The Nexus Report

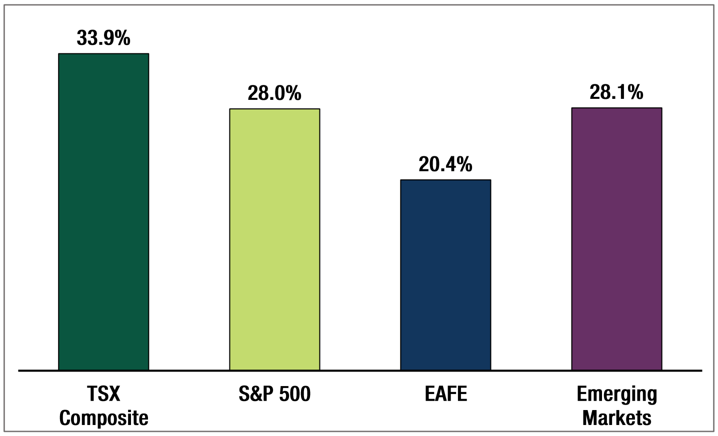
Second Quarter, 2021

Investment Outlook

The Beat Goes On

The second quarter of 2021 was another outstanding period for stock market investors. Over the last three months, the TSX Composite generated a total return of 8.5% and the S&P 500 gained 7.0%.[1] As was the case in the first quarter, the Canadian dollar strengthened, presenting a headwind for our non-Canadian investments. In U.S. dollar terms, the S&P 500 total return was the same as that of the TSX: 8.5%.

The stock market recovery from the COVID-related bear market started in late March 2020 and continued in full flight over the 12 months ended June 30, 2021. The TSX Composite generated a 33.9% return over the last year. While the S&P 500's return was even better (40.8%) in U.S. dollar terms, the significant strengthening of the Canadian dollar reduced it to 28.0% when expressed in Canadian dollars. International stock markets were equally rewarding.



Total Returns for 12 Months ended June 30, 2021 (C$)

Market strategists love statistics and there are some fascinating ones about how strong stock markets have been. Not only did all major U.S. market indexes hit all-time highs on June 30, the S&P 500 close on July 2 was the seventh record daily close in a row – the longest such streak since 1997.[2] The S&P's 15.3% U.S. dollar total return in the first half of 2021 is the second-best return in the first half of a year in over 20 years. The S&P 500 now has gained more than 5% for five consecutive quarters. This is the first time this has happened since 1954 and only the second time since 1945. Equally amazing is the fact that the two-year return on the TSX is 14.4% per year. The S&P 500 gained 19.7% per year over the last two years. Moreover, while markets have soared, volatility has plunged. The widely followed VIX measure of volatility closed the most recent quarter at a very low level, suggesting a calm and complacent environment. It is like the pandemic never happened.

Just as we reported last quarter, however, the only caveat to this happy circumstance is that it has been a tough period in the bond market. While interest rates fell slightly in the last three months, and bond prices rose, the return on the principal bond index in Canada remains negative over the course of 2021 and the last 12 months.

Riding the Re-Opening Wave

Game on. Economic re-opening following more than a year of pandemic lockdowns began this spring. The U.S. was the first out of the blocks, largely on the basis that its vaccine rollout was faster than most other countries. By June, U.S. consumer confidence had surged back to pre-pandemic levels. Thankfully, Canada has now surpassed the U.S. and many others on the vaccination front and our own economic re-opening accelerated in most provinces through June. One

[1] Returns are total returns in Canadian dollars, except where indicated.

[2] The major U.S. indexes are the S&P 500, the Dow Jones, and the NASDAQ. The TSX hit an all-time high a few days before June 30, then reached another new high early in July.

consumer confidence survey here recorded the highest reading in its history in late June.[3] Consumers in both countries are flush with cash and eager to start spending.

Reflecting this increased activity, the World Bank recently raised its U.S. GDP growth forecast for 2021 to 6.8%. In January, its estimate was only 3.5%.[4] Economists also expect Canadian GDP growth to exceed 6.0% in 2021, and global growth overall is forecast at about the same level.[5] Similarly, corporate earnings expectations are trending higher. S&P 500 earnings are now expected to reach an all-time high of $191 in 2021, up from estimates of $167 at the beginning of the year and $140 in 2020.

Labour market trends tell a similar story. In the U.S., there were 850,000 new jobs created in June, easily beating estimates for 720,000. Both April and May job gains were revised higher. Most of the job gains came in leisure and hospitality as re-opening has breathed some life back into those sectors. The U.S. labour market is still 6.8 million jobs short of its February 2020 peak, but conditions are rapidly improving. The Canadian labour market also beat estimates in June, adding 231,000 new jobs compared to expectations for 175,000. The unemployment rate moved down to 7.8% from 8.2% in May, even as more people entered the workforce. More than all of the jobs were part-time (full-time jobs declined), causing some to call the “beat” a low quality one. Nonetheless, it is inarguable that conditions in Canada also are improving rapidly.

As encouraging as the economic momentum is in both Canada and the U.S., there remains a headwind to growth in the form of supply constraints. Whether it be raw materials or labour, manufacturers across the continent are now worried about meeting resurgent demand. The lack of semi-conductors needed in the auto industry is one well-reported example of the supply constraints. On the labour front, the latest JOLTs survey in the U.S. revealed that there are 9.2 million unfilled job openings – more than enough to bring employment back above its previous peak.[6] As well, the “quit rate” is at high levels, suggesting that workers are confident of finding new employment whenever they wish. The Bank of Canada’s recent Business Outlook Survey noted that 60% of Canadian businesses felt they would have trouble meeting demand, largely because of a lack of labour. 49% expect labour costs to accelerate in the next 12 months. While the demand picture across North America is robust, it will be challenging for supply to keep up.

The most significant threat to economic growth and prosperity over the period ahead, however, is inflation. We discuss this in more detail later in this *Nexus Report*; however, it bears mentioning here. Current data on inflation are certainly elevated. Energy, house prices, and many other prices have been on a tear. However, central bankers in Canada, the U.S. and elsewhere have largely dismissed the threat. They believe that current trends are transitory as economies re-open. For example, it is unsurprising that hotel rooms and plane tickets are a lot more expensive now than they were a year ago. On the other hand, many thoughtful economists do not dismiss the inflation risk so readily. It certainly will be one of the most important economic dynamics to watch in coming quarters.

Market Outlook

There are opposing outlooks for the stock market, just as there are divergent views on the risk of inflation. The bulls see strong economic growth over the balance of the year and continuing into 2022. Earnings estimates will continue to move higher and stocks should provide solid returns. On the other hand, the bears believe that the economic rebound has already been priced in and the risk of disappointment in the months to come is higher than the opportunity for positive surprises. They also worry about the possibility of central bank policy errors, particularly related to inflation.

This uncertainty is also reflected in the ebb and flow of enthusiasm for growth and value stocks. Growth stocks typically shine when investors worry that economic growth will be hard to come by. Value stocks shine when the rising tide is lifting all boats. Our quarterly investor review presentations have pointed out how strong growth stocks were in 2020 and how strongly value recovered in the first quarter of 2021. We also discuss this later in this *Nexus Report*. In the last quarter, sentiment seemed to alternate week-by-week between the two. Investors are clearly uncertain about what the future holds.

As you know, our investment approach does not rely on seeing around corners to predict what might unfold in the weeks or months ahead. Instead, we focus only on the long term and try to identify companies that ought to succeed in a variety of environments. After all, we are likely to own them through a variety of environments. We have paid specific attention to the issue of inflation as it might affect the stocks we own and are comfortable that they all can manage a surprise in this regard. We also maintain short bond maturities to mitigate the challenges from rising interest rates. Moreover, since all our investments are valued at reasonable levels, and all have strong competitive positions, we are optimistic that they will prosper. And prosper not just over the balance of this economic recovery, but for many years into the future..

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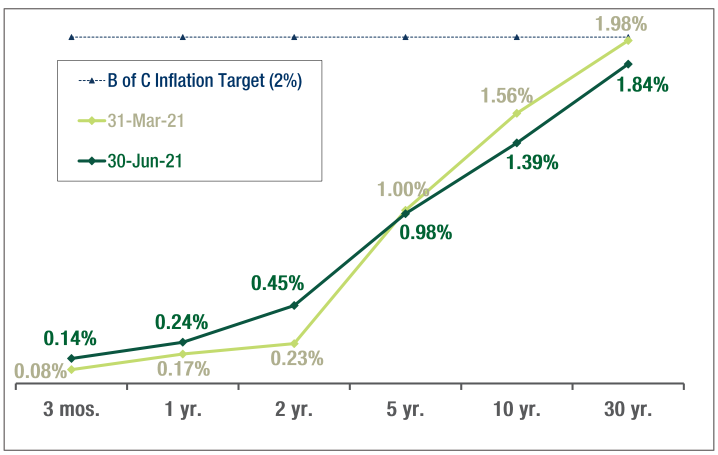
[3] This is the Bloomberg-Nanos survey, which started in 2008.
[4] “The Jabs and the Jab-Nots”, *The Economist*, June 19, 2021.
[5] Doug Porter, *Focus*, BMO Capital Markets, July 2, 2021.
[6] Job Openings and Labor Turnover survey.

Asset Class Review

Fixed Income

The rise in interest rates that coincided with the announcement of an effective vaccine last November ended this past quarter. While short rates rose slightly (2-year Canadas up 0.11%), the rates of longer-dated bonds fell (10-years down 0.15%). It continues to be the case that Government of Canada bonds of all maturities yield less than the target rate of inflation (see chart). For now, the fixed income world is in a state of confused limbo. Investors have one eye focussed on the actions and messaging from central banks, and the other eye watching the succession of economic data that describes an acceleration in the rate of inflation and a vigorous economic recovery. Let's look at each in turn.



Government of Canada Yield Curve

In the first instance, central bankers, led by the U.S. Federal Reserve (the Fed), have told the story that ultra-low rates and abundant quantitative-easing remain necessary in order to assure a recovery of the economy back to full employment and inflation to a level of 2% or so. In fact, Chairman Powell said this explicitly in his press conference the day after the June 16th announcement, which left the fed funds rate unchanged. In his remarks he said, *"We continue to expect that it will be appropriate to maintain the current zero to one quarter percent target for the federal funds rate until labour market conditions have reached levels consistent with the committee's assessment of maximum employment and inflation has risen to 2% and is on track to moderately exceed 2% for some time."*

In a similar fashion, on June 16th, in prepared remarks before the Senate Committee on Banking Trade and Commerce, Bank of Canada Governor Macklem said, *"We remain committed to holding the policy interest rate at the effective lower bound until economic slack is absorbed so that the 2 percent inflation target is sustainably achieved. Based on our latest projection, this is expected to happen sometime in the second half of 2022, although this timing is unusually uncertain given the difficulties in assessing the economy's supply capacity."* The message couldn't be more clear: easy money is not going away soon.

Let's turn to the second instance: improving growth and accelerating inflation. Our trouble with the message from central bankers is that the rate of inflation in both countries is well above 2%. In Canada, the latest reading of CPI was 3.6%, the second highest level since March of 2003, and in the U.S., the Fed's policy target, the Core PCE Deflator was 3.4%. In the last six months it has risen at its fastest rate in 30 years. To many investors, the inflation genie is already out of the bottle.

We also think that there are abundant signs that the economy has a head of steam and that central bankers' concern about the labour market is unfounded. For instance, there are currently over 9 million unfilled jobs available in the U.S. Demand for labour is high, and economic growth is restrained by a shortage of workers, rather than lack of demand. The business press is filled with stories of the increasingly common practice of paying hiring bonuses to entice people off government-paid income support. As well, asset prices of all types are inflating. The prices of real assets like housing and commodities have been increasing, but so too have the valuations of speculative new age assets such as crypto-currencies, non-fungible tokens and Reddit / meme stocks. But perhaps the most persuasive sign that economic growth is on a solid footing is continued commitment to lavish fiscal spending. In both Washington and Ottawa, there are virtually no signs of moderation to a level of spending and deficits unknown since wartime. Many investors, including Nexus, feel that unless fiscal and monetary stimulus is curtailed, it is only a matter of time before inflation expectations become unanchored in the general population and wage demands beget more price increases. Such an environment would make the returns from long-dated bonds very unattractive.

Historically, we pay close attention to the guidance and messaging from central bankers. However, these days we suspect their confidence that inflation is only a temporary phenomenon is misplaced. As we have stated for some time, meagre yields in the bond market could easily be swamped by an erosion of capital value when rates rise to more normal levels. Our bond portfolio has a duration of 4.0 years and will be less affected by changes to the general level of interest rates which we still expect will rise. This quarter, the FTSE Canada Universe Bond Index (Universe) returned 1.7%, while our portfolio lagged, generating a 0.5% return. Over the last 12 months, our bond holdings returned 0.7%, ahead of the 2.4% loss for the Universe.

Equities

Following big gains in the first quarter, the markets continued to move up strongly in the second quarter. The Equity Fund was up 6.1% in the quarter and a very significant 33.2% for the last 12 months.[7] In part, the strong twelve-month return reflects the post-COVID recovery, but the markets are now well above pre-COVID levels.

We have written about the recent gyrations between high-valuation growth stocks and the steadier value stocks which carry more reasonable valuations. The first 9 months of 2020 had heavily favoured growth stocks – a continuation of a cycle that had been going on for some years. From the fall until the end of this year's first quarter, value stocks enjoyed a comeback. In the most recent quarter, growth stocks have once again re-asserted themselves. Over longer periods that include both good and bad market environments, value stocks have provided better risk-return characteristics and outperformed growth. Nexus's investment approach emphasizes quality companies with attractive valuations and our approach is closer to value than growth.

The Equity Fund slightly lagged the blended benchmark in he quarter and comfortably outperformed over the 12 months (the Fund's blended benchmark was up 7.4%, and 29.4%, respectively)..

Canadian Equities

Nexus's Canadian stocks returned 8.5% in the quarter and 41.6% for the 12 months.

Given that the second quarter favoured growth stocks, we were pleased that the Canadian portfolio kept pace with the TSX Index in the quarter and outperformed the TSX over the 12 months. In part, our portfolio benefitted as investors looked ahead at the cyclical recovery. Our industrial (Toromont and Finning – both Caterpillar dealers) and real estate (H&R and Allied Properties) holdings made meaningful positive contributions in the quarter (others also helped). We also benefitted from not holding the Canadian cannabis stocks or gold stocks, which collectively sank in the quarter.

U.S. Equities

Our U.S. equity portfolio increased 6.2% in the quarter and 35.0% for the 12 months.[8] Again, given the growth-oriented nature of the quarter, we are pleased that our U.S. portfolio's return was just a snick behind the S&P 500 in the quarter and well ahead over the 12 months.

During the quarter, the Canadian dollar continued to strengthen. This strength reduced the S&P 500 returns by 1.5 percentage points from what they would have been with an unchanged dollar. For the 12 months, the drag from the stronger Canadian dollar is very significant: the S&P 500's 12-month return was 40.8% in US dollars, but only 28.0% when measured in Canadian dollars.

As occurred in Canada, the second quarter was a pro-cyclical and growth quarter in the U.S. This is evidenced by the U.S. S&P 500 sectors that performed the best. These were Energy, Real Estate, Communication Services and Information Technology. Our holdings of UPS, Alphabet and Facebook did particularly well. Our banks (JP Morgan and Citigroup) and value tech holdings, after big first quarter recoveries, were fine but lagged their respective sectors in the second quarter.

In the quarter, we added a new holding, CVS Health. CVS is a large company with 2020 revenue of US$268 billion. Many think of CVS as a retail pharmacy, but this is only 30% of its revenue. The other two segments are Pharmacy Services (administering prescription drug programs) and Health Care Benefits (CVS acquired Aetna). CVS aims to offer integrated services across these segments to deliver better health care outcomes at lower cost than has previously been the case.

U.S. equity market valuations remain elevated, although rapid post-COVID earnings growth expectations have slightly lowered forward valuation multiples, even as the markets have continued to rise. As has always been the case, we take comfort from our investment approach, whereby our overall equity portfolio and most of the individual holdings carry lower valuation multiples than the market. This typically offers better downside protection during inevitable market corrections.

Other Equity Investments

We remain invested in two externally-managed pooled funds, which add international exposure and diversification to our Funds.[9] For the second quarter and the 12 months, their returns were good, but not as strong as those in North America. Of course, the stronger Canadian dollar has contributed to this. In the quarter and for the 12 months, EQIT (international developed market equities) returned 4.3% and 21.6%, while EMEC (emerging market equities) returned 1.3% and 33.6%. These holdings remain attractively valued relative to the U.S. equity market and should benefit as international economies re-open. For more information on EQIT and EMEC, please see the Nexus International Equity Fund section of this report.

[7] 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.
[8] Except where indicated, all U.S. and international returns are measured in Canadian dollars.

[9] Both pooled funds are managed by teams from J.P. Morgan 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 6.1% in the second quarter, adding to the strong gains achieved in the first quarter. Markets have been infused with optimism as vaccine rollouts have brightened the outlook and solid corporate earnings have reinforced the sentiment that the economic recovery is well underway.

Over the last 12 months, the Fund rose 33.2%. This notable return reflects not only how depressed markets were one year ago, but also how swift the recovery has been since effective vaccines were announced last fall. Our holdings in the Fund proved resilient during challenging times and have performed well during the subsequent recovery period.

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

The Canadian market continued its strong performance, rising 8.5% in the quarter. Our Energy holdings — Cenovus and Suncor — had a strong quarter, benefitting from high demand for the energy needed to power the economic re-opening. Our real estate investment trust holdings also delivered strong gains, with H&R REIT and Allied Properties poised to benefit from a post-COVID recovery. Many of our other holdings also rallied alongside the market gains.

The U.S. market gained 8.5% in the quarter.[10] The strength was broad-based across sectors, with particular strength in Real Estate, InfoTech and Energy. Several of our U.S. technology holdings gained significant ground, with Alphabet rising 21% and Facebook rising 18%. In addition, our position in United Parcel Service gained 23% after the company reported strong quarterly earnings and noted a positive outlook for its business.

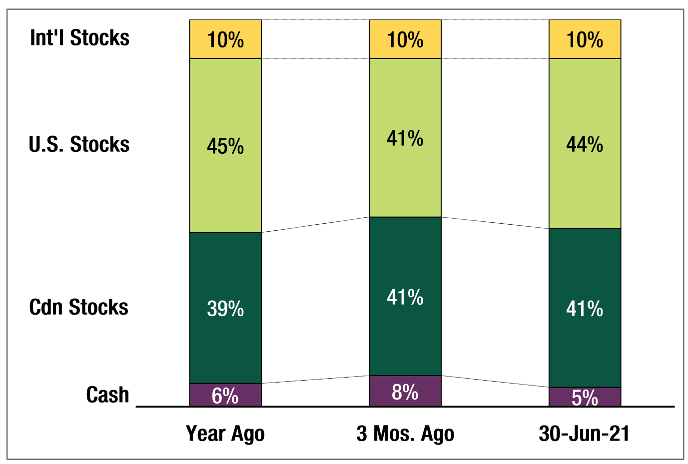
Outside of North America, our international holdings also rose in the quarter. The developed markets fund, EQIT, gained 4.3% and the emerging markets fund, EMEC, rose 1.3%.

At the end of the second quarter, the Fund's cash position was 5%. Our allocation to Canadian stocks was 41% and our allocation to U.S. stocks was 44%. The remaining 10% is allocated to markets outside North America, which have attractive growth and valuation characteristics. These holdings also add important diversification benefits to our North American investments.

	Equity Fund	Cdn Stocks	U.S. Stocks	Int'l Stocks
Quarter				
Fund	6.1%	8.5%	6.2%	2.9%
Benchmark	*7.4%*	*8.5%*	*7.0%*	
One Year				
Fund	33.2%	41.6%	35.0%	26.8%
Benchmark	*29.4%*	*33.9%*	*28.0%*	

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 June 30, 2021



Equity Fund Asset Mix

[10] All return figures in this paragraph are in US dollar terms. Company-specific figures are price returns only.

Nexus North American Balanced Fund

The Nexus North American Balanced Fund generated a total return of 4.5% in the second quarter. The main positives were our Canadian stocks, which rose 8.7% and our U.S. stocks, which rose 6.1%. These gains were partly offset by the more modest returns of our bond holdings, which gained 0.5%.

In the last 12 months, the Fund has returned 21.8%, driven initially by the strong recovery in our stock holdings from the COVID-induced lows of last year, and more recently by the equity markets reaching new highs.

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

For our bond holdings, the modest second quarter gains were a partial reversal of the sell-off witnessed in the first quarter. A shift in sentiment around inflation and strong investor demand saw longer-dated bonds move higher. As a result, our bond holdings, which are focused on shorter-dated maturities, lagged the benchmark. However, on a year-to-date basis, this positioning has served us well, as Nexus's bond portfolio is down only 1.3% versus the benchmark's 3.5% decline.

For our equity holdings, the strength in our Canadian stocks was driven by improving prospects for the Energy, Real Estate and Industrial sectors as the economy re-opens. Along these lines, we benefitted from our ownership of energy companies Cenovus and Suncor, real estate companies H&R REIT and Allied Properties, and our industrial holdings Toromont and Finning. In our U.S. stocks, we saw large gains in UPS, Alphabet and Facebook, each of which rose about 20% (in US dollar terms).

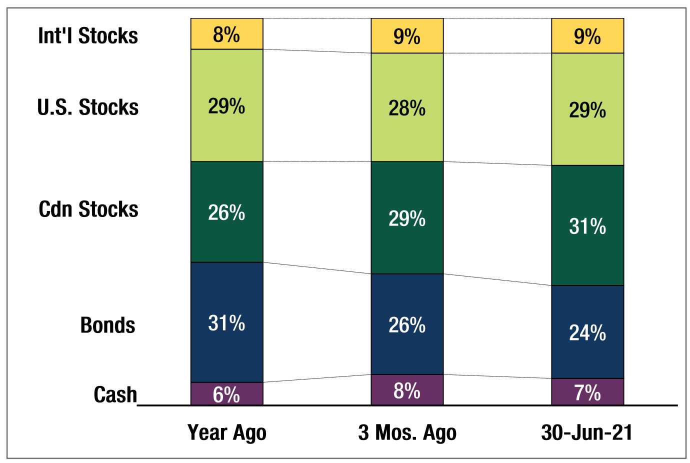
In addition to our North American stocks, our international holdings also gained ground. The developed markets fund, EQIT, rose 4.3% in the quarter and the emerging markets fund, EMEC, rose 1.3%.

At the end of the quarter, cash represented 7% of the Fund's asset mix, bonds were 24% and stocks accounted for the remaining 69%. 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	4.5%	0.5%	8.7%	6.1%	2.9%
Benchmark	*5.7%*	*1.7%*	*8.5%*	*7.0%*	
One Year					
Fund	21.8%	0.7%	40.2%	31.8%	26.7%
Benchmark	*18.9%*	*-2.4%*	*33.9%*	*28.0%*	

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 June 30, 2021



Balanced Fund Asset Mix

Nexus North American Income Fund

The Nexus North American Income Fund produced a total return of 1.7% in the second quarter. Our bonds produced a modest 0.5% gain which was bolstered by our income-oriented stocks, which produced solid gains in the period. In the last 12 months, the Fund rose 6.6%, exceeding the Fund's benchmark, which declined 2.4%.

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

For our bond holdings, the modest second quarter gains were a partial reversal of the sell-off witnessed in the first quarter. A shift in sentiment around inflation and strong investor demand saw longer-dated bonds move higher. As a result, our bond holdings, which are focused on shorter-dated maturities, lagged the benchmark. However, on a year-to-date basis, this positioning has served us well, as Nexus's bond portfolio is down only 1.1% versus the benchmark's 3.5% decline.

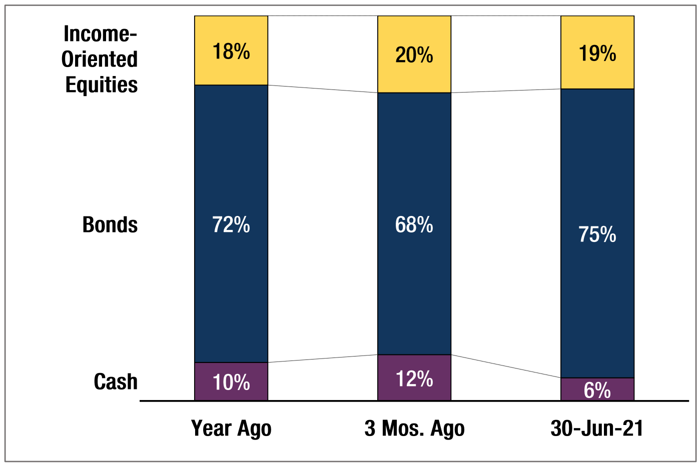
The income-oriented equities we hold in the Fund continued to add value in the quarter. Our Canadian stocks rose 8.4%, while our U.S. stocks rose 3.1%. Results over the 12-month period continue to be robust, reflecting the strong recovery of stock markets since the COVID-induced lows and, more recently, new highs in the equity markets.

At the end of the first quarter, the Fund's cash position was 6%, income-oriented equities accounted for 19% and the balance, 75%, was in our core bond holdings.

	Income Fund	Bonds	Cdn Stocks	U.S. Stocks
Quarter				
Fund	1.7%	0.5%	8.4%	3.1%
Benchmark	*1.7%*	*1.7%*		
One Year				
Fund	6.6%	0.7%	32.0%	31.4%
Benchmark	*-2.4%*	*-2.4%*		

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 June 30, 2021



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).[11]

Returns in the second quarter were positive, marking the fifth consecutive quarter of gains for the International Fund. This trend is notable given that many international countries have struggled in their efforts to contain COVID, particularly in emerging markets. However, investors appear to be looking through this near-term challenge and are focusing more on the long-term positives of international markets, such as their youthful, growing populations that can support stronger economic growth than is available in North America.

During the quarter, NIEF gained 3.0%, comprised of a 4.3% gain for EQIT and a 1.3% gain for EMEC.

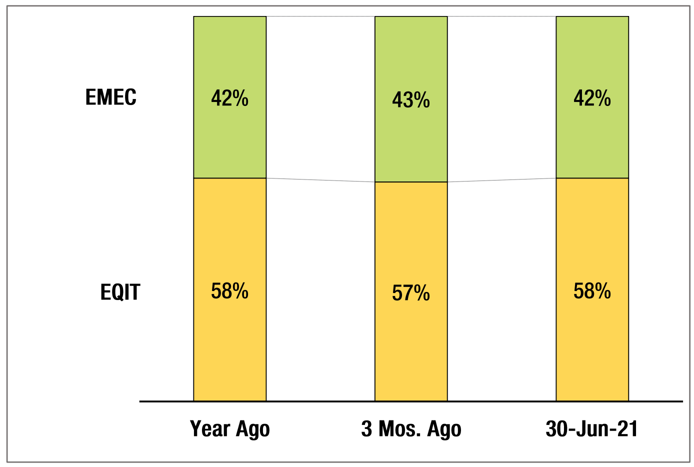
More detail on the Fund's performance is presented in the table below.

At the close of the first quarter, the International Equity Fund's investment in EQIT accounted for 58%, while EMEC accounted for 42%.

	International Equity Fund	EQIT	EMEC
Quarter			
Fund	3.0%	4.3%	1.3%
Benchmark	*3.6%*	*3.7%*	*3.5%*
One Year			
Fund	26.6%	21.6%	33.6%
Benchmark	*22.4%*	*20.4%*	*28.1%*

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 June 30, 2021



International Equity Fund Asset Mix

[11] 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.