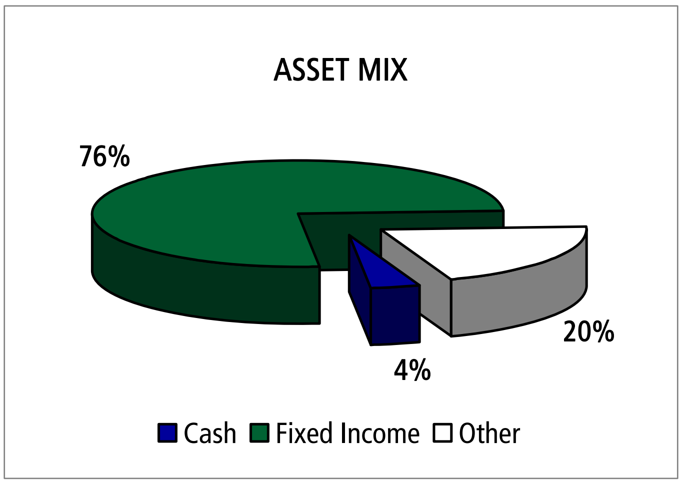
NEXUS

Portfolio Management & Financial Counsel

NEXUS NORTH AMERICAN INCOME FUND

QUARTERLY REPORT – December 31, 2012

At the conclusion of the third quarter of 2012, capital markets faced a number of important uncertainties that darkened the investment outlook. Worries of European political stability, the prospects of an unco-ordinated approach in Washington to managing the 'fiscal cliff', as well as the uncertainty of the outcome of the U.S. election were but a few of the concerns that kept investors in a state of unease as we entered the 4th quarter. Yet, despite these and other uncertainties, the final quarter of 2012 was, in the end, another rewarding quarter for investors in bonds and stocks alike. Looking back at the full year, 2012 produced modestly positive bond returns and very satisfactory equity returns. Thankfully, the Fund was positioned well to take advantage of the strength in markets over the past year and, as we look at what is to come in 2013, there is cause to believe that positive returns in the coming year are achievable.



On the economic front, there is no clear evidence that the tepid global economic recovery is either accelerating or sliding back into recession. Canada's economic performance was disappointing last year, with GDP growth again decelerating.[1] Several factors are to blame. One area of economic weakness in Canada is the housing sector where, prices and sales activity have clearly moderated in the last year. Moderation in this sector is the result of deliberate policy changes in Ottawa that have made accessing mortgage financing more demanding and have been intended to prevent bubble conditions such as occurred in the U.S.

After many years when net exports were a prop to the economy, the trade account has been a drag on economic growth in the last year. Softer demand and weaker prices for energy, particularly natural gas, have been large contributors to a weaker export sector. In addition, strength in the Canadian dollar (C$) has had a negative effect on our international competiveness. Due largely to foreign capital flows into our bond market[2], the C$ has strengthened almost 5% from where it was at mid-year.

On the brighter side, there have been some positive economic developments, particularly with respect to the United States and China, the two largest economies in the world. There is evidence that both of these major economies have bottomed and that economic growth is set to improve. In the instance of the United States, low interest rates and the demographic effect of more normal household formation have finally begun to generate a recovery in the housing sector. Better housing conditions (resales, new starts and pricing) improve consumer balance sheets, create good quality jobs and eventually will contribute to a stronger consumer sector. Additionally, U.S. employment growth in the second half of the year has consistently been ahead of forecasts and data on job openings shows a marked improvement, although filling those jobs is hampered by a shortage of workers with the required skills.[3]

At mid-year, a slowdown in the Chinese economy was a widespread worry, with fears that GDP growth would not match the official target of 7.5%. Instead, a combination of monetary ease (lending incentives, lower interest rates) and fiscal stimulus (infrastructure spending) have put the Chinese economy back on a better growth track. An index of leading indicators in China, which had been positive, but declining, for the last two years has shown improvement in its last three releases and, in November, for the first time in 13 months, the Chinese Manufacturing Purchasing Managers Index rose above 50, marking an acceleration of growth in this important sector of the global economy.

As we mentioned in our previous report, Europe remains an important focus of investor economic and political concern. However, there continues to be some stabilization of the situation there, although a return to more normal economic and political conditions remains years away in our estimation. One of the brighter developments of the last quarter was the successful retirement of more than €20 billion of Greek debt through a buy-back operation in early December. Essentially Greece was able to use €10 billion of EU and IMF rescue funds to purchase from private holders more than €30 billion of Greek bonds at one third of their face value. Elsewhere across Europe there is evidence that sentiment is beginning to improve. In December, a survey of economic sentiment in Europe increased for the second month in a row and moved to its highest level in 5 months. This survey data, as well as the German Ifo business confidence data, which also improved in November and December, hold out hope that European economic conditions may have seen their worst.[4] Also this quarter, government bond yields in peripheral countries continued to fall, reflecting capital market confidence that the ECB's OMT program, which commits the ECB to stand behind the debt markets of countries like Spain and Italy, was having its intended effect. From their highest levels in July, when worries of European prospects were most bleak, rates on Spanish and Italian government bonds have declined sharply and each government has been able to conduct successful auctions and roll over their maturing debts without incident. Since July, interest rates of two-year Spanish bonds have fallen from more than 6.6% to just less than 3.0% and rates on Italian two-year bonds declined from just over 5.0% to 2.0%.

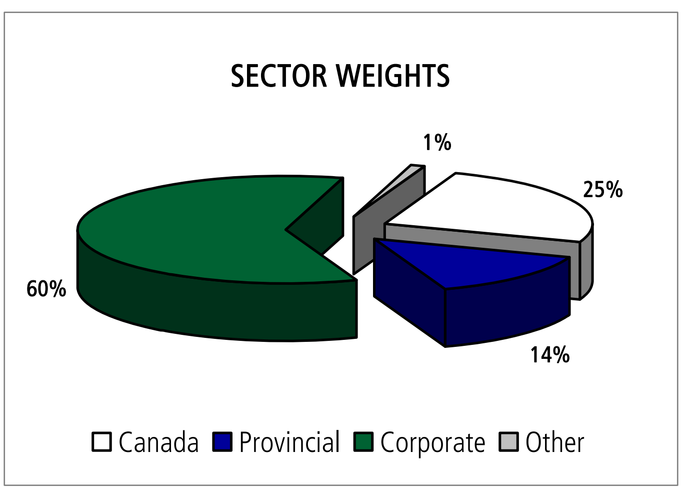
As we look ahead, we continue to expect a difficult investment environment. The deal to avert the worst of the 'fiscal cliff' underwhelmed the markets, and there will be more unease between now and February, as Washington deals with spending cuts and the extension of the debt ceiling. Despite the strong rally of the last month, equity markets remain attractively valued. Bond yields continue to reflect investor preference for short-term safety, but offer very unattractive returns for longer holding periods. As we have stated many times, discipline, sensible diversification and a steadfast refusal to be distracted by short-term noise will be essential for long-term investment success.

The Fund had another solid quarter, rising 1.1%[5] while the DEX Universe Bond Index (DUBI) rose 0.3%. In the last 12 months, the Fund's returns are well ahead of its DUBI benchmark – the Fund returned 5.9% and the DUBI 3.6%.

Asset Mix

Our allocation to 'other income-oriented securities' is at the maximum of 20% and will have to be pared back should it grow further. Our allocation to bonds increased from last quarter so that we now have 76% of the Fund in the bond market. Cash, at 4%, makes up the difference.

Fixed Income (76% of Assets)



Once again, there was little change in interest rates over the course of the quarter. Rates across the yield curve moved slightly higher but the change was not material. Two-year bonds rose 0.08% (8 basis points) and ten-years rose 0.07% (7 basis points). Low and stable interest rates continue to foster an environment that is perfect for borrowers (governments and corporates alike) to raise money, and the 4th quarter remained a very busy period for new issuance. We participated in a number of new issues, typically funding our purchases of bonds issued close to par ($100) with the sale of current holdings of a similar maturity that were valued at a premium. This sort of rotation has the effect of capturing return in the bond market as capital gain rather than as interest, and improves the after-tax returns of the Fund for units that are held in taxable accounts.

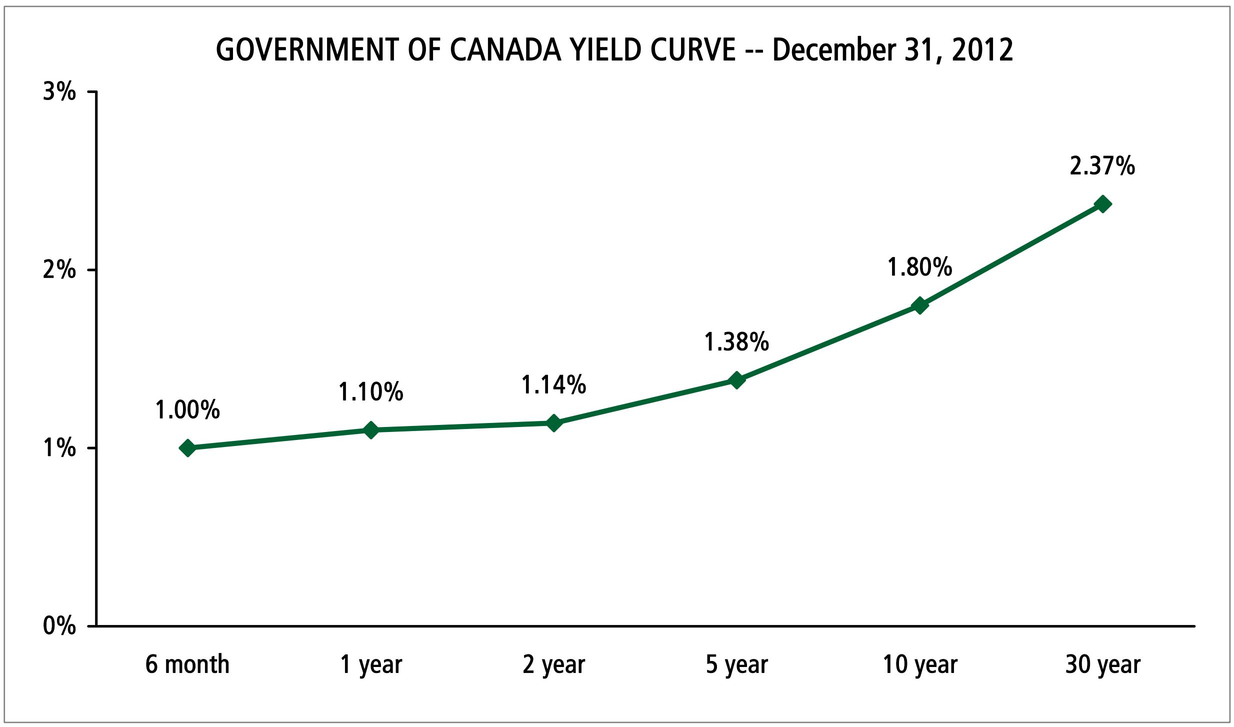
Led by the U.S. Federal Reserve, central banks around the globe continue to pursue extraordinarily accommodative interest rate policies. These policies are not limited to just low administered rates, such as the

Fed Funds Rate in the U.S. or the Bank Rate as it is known in England and Canada. Instead, many central banks have also committed to policies of Quantitative Easing (QE) whereby securities are purchased in the secondary markets in order to drive down interest rates of longer maturity securities. In the instance of the U.S. Fed, since the end of 2007 its balance sheet has grown from $900 billion in assets to $2.9 trillion. In mid-December, the Fed extended these QE policies, committing to keep exceptionally low rates while the unemployment rate was above 6.5% and inflation was below 2.5%. In addition, it re-committed to buy $85 billion per month of Treasury bonds and mortgage-backed securities through to the end of 2013. For now, the commitment to easy money policies such as these is welcomed by bond and equity markets alike, but QE policies are having a diminishing impact on real economic activity. Many wonder how central banks will ever normalize the size of their balance sheets and reverse these policies without creating tremendous capital market disruption. In early January, the minutes of the Fed's recent meeting were released and revealed that some members of the Fed have begun worrying about this very issue. To us, it confirms that positioning the portfolio in shorter maturities remains the preferred decision as we start 2013.

Although government interest rates rose modestly over the quarter, our large allocation to corporate securities generally benefitted from a compression in their spreads relative to government bonds. Last quarter, our bond portfolio generated a positive return of +0.4%, while the DUBI increased 0.3%. In the last 12 months, our bonds generated a return of +3.9% while the DUBI was up 3.6%.

Other Income-Oriented Securities (20% of Assets)

This was another strong quarter for holdings of 'other Income-oriented' securities. Returns from this area were +5.0% and are up 16.8% in the last year. We made no changes to our positions, and continue to have a strong belief that there is better long-term opportunity with these securities than there is in the bond market.



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[1] According to a Bloomberg survey of 21 economists, Canadian real GDP was 3.2% in 2010, 2.6% in 2011 and is estimated to be 2.0% in 2012 and only 1.8% in 2013.

[2] Foreign investors purchased $99.3 billion of Canadian securities in the 12 months ended October 31, 2012. Source: BMO Capital Markets.

[3] The ratio of unemployed people to job openings has moved from 6.7 at the worst of the recession to 3.3 currently. A figure of between 1 and 3 is common in a healthy labour market. Source: U.S. Bureau of Labor Statistics.

[4] European Commission Economic Sentiment Index (ESI) for December increased 1.3 to 87.0. The German Ifo Business Climate Index rose 1.0 to 102.4 in December.

[5] Fund returns are shown before the deduction of management fees but after the deduction of direct expenses.