positive total return of 0.5% in the third quarter. This compares to the 1.0% *decline* of the Fund's benchmark during the same period. In the last 12 months, the Fund has returned 2.1%, surpassing the benchmark return of 1.7%. From a longer-term perspective, our returns for the 2, 5 and 10-year periods remain at or above the benchmark and are very attractive on an outright basis.

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

Our bond holdings declined 0.2% in the quarter, outperforming the bond benchmark which fell 1.0%. We made few changes to the composition of the bond portfolio this quarter. We participated in some new issues of corporate bonds and sold our provincial bonds because of strong recent performance and relatively thin credit spreads. We maintain our high-quality and short-maturity emphasis, which served us well in the quarter as longer-maturity bonds underperformed those with shorter maturities. This positioning resulted in our bond portfolio outperforming the index, although our quality bias created a small drag on the portfolio as credit spreads continued to tighten.

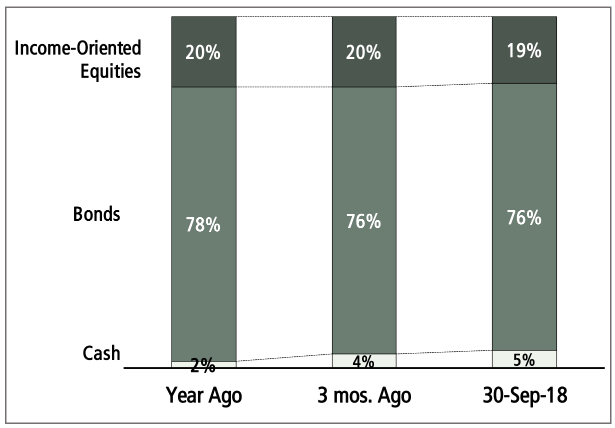
Our holdings of Income-Oriented Equities in Canada and the U.S. provided a tailwind to the Fund’s performance. Specifically, our Canadian stocks were up 1.6% and our U.S. equities produced a 9.0% gain, both adding to the Fund’s return.

At the end of the third 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	0.5%	-0.2%	1.6%	9.0%
Benchmark	*-1.0%*	*-1.0%*		
One Year				
Fund	2.1%	0.9%	3.0%	19.1%
Benchmark	*1.7%*	*1.7%*		

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 September 30, 2018



Income Fund Asset Mix

Nexus International Equity Fund

The Nexus International Equity Fund holds two underlying funds: EQIT (invested in international developed market equities) and EMEC (invested in emerging market equities).[6]

The Nexus International Equity Fund declined 2.6% in the third quarter. This return compares to the 1.0% decline of the Fund's blended benchmark during the same period. Over the past year, the Fund has returned 3.7%, but lagged the benchmark return of 5.7%.

Longer-term returns for both EQIT and EMEC have been solid, with EQIT up 8.4% per year and EMEC up 13.4% per year over the past three years.

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

The declines in international markets this quarter reflect rising global trade uncertainty. We noted last quarter that the risk of a breakdown in international trade relationships was on the rise, particularly between the U.S. and China. Events this quarter did little to alleviate those concerns.

In Europe, unsettled Brexit negotiations are calling into question the future of the trade relationship between Europe and the U.K., adding uncertainty to the entire region. In China, the impact of U.S. tariffs and the threat of a drawn-out trade war increased uncertainty and contributed to a decline in Chinese markets. In other international markets, significant inflation and currency problems have arisen in Turkey and Argentina. But so far, the damage appears contained to these countries. The International Monetary Fund recently noted that it expects most emerging economies to navigate through the recent turmoil. Nevertheless, there is an outside chance of more widespread instability in emerging markets.

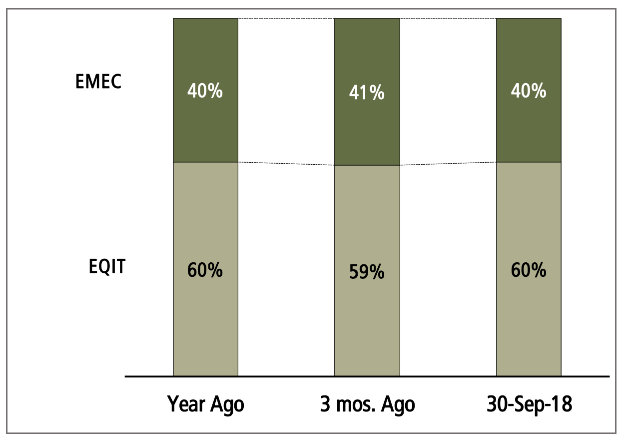
While current events in international markets have caused some near-term turmoil, we remain optimistic on the long-term outlook for both EQIT and EMEC. Both funds follow a disciplined investment approach that emphasizes quality holdings that should withstand the turmoil. We continue to believe that over time, the International Fund will deliver valuable diversification and growth benefits beyond what is available in North America.

At the close of the third quarter, the Fund's investment in EQIT accounted for 60% of the Fund’s assets, while EMEC accounted for 40%.

	International Equity Fund	EQIT	EMEC
Quarter			
Fund	-2.6%	-2.4%	-2.8%
Benchmark	*-1.0%*	*-0.4%*	*-2.8%*
One Year			
Fund	3.7%	2.7%	4.6%
Benchmark	*5.7%*	*6.6%*	*2.9%*

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

Investment Returns – As at September 30, 2018



International Equity Fund Asset Mix

[6] 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.