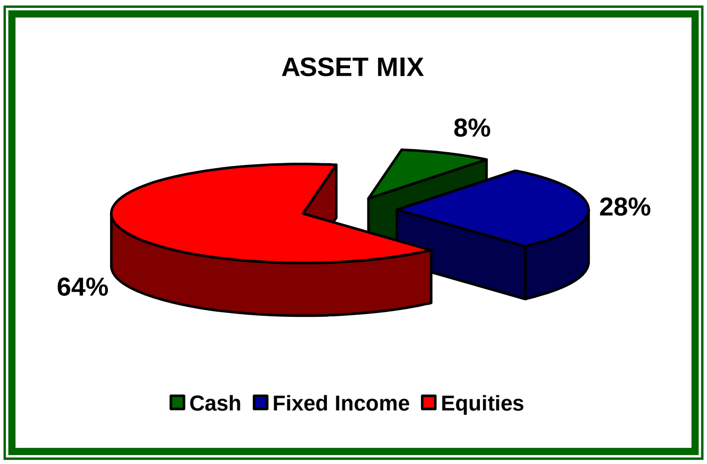
NEXUS

Portfolio Management & Financial Counsel

NEXUS NORTH AMERICAN BALANCED FUND
QUARTERLY REPORT – June 30, 2012

After a strong start to 2012, the latest quarter proved more difficult for investors. While fixed income returns have provided a low but steady return over this period, the returns from being an equity investor, although positive, have been much more volatile. There are three primary sources of concern: an unsettled political and economic situation in Europe, worry of a possible economic slowdown in the U.S. (exaggerated by fiscal retrenchment and political mismanagement), and concerns that developing world economies are also slowing.

Given how connected we are to the rest of the world by trade, Canadian economic performance has held up remarkably well in the first half of the year. Despite highly stimulative monetary conditions, inflation is well contained, economic growth this year should exceed 2% and labour market conditions are continuing to improve, albeit at a modest pace.[1]



Europe dominates the business headlines and has provided the greatest day-to-day influence on markets. European events are impacting not only Europe, but also the rest of the world. There is a negative effect on the real economy as business leaders postpone investment and hiring decisions and consumers rein in their spending out of concern for the future. At this point, the problems are well known: many countries lived beyond their means for too long and are now having to deal with unsustainable debt burdens. The required de-leveraging – across households, the banking system and the government sector – is magnifying an economic slowdown and risks plunging the continent into an economic depression. It has torn at the social cohesion of Europeans, pitting the countries of the periphery (Spain, Greece, Portugal and Italy) against the countries of the core (primarily Germany but also Finland and the Netherlands). We continue to believe that, over time, a solution to these problems will emerge. Late in June, to the surprise of many and the great relief of the markets, a substantial first step towards a lasting solution appears to have occurred. At their 20th summit in 30 months, amongst a number of important initiatives, the European heads of state seemed to have agreed on a framework that would provide for a pan-European plan to shore up the EU financial sector. This plan may be a precedent that establishes greater integration (read German oversight and control) in exchange for 'risk sharing' (read German financial backing) and is an important precedent for tackling other important issues that the EU faces, such as loan guarantees or stimulus spending. Time will tell if this latest agreement represents a turning point in the Euro crisis or is just another of many false hopes.

In North America, the primary area of concern is the dire state of U.S. government finances and the lack of urgency to deal with impending policy changes that will, if implemented, subtract 3% to 5% from GDP in 2013.[2] This debacle arises from the failure of a bipartisan committee of Republicans and Democrats to create and pass legislation that would address the federal budget deficit. Instead, in 2013, payroll tax cuts will expire, taxes on investment income will increase, and there will be substantial across the board spending cuts. On their own, each of these measures has the effect of slowing economic growth. Taken together, economists have named the impending phenomena a 'Fiscal Cliff', and worry that it will contribute to a sharp slowdown in economic activity. Until the results of the Presidential election are known in November, it is unlikely that any progress will be made on this issue. In the meantime, economic performance is decidedly mixed. Indicators of sentiment show that both business and consumer confidence have faltered, at least in part a consequence of the unsettled conditions in Europe. However, there are other indications that the latest slowdown may only be a pause and not the start of more meaningful economic weakness. Housing, a persistent source of weakness for many years, seems to be making a bottom. Home sales are up, mortgage delinquencies are declining and home prices have stopped falling. Consumers also stand to benefit from a decline in food and energy prices that will improve discretionary purchasing power over the rest of 2012. Interest rates are low, making the purchase of 'big ticket' items affordable. Businesses and consumers have done an excellent job of improving their balance sheets in the last two years and there is some pent-up capacity to spend, especially with rates so low. What is needed is an improvement in business and consumer confidence, which will come only with further progress in Europe and on the political front in Washington.

We continue to watch the deceleration of economic growth in China closely. As the second largest economy in the world, China is crucial to the performance of the global economy. Evidence of an impending slowdown there is abundant but we think stops short of a 'hard-landing.' To state the obvious, China's economy is unlike the economies of Western Europe or North America. Investment, not consumption, drives economic activity and this investment in infrastructure, housing, and machinery is funded by domestic savings, not external borrowing. In short, in a command economy, centrally controlled in Beijing, investment spending will continue to be strong. However, we know that there are some commentators who maintain a darker view of economic performance in China and we are alert to the downside risks should our current opinion prove to be too sanguine.

After a strong start to the year, the Fund had a weaker quarter declining 1.7%.[3] In the last 12 months the return has been positive, rising 2.2%.

Asset Mix

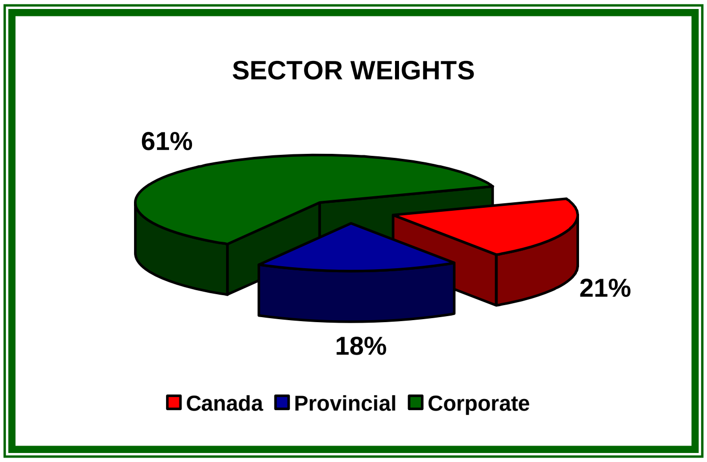
A little extra cash has been allowed to accumulate at the expense of being invested in the bond market and is available for new opportunities as they arrive. In fact, for much of the quarter, the cash position was running slightly higher than current levels. However, in late May and early June, we added to established positions in certain Canadian and U.S. stocks as well as to our allocation of 'Other Investments'. The current allocation to fixed income remains underweight target levels, reflecting our expectations for low returns from the bond market. Our allocation to equities is little changed from last quarter.

Fixed Income (28% of Assets)

Yields of longer maturity bonds fell more than those of shorter maturities this quarter. This was the result of an unprecedented investor preference for safety-at-all-costs, rather than any policy changes coming from the Bank of Canada. Over the course of the quarter, 10 year Canada bonds moved from 2.11% to 1.76%, a decline of 35 basis points, while the 1 year rate declined from 1.09% to 0.99%, a decline of only 10 basis points. Governor Carney has continued to deliver a message reminding Canadians that current low interest rates are unsustainably accommodative and that a normalization of monetary conditions is not far off.[4] Likewise, Governor Bernanke has been explicit in stressing that further economic progress in the United States has to be the result of sensible fiscal policies that put Federal government finances on the path to sustainability, and not solely an effort of the Federal Reserve's zero interest rate and quantitative easing policies.[5]

We have kept a maturity profile that is shorter than the DUBI Index, due to our belief that prospective returns in the bond market could well be significantly negative should inflation accelerate and interest rates rise. Rates at today's levels represent a historic opportunity for borrowers to raise capital and, conversely, a particularly inopportune time for investors to tie up their capital.

We think the *purchase* of bonds is a somewhat discretionary decision on the part of investors. Depending on the rates offered, the risk tolerance of the buyer and other motivations (perhaps regulatory requirements), demand ebbs and flows. The *issuance* of bonds is much less discretionary. In particular, governments must regularly borrow in the bond markets in order to roll over debt maturities and finance new deficits. Nowhere is this more evident than with the Province of Ontario, a borrower of prolific expertise and size. In the current fiscal year, Ontario must borrow $35 billion and a similar figure is to be expected for at least three years after. Hardly a week goes by, that Ontario doesn't bring an issue to market in Canada or in some other currency or market elsewhere around the globe. They come to market not out of opportunity but because they have to. Ontario maintains a AA (low) credit rating and for now, we are not really worried about its capacity to pay interest. Rather, to us, there is risk they will wear out their welcome and that investors will demand a higher yield in order to keep adding to their positions. At present levels, paying an extra 1% over the rate of ten year Canada bonds, the extra yield one earns is not enough to offset the risk that Ontario spreads could widen substantially and erode the capital value of its bonds. This quarter we dramatically reduced our exposure to Ontario, switching into higher yielding corporate bonds, Canada Housing Trust bonds and the bonds of other provinces that have lower borrowing requirements.



Last quarter, our bond portfolio generated a positive return of +1.2%, while the DEX Universe Bond Index (DUBI) increased 2.3%. In the last 12 months, our bonds generated a return of +7.3% while the DUBI was up 9.5%.

Canadian Equities (36% of Assets)

For many years, we have maintained significant exposure to the Canadian telecom sector and our holdings in both Telus and Rogers Communications have been successful. Each company is run by a strong management team that has demonstrated an ability to adapt to technological and competitive changes. Historically, the industry has benefitted from the broader adoption of innovative communication technologies by consumers and businesses and there was considerable operating leverage in their business models that was able to take advantage of this revenue growth. As we consider the future prospects, it is clear that the competitive dynamics of the industry are changing. There is more pricing pressure and greater competition than has been the case historically. Since it is less clear to us who the winners and the losers will be, we decided to trim back our positions modestly in both names.

TEN LARGEST HOLDINGS	
Toronto Dominion Bank	3.0%
Royal Bank of Canada	2.8%
Bank of Nova Scotia	2.6%
Alimentation Couche-Tard	2.4%
Brookfield Infrastructure	2.4%
H&R REIT	1.9%
Enbridge Inc.	1.9%
Progressive Waste	1.6%
Suncor Energy	1.6%
Cenovus Energy	1.5%

A long-term holding of the Fund, Alimentation Couche-Tard, announced a transformational acquisition in mid-April. Couche-Tard is one of the largest convenience store operators in North America, operating the chain of Mac's stores in Canada and Circle K in the U.S. In the last quarter it acquired Statoil Fuel & Retail (SFR), which is the leading convenience store operator in Scandinavia with a rapidly-growing presence in Central and Eastern Europe. SFR has strong management and a profitable, growing business. The deal will be significantly accretive to Couche-Tard's profitability, although it does add a heightened level of execution risk to the story as Couche-Tard expands to new geographies. Overall, we view it as an exciting opportunity that has been very well-received in the market.

On a relative basis, we had another solid quarter. Our Canadian equity selections declined 1.6%, while the TSX Index return was 5.7%. Over the last 12 months, we have a wide margin of outperformance when compared to the TSX, with our selections having declined 2.8% when the TSX fell 10.3%.

U.S. Equities (21% of Assets)

TEN LARGEST HOLDINGS	
Apple	**2.2%**
DaVita	**2.1%**
Pfizer	**2.1%**
Wal-Mart Stores	**2.1%**
Covidien	**2.0%**
J.M. Smucker	**1.6%**
Google	**1.6%**
CarMax	**1.4%**
Cisco Systems	**1.3%**
Western Digital	**1.3%**

We added no new names to the U.S. holdings this quarter although we made additions to a number of current holdings as new cash came into the Fund. Much like the Couche-Tard transaction described above, one of our largest and best performing investments, DaVita Holdings, announced an important acquisition in early June. DaVita is primarily a dialysis services provider, but with the acquisition of HealthCare Partners, it has begun a move into an area of the healthcare sector where the medical services provider is responsible for the provision of all healthcare service to its members. This deal is significantly accretive, opens up a new area of growth for the company and is consistent with the operating expertise of DaVita's management. We like the outlook for this deal and it has been well received by the market.

Our U.S. equity returns were weak last quarter, falling 5.9%, a disappointment after a strong first quarter. These results trailed the S&P 500 Index which fell 0.8% over the same period. In the past 12 months our U.S. equity holdings lagged the broader market, gaining 6.3%, while the Index advanced 11.4%.

Other Investments (7% of Assets)

We continue to believe that diversification, through international investing, remains an important component of a well-constructed investment portfolio. In early June we announced the intention to add a small allocation to emerging markets (EM) in order to improve diversification and enhance the long-term growth of the portfolio. We think the investment case for this asset class is compelling. EM economies are younger and are growing faster than are economies in the developed world. Not only is there a favourable economic backdrop, but the security valuations compare well to developed markets. As a generalization, companies trade with lower P/E multiples, grow faster and pay higher dividends. We are confident that a modest allocation to this sector will prove rewarding over the medium term. Investing directly in EM is difficult so we have hired JP Morgan Asset Management to do this for us. Their Emerging Markets Equity - Canada Fund (EMEC) has a superb track record. This quarter we introduced a starting position in EMEC and our intention is that it will be about the size of two normal security positions (4% to 6%) when it is fully established.

We continue to maintain our position in the JP Morgan EQIT Fund. This quarter, the EQIT Fund fell 5.3%, matching the performance of the benchmark EAFE Index. EQIT continues to perform better than the TSX. In the last year, the EQIT Fund returned -5.4%, while the EAFE Index fell -8.9% and the TSX Index declined -10.3%.

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1 Latest economic releases: The rate of change of Canadian CPI was 1.2% in May, monthly GDP growth in April was a surprising 0.3% and the unemployment rate was 7.3% in June.
2 'Economic Effects of Reducing the Fiscal Restraint That is Scheduled To Occur in 2013', Congressional Budget Office May 22nd 2012.
3 Fund returns are shown <u>before</u> the deduction of management fees but after the deduction of direct expenses.
4 'Financing the Global Transition', Remarks to the Atlantic Institute for Market Studies, June 21, 2012.
5 'Economic Outlook and Policy', Testimony Before the Joint Economic Committee, U.S. Congress, June 7, 2012.