The Nexus Report

Fourth Quarter, 2020

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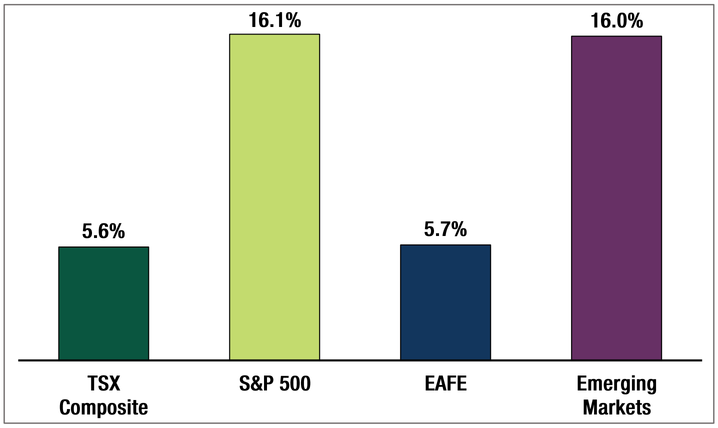
Investment Outlook

Who Would Have Thunk?

Human nature is such that we are often beguiled by those who claim to know the future. Surely, 2020 proved, once and for all, something Nexus has argued incessantly – that predicting the short-term path of financial markets is impossible. A year ago, who would have imagined the global economy would come to a virtual standstill as a new virus spread like wildfire? Who would have predicted, as a consequence, that stock markets would plunge into a bear market more rapidly than ever before experienced? In late March, at the market's nadir and in the depths of uncertainty, who would have guessed that stocks were about to recover more vigorously than ever before seen? And who would have predicted, as the calendar flipped from 2020 to 2021, that Canadian and U.S. stock markets would hit new all-time highs at the same time that COVID infections, hospitalizations and deaths also hit all-time highs, and, at the same time, that armed Trump supporters would storm the U.S. Capitol? For the record, we did not.



2020 Full-Year Total Returns (C$)

Considering all that happened in 2020, the 5.6% return on the TSX Composite may seem quite satisfactory.[1] While this was similar to the 5.7% return realized in international developed markets (EAFE), it trailed the magnificent returns earned in the U.S. (16.1%) and Emerging Markets (16.0%) quite significantly.

U.S. equity returns are particularly remarkable considering how the U.S. struggled to contain the virus and how deeply its economy and labour market were affected. In U.S. dollar terms, the S&P 500 not only gained 16.3% in 2020, it is up nearly 50% over the last two years, the strongest two-year run since 1998-1999.[2] Incredibly, the NASDAQ had its best year since 2009, rising 43.6%. The Russell 2000, a broad measure of smaller companies, many of which had significant COVID challenges, was up 18.4%. It was up another 5.9% in the first week of 2021, the best start to a year since 1987. Markets are a forward-looking mechanism. Investors clearly are expecting a successful vaccine rollout.

The Only Question is: When?

There is a remarkable consensus among economists on the prospects for 2021. Current conditions are weak, but almost all expect a robust rebound as soon as the COVID crisis is behind us. With the approval of two vaccines late in 2020 for use in North America, and the prospect for more in 2021, the only question up for debate is, "when?" When will the virus abate so that regular economic activity can resume?

The final quarter of 2020 saw both Canada and the U.S. experience a slowdown from the summer months. The second wave of the pandemic has forced most jurisdictions to impose some form of lockdown, which is stalling economic growth once again. Canada shed 62,000 jobs in December compared to estimates for a loss of 37,500. In the U.S. 140,000 jobs were lost in December, compared to an estimated *gain* of 50,000.

[1] Returns in this paragraph are total returns in Canadian dollars.

[2] Returns in this paragraph exclude dividends and are in U.S. dollars.

While employment has recovered from the low, the Canadian economy still has 636,000 fewer jobs than it did in February. The U.S. is still 9.4 million jobs below its pre-pandemic levels. For context, this is almost twice the number of jobs lost in 2009, the worst year of the Global Financial Crisis. If there is some good news in the U.S. labour report, it is that several previous months' job totals were revised higher, and that December job losses were entirely in the travel and hospitality sectors. Other sectors had modest gains.

The weakness in 2020's final quarter also appeared in data like consumer confidence and spending. S&P 500 earnings are expected to be 12% lower in the last quarter of 2020 than they were in 2019 on a 6% reduction in sales compared to last year. This is a marked deterioration from the third quarter, when S&P 500 earnings were down 8.6% year-over-year on a 3% decline in sales.[3] The second wave has had an impact.

At some point in 2021, the mass vaccination program that has commenced is expected to conquer the health crisis and allow the economy to rebound sharply. The stimulus spending in Canada and the U.S., combined with the fact that locked-down consumers have less to spend their money on, means that consumer savings have skyrocketed and pent-up demand is significant. For example, total household liabilities relative to net worth in the U.S. are at a multi-decade low.[4] Moreover, the economic challenges we have faced have not resulted from an imbalance in the economy. They have resulted from a government-mandated lockdown. When restrictions are lifted, many think the economy will boom.

What also seems to be gradually lifting is the dark cloud of U.S. political uncertainty. The "blue wave" Democratic victories ought to be positive for the economy and markets in the short term, as more aggressive economic stimulus is likely. And the fears that many had of a new "tax and spend" regime may not be quite so worrisome as previously thought. The Democratic margin in both houses is sufficiently slim that power may now reside in the moderates. Many think it is unlikely that the Biden administration can successfully pursue some of the more aggressive tax and regulatory reforms that the "progressives" in his party have favoured.

Of course, all of this depends on the vaccine conquering the virus. The pace of the early roll-out has been disappointing everywhere, except in Israel. Many jurisdictions have only used a fraction of the doses that have been delivered. Canada says it will take until September to get shots in the arms of all that will take it. Logistics have proven more daunting than expected. At the same time, the rate of infections is accelerating. There remains a risk that COVID spirals out of control before a sufficient number of people get vaccinated.

Market Outlook

While there is strong conviction among investors that economic growth is poised to rebound in 2021, the outlook for markets is somewhat more complicated. Many stocks, particularly in Canada, remain a long way below their pre-pandemic levels. Travel and hospitality companies, as well as energy firms, are obvious examples. Financial service companies, like banks, also have not had the rebound that some other sectors have enjoyed. In fact, a frustrating reality for many investors is that market gains in 2020 were driven by a fairly narrow group of stocks: in particular, those companies that support people working from home, shopping from home, and exercising at home. In an article in *The Financial Post*, well-known economist, David Rosenberg, described current conditions as the most speculative and momentum-driven market on record.[5] He gives the example of Tesla, which gained 743% in 2020, Bitcoin, which rose 305%, and SPACs – blind investment vehicles in which investors fund acquisitions not yet imagined – which raised US$82.1 billion in 2020, up from US$13.5 billion in 2019. Hardly a sign of nervous investors.

At the same time, interest rates plunged to new lows in 2020. Rosenberg points out that there is $18 trillion of bonds around the world trading with negative yields. Three-quarters of global investment grade debt has a yield of less than 1%. Importantly, however, the U.S. 10-year treasury bond yield traded back above 1% to start 2021, the first time it has traded above that level since April. While we do not expect a significant rise in rates from current levels, even a modest rise from historic lows could present a significant challenge to fixed income investors.

While mindful of these risks facing financial markets in general, we remain confident in the holdings in client portfolios. Our bonds have a short average maturity, thereby limiting the risk that higher interest rates present. The companies in which we are invested remain well-positioned to prosper when the world returns to "normal". None is fuelled by speculative excesses that exist in some corners of the market (otherwise we would sell them, as we did with Apple). We expect all of them to perform well over time.

Just as we never could have predicted what happened in 2020, so too can we not predict what will happen in 2021. Nonetheless, we are certain that investors with a portfolio of high-quality and reasonably-priced securities will prosper over the long term.

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[3] *Barron's*, January 11, 2021.

[4] Tom Porcelli, "2021 U.S. Economic Outlook: How Strong?", RBC Capital Markets, December 17, 2020.

[5] *The Financial Post*, January 5, 2021.

Asset Class Review

Fixed Income

Interest rates continued to track sideways last quarter and bonds produced meagre returns. Central bank policy rates, such as the Bank Rate and the Fed Funds rate, remain at ultra-low levels – essentially at what most people believe is the lower bound of monetary policy settings. As was the case in the previous quarter, central banks have continued to use other means to influence credit markets. Most notably, quantitative easing programs remain a major factor in supporting government bond issuance, providing both federal and provincial governments with the cheap and abundant capital needed to undertake fiscal programs in support of the economy during the COVID crisis. In addition, central bankers have also used their speeches, the release of meeting minutes, and testimony before government entities to leave no doubt that ultra-easy monetary conditions can be counted on for many years.

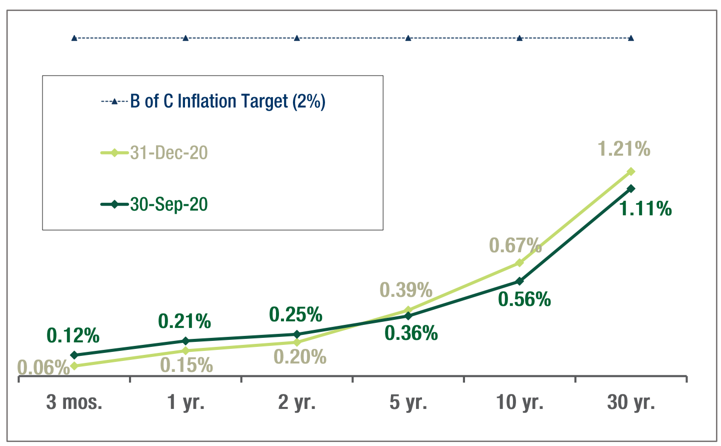
News of the vaccine this quarter provided a spark to equity markets and hopes of an economic rebound. Many investors were inclined to re-allocate capital away from the safety of government bonds and back into equities. Historically, such a shift would have pressured interest rates higher. However, these days such market effects are muted by the intervention of central banks. In Canada, the flagship program to aid credit markets is the Large Scale Asset Purchase Program, and large it is! Each week the Bank of Canada spends roughly $4 billion buying government bonds. This is the largest program, but there are two others as well, one designed to support provincial markets, and another to support corporate bond markets.

As we consider the economic effect of widespread vaccinations in 2021, we are confident that economic growth, both in Canada and globally, will accelerate sharply. Although there is abundant slack in the economy to absorb a pick-up in aggregate demand, to us the risk of an eventual acceleration in inflation is real. As well, for now, investors are prepared to look past their worries about how all this debt will ever be repaid. Eventually, however, there will come a day of reckoning and market confidence in the value of our currency could evaporate.

These worries are real, but they don't keep us up at night. Due to our portfolio positioning we are not overly exposed to the capital erosion that would occur if rates moved higher. The core of our holdings is in bonds of shorter maturity that will not fall in value the way longer-term bonds will if rates rise. The duration of our portfolio is 3.9 years, as compared to the FTSE Canada Universe Bond Index duration of 8.3 years. On the credit front, almost 90% of our holdings are rated AA or better and only 1% of our holdings are BBB-rated securities.[6] It is a portfolio designed for liquidity and capital safety.

The fourth quarter was busy with new issuance, and we used the opportunity to make refinements to our holdings. In fact, the quarter concluded a record year for new debt underwritings in the Canadian government and corporate credit markets – a testament to the effect of central bank policies designed to ensure ready and available capital for governments and businesses. Despite the tsunami of new supply, credit spreads continued to narrow. While the general level of interest rates didn't change much this quarter, there was a slight steepening of the yield curve. Two-year yields fell 5 basis points (from 0.25% to 0.20%), while 10-year yields rose 11 basis points (from 0.56% to 0.67%).[7]

The bond return in our Income Fund was 0.8% for the quarter, while the FTSE Canada Universe Bond Index returned 0.6%. Over the last 12 months, our bond holdings returned 6.9%, which trailed the 8.7% return of the FTSE Canada Universe Bond Index.



Government of Canada Yield Curve

[6] Returns and credit information are for the bond portion of the Nexus North American Income Fund, which serves as the model for all bond portfolios at the firm.

[7] A basis point is one-hundredth of one percent.

Equities

Last quarter markets continued to recover. The Equity Fund was up 11.0% in the quarter and 6.8% for the 12 months.[8] For a year as tumultuous as 2020 has been, and after a full 12 years of strong equity returns, this is a very satisfactory outcome.

After a difficult 9 months, our investment approach fared well in the final quarter of 2020. We outperformed the blended benchmark in the quarter, which was up 7.7%. But we still lag on an overall basis for the year, with the blended benchmark up 10.3%. 2020 was a year that heavily favoured high-valuation growth stocks over value stocks. This is a continuation of a cycle that has been going on for several years. Nexus's investment approach emphasizes quality companies with attractive valuations. The overall portfolio has both growth and value characteristics, but our approach is closer to value than growth. As was described in our December client presentation, the problem with high-growth stocks is that investors tend to pay too much for them. This may well work for some time, but it ultimately reverts and leads to disappointment. The last time this happened was the tech bust of the early 2000s. We remain convinced that our investment approach works well over the long term and are excited about the prospects for our holdings.

Canadian Equities

Nexus's Canadian stocks returned 15.6% in the quarter, faring well in comparison to the TSX, which was up 9.0%.

Parts of our portfolio benefitted from a recovery from an over-sold position. As investors looked ahead to post-COVID travel normalisation, CAE rose 81%. Magna and Cenovus, two of our more cyclical and value-oriented stocks, rose about 50%, while a few other cyclicals increased more than 30%. As is typical in this sort of rotation, our consumer staples (a defensive sector) holdings, Alimentation Couche-Tard, Metro, and George Weston, declined. Notwithstanding the partial recovery, our holdings in energy, real estate and ATCO (an Alberta-based utility company), remain down significantly for the year. We think they have good recovery potential ahead.

The strong performance of our Canadian portfolio last quarter was a partial reversal of circumstances earlier in 2020. For the full year, our Canadian portfolio was down 3.9%, whereas the TSX was up 5.6%. The explanation for this is twofold. First, the 5.6% TSX return is heavily buttressed by a handful of stocks that do not fit with our investment philosophy. These include Shopify, a high-growth eCommerce company that we think is valued too richly, and several Canadian gold stocks that have done particularly well this year, but which have a poor long-term track record.[9] Excluding these, the rest of the TSX index has not yet recovered. Second, and to a smaller degree, our two REIT holdings (Allied Properties and H&R) and ATCO have been a relative drag on our portfolio.

U.S. Equities

Our U.S. equity portfolio increased 8.9% in the quarter and 17.8% over the year, both slightly outperforming the S&P 500.[10]

A notable change in the quarter was a substantial weakening of the U.S. dollar. This had the effect of reducing our U.S. equity returns when measured in Canadian dollars (from 14.1% in U.S. dollars to 8.9% in Canadian dollars).

As occurred in Canada, in the most recent quarter we had several value stocks that recovered strongly, such as Western Digital (computer storage), General Motors, and Citigroup. The full-year stars were our large-cap tech and communication services holdings (Alphabet, Facebook, Microsoft), along with UPS and Dollar General. The notable full-year losers were value-tech (Western Digital and Cisco) and the banks (Citigroup and JP Morgan).

Concerningly, the overall U.S. equity market now carries a high valuation, and growth stocks as a group are valued at an unprecedented premium to value stocks. We are comforted, indeed enthused, that almost all our U.S. holdings have valuations below that of the S&P 500. Our "growth" stocks (Microsoft, Alphabet, Facebook, Boston Scientific) have reasonable valuations after factoring in excess cash on their balance sheets, their solid attributes, and their growth prospects.

Other Equity Investments

We remain invested in two externally-managed pooled funds, which add international exposure and diversification to our Funds.[11] Both continue to perform strongly, adding to our overall equity returns and outperforming their respective international indices. For the quarter, EQIT (international developed market equities) returned 11.1% and EMEC (emerging market equities) 17.7%. For the year, their returns were 10.9% and 27.9%, respectively. Even after such returns, these holdings remain attractively valued on an absolute basis and more so relative to the overall U.S. equity market. For more information on EQIT and EMEC, please see the Nexus International Equity Fund section of this report.

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[8] All the return data in the Equities section are total returns for the Equity Fund. Equity returns within the Balanced Fund were similar. For Specific performance, please refer to the Fund reports that follow or your client-specific report.

[9] This was more fully explained in last quarter's *Nexus Report*.

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

[11] Both pooled funds are managed by teams from JPMorgan Asset Management in the U.K. and are held in our Equity and Balanced Funds.

Pooled Fund Reports

Nexus North American Equity Fund

The Nexus North American Equity Fund generated a total return of 11.0% in the fourth quarter, capping off a volatile year with strong gains. The gains reflect market optimism for economic recovery as vaccines are deployed, as well as the prospect of further government stimulus. In addition to market optimism, business sentiment is also improving as news about vaccines provides some light at the end of the COVID tunnel.

Over the 12-month period, the Fund delivered a positive return of 6.8% during what proved to be an exceptionally unsettled year for markets. Reflecting this volatility, our underlying performance was mixed, with strong gains in our U.S. and International stocks offset by a challenging year for our Canadian holdings.

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

In Canada, the equity market gained 9.0% in the quarter, driven by rising optimism about the positive impact of vaccines in speeding our return to more normal economic conditions. Our Canadian holdings outperformed, delivering a 15.6% return. As investors looked ahead to post-COVID travel normalization, CAE rose 81%. Magna and Cenovus, two of our more cyclical and value-oriented stocks, rose about 50%, while a few other cyclicals increased more than 30%.

In the U.S., the equity market also gained ground, bolstered by the same vaccine and stimulus optimism that drove the Canadian market in the quarter. Despite COVID trends worsening and the antagonistic U.S. election, the equity market gained 7.0% (in Canadian dollars) in the quarter. Our U.S. holdings outperformed, generating an 8.9% return. We had several value stocks that recovered strongly, such as Western Digital (computer storage), General Motors, and Citigroup.

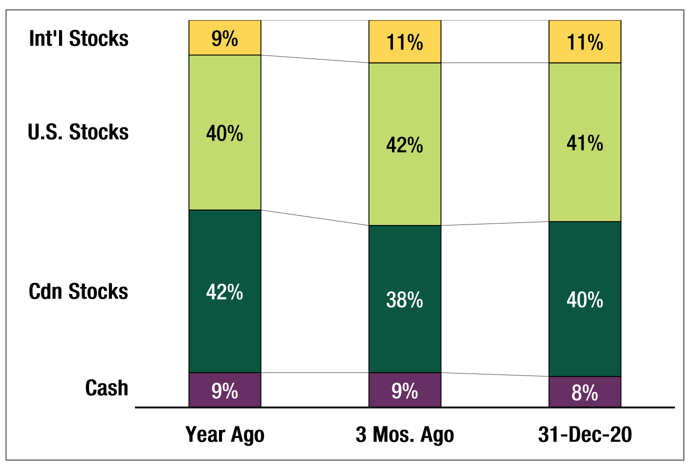
Our international holdings delivered very strong fourth quarter results. The developed markets fund, EQIT, rose 11.1% in the quarter and the emerging markets fund, EMEC, rose 17.7%.

At the end of the quarter, the Fund's cash position was 8%. Our allocation to Canadian stocks was 40%, while U.S. stocks represented 41% of the mix. We have maintained an allocation of 11% to markets outside North America and remain confident that this will provide important diversification to our North American investments.

	Equity Fund	Cdn Stocks	U.S. Stocks	Int'l Stocks
Quarter				
Fund	11.0%	15.6%	8.9%	14.0%
Benchmark	*7.7%*	*9.0%*	*7.0%*	
One Year				
Fund	6.8%	-3.9%	17.8%	18.6%
Benchmark	*10.3%*	*5.6%*	*16.1%*	

Returns are presented before deduction of management fees. Benchmarks are (a) for the Fund: 5% FTSE Canada 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, 2020



Equity Fund Asset Mix

Nexus North American Balanced Fund

The Nexus North American Balanced Fund generated a total return of 7.0% in the fourth quarter, comprised of gains in both stocks and bonds. Improving sentiment around vaccine news was the main tailwind driving these gains.

In the last 12 months, the Fund has returned 7.4%. Over this period the return distribution has been mixed, with strong gains in our bonds, U.S. stocks and international holdings, but lagging performance from our Canadian stocks. For a more detailed discussion of our Canadian performance, please refer to the Canadian Equities section earlier in this report.

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

Fixed income markets delivered a 0.6% gain in the quarter and our bond holdings produced a 0.8% gain.

The equity holdings in the Balanced Fund finished the year on a positive note, with our Canadian stocks rising 14.2% in the quarter while our U.S. stocks were up 7.5%. In Canada, expectations for a normalization in travel helped boost CAE's stock 81% during the period. Magna and Cenovus, two of our more cyclical and value-oriented stocks, rose about 50%, while a few other cyclicals increased more than 30%. In the U.S., several of our value-oriented stocks recovered strongly, including Western Digital (computer storage), General Motors, and Citigroup.

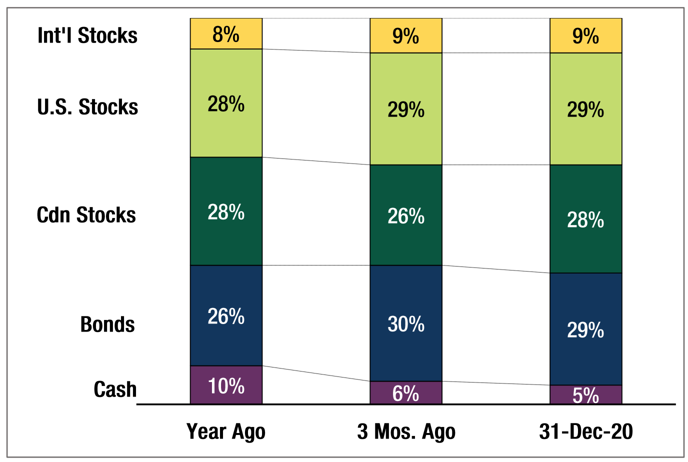
These gains were complemented by strong returns in our International holdings. The developed markets fund, EQIT, rose 11.1% in the quarter and the emerging markets fund, EMEC, rose 17.7%.

At the end of the quarter, cash represented 5% of the Fund's asset mix, bonds were 29% and stocks accounted for the remaining 66%. These asset allocations remain close to the Fund's long-term guideline.

	Balanced Fund	Bonds	Cdn Stocks	U.S. Stocks	Int'l Stocks
Quarter					
Fund	7.0%	0.8%	14.2%	7.5%	14.0%
Benchmark	*5.6%*	*0.6%*	*9.0%*	*7.0%*	
One Year					
Fund	7.4%	7.4%	-3.6%	17.0%	18.1%
Benchmark	*9.4%*	*8.7%*	*5.6%*	*16.1%*	

Returns are presented before deduction of management fees. Benchmarks are (a) for the Fund: 5% FTSE Cda 91Day TBill, 30% FTSE Cda Universe Bond, 40% TSX, and 25% S&P 500 (in C$) (rebalanced monthly); (b) for Bonds: FTSE Cda Univ. Bond; (c) for Cdn Stocks: TSX; and (d) for U.S. Stocks: S&P 500 (in C$).

Investment Returns – As at December 31, 2020



Balanced Fund Asset Mix

Nexus North American Income Fund

The Nexus North American Income Fund produced a total return of 2.4% in the fourth quarter. Our fixed income holdings rose 0.8%, while our income-oriented securities provided additional tailwinds. In the last 12 months the Fund has delivered a total return of 5.0%.

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

Our fixed income portfolio remains designed with capital safety in mind and is positioned to be liquid and able to take advantage of an eventual rise in interest rates. The portfolio has a large allocation (60%) to highly-rated corporate securities, which benefitted from the prospects of economic recovery following the news of Pfizer's clinical trial results. As was the case in the third quarter, there was a modest steepening of the yield curve, but very little change in the general level of interest rates.

For further details on our bond performance, please refer to the Fixed Income section earlier in this report.

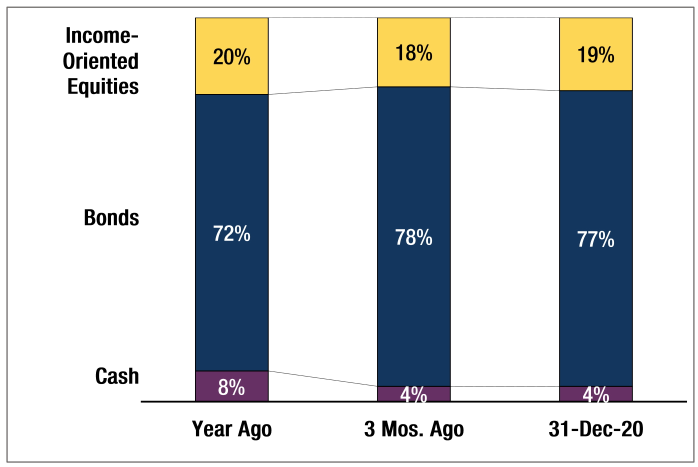
The quarterly performance of our income-oriented equities was also positive, with our Canadian stocks rising 8.4% and our U.S. stocks rising 10.7%. Over the 12-month period, results have been more mixed with strong gains in our U.S. holdings offset by a challenging period for our Canadian stocks.

At the end of the fourth quarter, the Fund's cash position was 4%, income-oriented equities accounted for 19% and the balance, 77%, was in our core bond holdings.

	Income Fund	Bonds	Cdn Stocks	U.S. Stocks
Quarter				
Fund	2.4%	0.8%	8.4%	10.7%
Benchmark	*0.6%*	*0.6%*		
One Year				
Fund	5.0%	6.9%	-5.9%	7.9%
Benchmark	*8.7%*	*8.7%*		

Returns are presented before deduction of management fees. Benchmarks are (a) for Fund: FTSE Canada Universe Bond; (b) for Bonds: FTSE Canada 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, 2020



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).[12]

The most recent quarter marked the third consecutive period of quarterly gains for international equity markets, following the first quarter downturn. Like North American markets, optimism regarding vaccine deployment was the main tailwind for international markets, including emerging markets. The promise of vaccines brings justifiable hope for an eventual end to lockdowns, sustained economic recovery, and a resumption of global trade growth. Another positive factor was the U.S. election outcome, which many hope will deliver renewed political stability in international relations.

With this positive backdrop, the Fund gained 13.9% in the quarter, comprised of an 11.1% gain for EQIT and a 17.7% gain for EMEC.

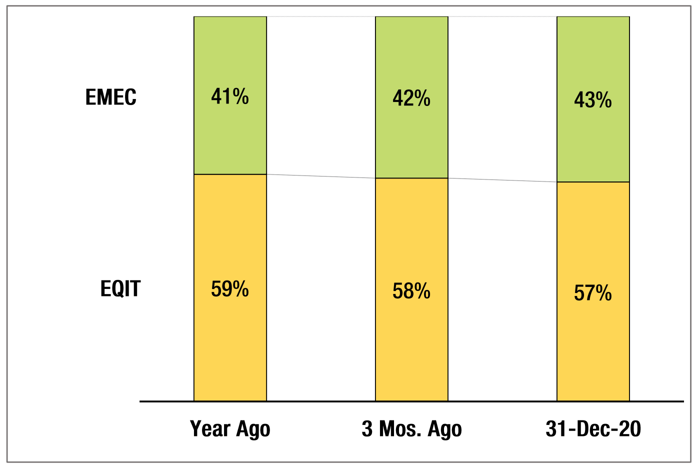
More detail on the Fund's performance is presented in the table below.

At the close of the fourth quarter, the International Equity Fund's investment in EQIT accounted for 57%, while EMEC accounted for 43%.

	International Equity Fund	EQIT	EMEC
Quarter			
Fund	13.9%	11.1%	17.7%
Benchmark	*11.7%*	*10.8%*	*14.2%*
One Year			
Fund	17.9%	10.9%	27.9%
Benchmark	*8.4%*	*5.7%*	*16.0%*

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, 2020



International Equity Fund Asset Mix

[12] International developed markets or "EAFE" includes Europe, Australasia and the Far East. Emerging markets include 26 developing countries. EQIT and EMEC are managed by J.P. Morgan Asset Management in the U.K. The Nexus Balanced and Equity Funds have held EQIT and EMEC for some time and continue to do so.