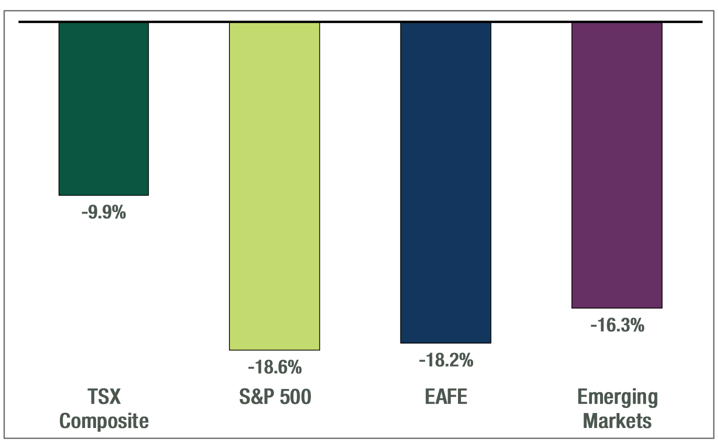
The Nexus Report

Second Quarter, 2022

Investment Outlook

No One Said It Was Going to be Easy

At the mid-year point of 2022 markets continue to make headlines for the wrong reasons. In the second quarter the S&P 500 declined 16.1% (in U.S. dollar terms), the TSX Composite fell 13.2%, and the Canadian bond market, typically a safe port in stormy times, fell 5.7%.[1] This comes on the back of a weak first quarter and, when taken together, is assuredly the weakest start to a year in more than 50 years. Thankfully, Nexus investors have been spared the worst of the carnage so far. But how the rest of the year unfolds from here remains under a dark cloud of uncertainty.



Total Returns for 6 Months ended June 30, 2022 (C$)

The issues confronting the market are numerous, global in nature and complicated. But foremost among them is the prospect for inflation and what the appropriate response of global central banks should be. During the worst of the pandemic, virtually all central banks opened a floodgate of liquidity. Interest rates were set to zero or even lower, and quantitative easing policies (QE) were enacted that had the effect of transferring government, as well as private sector debt, to central bank balance sheets.

Acting together with government fiscal policies that were incredibly stimulative, the economic effect of the pandemic was forcefully addressed. It was a strategy that was bold and untested, but it was right at the time. A disruptive period of deflation was avoided, employment levels rebounded quickly and, the recession was one of the shortest on record.

Unfortunately, the central bankers stayed with their approach for too long. Signs of accelerating inflation were ignored or were wrongly dismissed as temporary. Over the course of 2021 inflation in the U.S. rose from 1.4% to 7.0%, and it has continued to move higher in 2022, registering an 8.6% year over year gain in May. Unfortunately, it is a global phenomenon. Inflation is getting out of control in Canada (7.7%), the U.K. (9.1%) and the EU (8.1%). High levels of inflation distort economic decision-making and act as a tax on the economy, especially to those in lower income brackets who have little discretion in how they spend their earnings. In Canada, the predominant responsibility of the Bank of Canada is to maintain inflation in a range between 1% and 3%. In the U.S., the Fed has a dual mandate: to assure maximum employment and low and stable inflation. Clearly, policy errors have been made and corrections to monetary policy are needed. Both Governor Macklem and Chairman Powell have publicly admitted error and used speaking opportunities at the IMF meetings in April to pledge to restore the public's faith that inflation would return to low levels. The change of approach to tighter monetary conditions, as well as their forceful

[1] Unless indicated otherwise, all Nexus returns are compound annual average, time-weighted, total rates measured in Canadian dollars and calculated after deducting such direct and indirect costs as applicable withholding taxes, trading commissions, custody fees and other fund/account expenses, but without deducting Nexus's management fees. Returns for market indices and benchmarks are presented on the same basis, but without any such deductions. Blended benchmark weightings are rebalanced monthly. Past performance is not indicative of future results.

commitment to it, which was repeated by other members of the Governing Council of the Bank of Canada and other Federal Reserve governors, has rattled investors for fear that it will provoke a recession. Which brings us back to the second quarter in capital markets!

You Can't Run…

The eventual effect of tighter monetary conditions on the economy will be to dampen aggregate demand. But it is, to use a well-worn phrase, a blunt instrument, and it takes many months to have a direct effect. In the meantime, several economic indicators are signalling that a slowing of the economy might already be underway. For instance, the Institute of Supply Management Manufacturing survey has fallen steadily from 58.3 at the start of the year to 53.0. The National Federation of Independent Business Optimism index has declined from 98.9 to 93.1, which is the lowest level since April 2020, in the depths of the pandemic shutdown. Commodities, too, have weakened, perhaps signalling a reduction of demand rather than expanded supply. In the quarter copper fell more than 20%, nickel fell 30% and lumber fell 28%. Could the central banks be making another error and tightening aggressively while the economy is already slowing? If that is the case, then a hard landing of the economy is likely, and some form of recession will be at hand.

While this is a risk, there are reasons to believe not all is dire. The labour markets in Canada and the U.S. are in excellent shape. Unemployment is low, unfilled jobs are numerous, and wages, though lagging inflation, are accelerating. With both economies operating at full employment there is a substantial offset to tighter monetary conditions. As well, accumulated savings and improved household balance sheets will provide a buttress against the drag of inflation and rising rates. More subtly, some of the slowdown observable in North America is attributed to a normalization of demand conditions in the goods portion of the economy. In our estimation, a healthy consumer is beginning to rotate spending into the services side of the economy (which is twice as large) and it's a trend that will continue if higher-contact activities such as travel, dining, etc. continue to be safe.

Of course, interest rate policy and macroeconomic conditions are not the only issues on investor minds these days. It is becoming clear that the war in Ukraine is apt to be protracted and there is no certainty as to how it will be resolved. It is now an explicit policy of the EU to disentangle the European economy from Russia, but in the here and now it is disrupting economic activity. In particular, energy prices in Europe are high and rising, and supply is uncertain. In China, the pursuit of a zero-tolerance policy to COVID infections has derailed its economy, dampening the demand for western goods as well as industrial demand for many commodities. Lockdowns undermine global supply chains that originate or pass through China and perpetuate the imbalance of demand and supply that is a major factor in accelerating inflation. Recently though, restrictions in China are being lifted and there are signs that growth can be expected to strengthen in the balance of 2022.

…But You Can Hide

Our approach has never been to get in and out of the market opportunistically. Timing markets is a skill which we believe neither we nor any other manager possess. But security selection and a style that emphasizes quality do provide benefits in difficult, confusing times, such as we are experiencing currently. Nexus believes that an emphasis on high quality allows investors to "hide out" in businesses that will withstand the effects of the current tough conditions and recover in value as their management teams adapt and economic conditions become more favourable.[2] So far, most of our holdings have done a marvelous job of adapting to the cost pressures and changed circumstances of these new inflationary times. Earnings growth and dividend increases are still much the norm in the portfolio, and the effect of sagging share prices has made the current valuations more attractive than was the case at the start of the year. As unsettling as the times are, it feels very much like a bear market roller coaster and not a cliff dive to an unknown future such as was the case in the Great Financial Crisis of 2008 / 2009 or the NASDAQ technology implosion in 2000.

As we said at the outset, this is the toughest start to any year in more than 50 years. The second half may continue that trend, or the worst may be in the past. We don't know. But we do know that our portfolios are built for challenging times and our investment team is vigilantly watching corporate and economic developments. As is always the case, we thank you for the trust you put in us and welcome your questions and comments.

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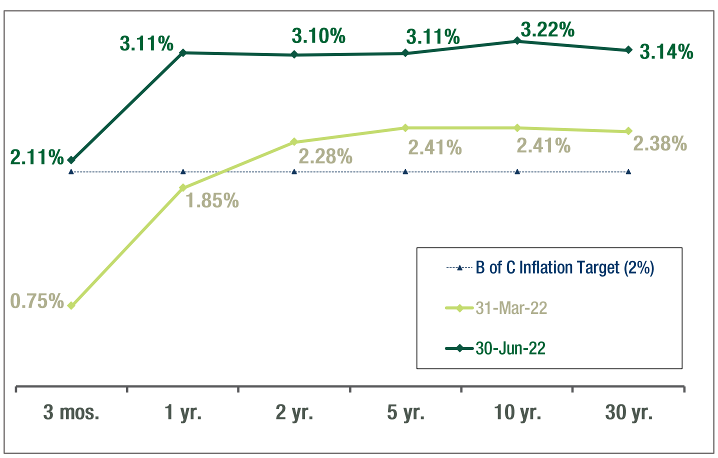
[2] There are qualitative and quantitative factors that are considered in assessing "quality". Examples include: stability of profit margins, an ability to fund organic growth without reliance on new capital, coverage and commitment to paying dividends, management experience, conservatism in the use of leverage and the degree of competition in the sector.

Asset Class Review

Fixed Income

The trend of rising rates continued in the second quarter, driven by central banks' messaging of their steadfast intention to rein in inflation before it becomes embedded in consumer and corporate expectations. Backed into a corner by inflation readings that had not been seen since the early 1980s, the Bank of Canada, the Federal Reserve and even the European Central Bank professed their desire to wrestle inflation lower, even at the expense of dramatically slowing the economy and rising unemployment. Fed Chair Powell was explicit in remarks he made at the IMF Meetings in mid-April. There he said, "We have had an expectation that inflation would peak… and come down over the course of the year. We are not going to count on supply side healing. We are going to be raising rates."

As many readers would be aware, one of the enduring adages of the investment world is "Don't fight the Fed." While we generally don't follow such pithy rules or expressions, we are not in the mood to fight either the Fed or the Bank of Canada! As it turned out, the quarter was a good time to adhere to the advice. In March of this year the Bank of Canada raised the target level for the Bank rate by 0.25% to 0.50%. In the three months thereafter, it raised rates twice more, and by 0.50% each time. Given the startling jump in inflation, an increase of a similar amount is widely anticipated with the release of its Monetary Policy Report on July 13th.



Government of Canada Yield Curve

Over the course of the quarter, two-year Canada yields jumped 81 basis points, from 2.28% to 3.09% and 10-year yields jumped the same amount, from 2.41% to 3.22%. When stacked on top of the increases in bond yields since the start of the year, the effect on bond valuations has been significantly negative. This quarter the FTSE Canada Universe Bond Index declined 5.7%, bringing year-to-date losses to 12.2%.

However, as recently as the middle of June, bond yields were significantly higher than at the end of the quarter. (In mid-June 10-year Canada bonds yielded 3.62%.) The abrupt improvement during the month arises from investor concern that the Fed's monetary tightness will produce a dramatic slowdown in the economy. In the eyes of many investors, such a slowing could do either one of two things: it could solve the inflation problem by better aligning demand and supply conditions, or, more problematically, it could provoke concerns about global financial stability as high U.S. rates attract capital from other jurisdictions. A bit worryingly, late in June the British Pound, the Euro and The Japanese Yen were trading at or near 20-year low values against the U.S. dollar. Our Loonie too, has been weak, although not nearly to the same degree, largely owing to the expectation that the Bank of Canada, too, will pursue higher interest rates like the Fed.

Yet for all the actual and anticipated tightening, interest rates remain well below the rate of inflation. In Canada, the latest headline inflation reading for May was 7.7%. An average of the Bank of Canada's measures of core prices rose 4.6%. Each of these readings was higher than forecast and higher than it had been in decades. Perhaps just as alarmingly, price increases are widespread. Fully 75% of the basket of goods measured by the Consumer Price Index increased by more than 3%, which is the top of the Bank of Canada's target range.[3]

After an extended period when we have pursued a very short duration strategy, we acknowledge that the recent increase in yields makes bonds more attractive than they have been for the last two or three years. Despite the rise, it is hard to be an enthusiastic investor in bonds. In June we added modestly to our duration exposure, such that the portfolio has a duration of 3.6 years (up from 3.3 years). In the quarter, our bonds outperformed the Universe benchmark, falling 2.0%, while the Universe declined 5.7%.

[3] The Impact of Inflation on Different Income Levels in Canada. June 23, 2022. Desjardins Economics.

Equities

Equity markets fell in the second quarter because of concern about high inflation, the accompanying policy response from central banks, and the risk of recession. In addition to inflation and higher interest rates, markets also had to contend with war in Ukraine and the lingering pandemic, which has now claimed more than 41,000 lives in Canada, 1 million in the U.S. and 6 million worldwide. In this context, the Equity Fund fell 8.3% in the quarter and is down 3.9% over the past 12 months.[4]

In the U.S., the S&P 500 fell 13.5% (in Canadian dollars) last quarter and is now down 18.6% so far this year, marking its biggest first-half decline since 1970. In Canada, the TSX Composite fared no better, losing 13.2% in the quarter, giving back all the first quarter's gains and more. Only one sector in Canada – Energy – has produced a meaningful gain this year, rising 26% amid worries of a global energy supply shortage.

Our equity portfolio outperformed in the quarter. Both our Canadian and U.S. stocks declined, but less so than their respective indices, reflecting the ability of the portfolio to endure periods of high volatility.

We anticipate that our holdings, which carry low valuations and defensive attributes, will successfully navigate the current turmoil and prosper in the longer term.

Canadian Equities

Nexus's Canadian stocks fell 7.7% in the second quarter, yet remain up 8.8% over the last 12 months. There were few places to hide in the quarter, with every TSX sector declining. Our outperformance in Canada was driven by our exposure to the Energy sector, particularly our core holdings of Cenovus and Suncor, which bucked the trend of falling markets and rose 18% and 12%, respectively. Our performance was also helped by avoiding the Materials and Information Technology sectors in Canada, which were among the worst-performing parts of the market, falling 24% and 31%, respectively, during the quarter.

One recent change was our sale of ATCO Ltd., a diversified, Alberta-based utility holding company that we had held for some time. For years, ATCO had productively allocated capital to energy infrastructure investments in Alberta and abroad. However, we see fewer of the same kind of opportunities ahead, and this more subdued outlook makes us less optimistic about the company's growth prospects.

U.S. Equities

The U.S. market is off to its worst start since Nixon's first term, and our U.S. stocks have not been immune to the downturn. Nexus's U.S. holdings fell 10.2% last quarter and have declined 13.5% in the last year, buffeted by the numerous issues articulated in the Investment Outlook section of this report. However, while all investors have been battered by the turmoil, Nexus's second quarter returns do compare favourably to the S&P 500 decline of 13.5%.[5]

The main driver of this relative outperformance was our emphasis on owning high-quality businesses that can successfully withstand difficult periods. While most of our stocks declined in the period, they typically fell less than their peers.[6] For reference, there were more than 40 companies in the S&P 500 that declined between 30 and 50% percent in the second quarter. While we had our share of big decliners – Alphabet, Meta, GM and Cisco each fell more than 20% – we avoided some of the hardest-hit areas like high-growth, unprofitable tech companies.

We added a new position in Ross Stores during the quarter. This discount retailer of apparel and home goods offers a value proposition that resonates with consumers (particularly the budget-conscious) and has an excellent track record of financial returns. In the years ahead, we expect it will grow through steady expansion of its store network while maintaining its strong balance sheet. In the event of recession, the company will benefit from middle-class consumers "trading down" to Ross's off-price stores in order to save money.

Other Equity Investments

We remain invested in two externally-managed pooled funds, which add international exposure to our Funds.[7] The difficult environment encountered by our international holdings in the first quarter continued into the second. EQIT (international developed market equities) fell 11.6%, reflecting the effects of war in Ukraine as well as risks from Europe's dependency on Russian oil and gas. EMEC (emerging market equities) fell 9.7%, hurt by slowing growth, high inflation and rising interest rates that stand to squeeze some developing economies and their consumers. Despite these near-term pressures, the long-term growth outlook for our international holdings remains solid and valuations are attractive. For more information on EQIT and EMEC, please see the Nexus International Equity Fund section of this report.

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[4] All the return data in the Equities section are 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.

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

[6] The exceptions were Dollar General, Gilead and Pfizer, which rose 10%, 4% and 1% in US$ terms, respectively.

[7] 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 declined 8.3% in the second quarter. While these results were better than the blended benchmark return, which fell 12.7%, they reflect the challenging conditions that defined the period. Stubborn inflation, higher interest rates and talk of recession conspired to drive markets lower in the quarter. When the quarter's returns are combined with the poor market returns in the first quarter, the result has been the worst first half-year for markets in more than 50 years.

In the last 12 months, the Fund has declined 3.9% as worries about inflation, aggressive tightening from central banks and a protracted war in Ukraine have weighed on market sentiment.

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

After holding up well in the first quarter, the Canadian equity market did an about-face, with the TSX Composite falling 13.2% in the second. Every sector declined, but among the hardest hit were Materials (which fell 24%) and Information Technology (down 31%). Nexus's Canadian holdings fell 7.7%, outperforming the TSX Composite. We were helped by the continued gains in our core Energy holdings, Cenovus and Suncor, which both delivered double-digit gains. In addition, while our other Canadian stocks fell, many proved more resilient to market stress than their peers, and fell by less, contributing to our relative outperformance.

The U.S. market experienced an equally difficult period, with the S&P 500 declining 13.5% in Canadian dollar terms. As in Canada, every sector in the U.S. declined, leaving few places for investors to hide. Though Nexus's U.S. stocks were not immune to the downturn, we did outperform on a relative basis, falling 10.2% during the period. While a handful of our holdings managed to gain ground in the quarter (Dollar General, Gilead and Pfizer), others declined more than 20% (Alphabet, Meta, GM and Cisco). Despite our setbacks, we did manage to avoid the most challenging areas of the market, such as high-growth tech, where many securities fell 30 to 50% during the quarter.

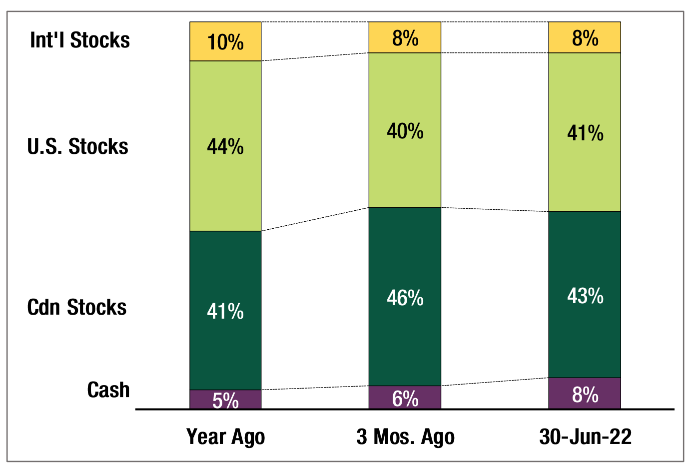
Outside of North America, our International holdings endured another difficult quarter. The developed markets fund, EQIT, fell 11.6% while the emerging markets fund, EMEC, declined 9.7%. International markets have been affected by the same factors that pressured North American markets, namely persistent inflation, rising interest rates, war on European soil and the lingering pandemic.

At the end of the second quarter, the Fund's cash position was 8%. Our allocation to Canadian stocks was 43%, while U.S. stocks represented 41% of the mix. We have maintained an allocation of 8% to markets outside North America which we expect, over time, will provide complimentary diversification to our North American investments.

	Equity Fund	Cdn Stocks	U.S. Stocks	Int'l Stocks
Quarter				
Fund	-8.3%	-7.7%	-10.2%	-10.8%
Benchmark	*-12.7%*	*-13.2%*	*-13.5%*	
One Year				
Fund	-3.9%	8.8%	-13.5%	-21.1%
Benchmark	*-5.0%*	*-3.9%*	*-7.1%*	

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 June 30, 2022



Equity Fund Asset Mix

Nexus North American Balanced Fund

The Nexus North American Balanced Fund declined 5.9% in the second quarter. In what was a tough quarter in all parts of the market, our holdings in Canadian, U.S. and International stocks declined, as did our bond holdings.

In the last 12 months, the Fund has retreated 3.5%. The challenges were concentrated in our U.S. and International stocks, as well as our bonds, but this was partly offset by the strong performance of our Canadian stocks.

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

For bonds, the quarter continued the trend of rising rates driven by central banks' stated intention to tame inflation. Recent inflation readings, both in Canada and abroad, remain elevated, which has led to a string of rate increases from central banks, with even further tightening anticipated in the months ahead. In this rising rate environment, the Canadian bond index fell 5.7%. Nexus's bond holdings, which maintain a shorter duration than the index, fared better, but still declined 2.0%.

Our equity holdings declined in both Canada and the U.S., yet in a tough quarter for stocks, we managed to outperform in both markets. This is in part the result of our emphasis on high quality stocks that have defensive characteristics in down markets. Two of our Canadian Energy sector holdings – Cenovus and Suncor – performed well, notching double-digit gains in the quarter. On the U.S. side, Dollar General bucked market trends to also produce a double-digit gain, while two of our Healthcare sector holdings – Gilead and Pfizer – also stayed in positive territory. However, we were not immune to the market turmoil and several of our equity holdings fell more than 20%, including Finning, Allied Properties, Alphabet, Meta, GM and Cisco.

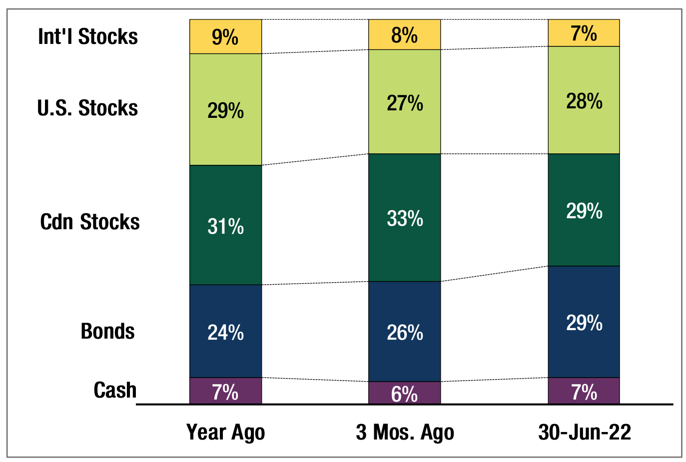
Outside of North America, our International holdings endured another difficult quarter. The developed markets fund, EQIT, fell 11.6% while the emerging markets fund, EMEC, declined 9.7%. International markets have been impacted by the same factors that pressured North American markets, namely persistent inflation, rising interest rates, war on European soil and the lingering pandemic.

At the end of the quarter, cash represented 7% of the Fund's asset mix, bonds were 29% and stocks accounted for the remaining 64%. 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	-5.9%	-2.0%	-6.9%	-9.6%	-10.7%
Benchmark	*-10.4%*	*-5.7%*	*-13.2%*	*-13.5%*	
One Year					
Fund	-3.5%	-6.2%	11.1%	-11.8%	-21.0%
Benchmark	*-6.6%*	*-11.4%*	*-3.9%*	*-7.1%*	

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 June 30, 2022



Balanced Fund Asset Mix

Nexus North American Income Fund

The Nexus North American Income fund retreated 3.2% in the second quarter. Rising rates and aggressive central bank tightening pressured our bond holdings, while our Canadian and U.S. stocks fell in tandem with the broad market downturn. Over the past 12 months, the Fund has declined 4.1%, outperforming the benchmark which has fallen 11.4%.

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

For bonds, the quarter continued the trend of rising rates, driven by central banks' stated intention to tame inflation. Recent inflation readings, both in Canada and abroad, remain elevated, which has led to a string of rate increases from central banks, with even further tightening anticipated in the months ahead.

In this rising rate environment, the FTSE Canada Universe Bond Index fell 5.7%. Nexus's bond holdings, which maintain a shorter duration than the index, fared better, but still declined 2.0%.

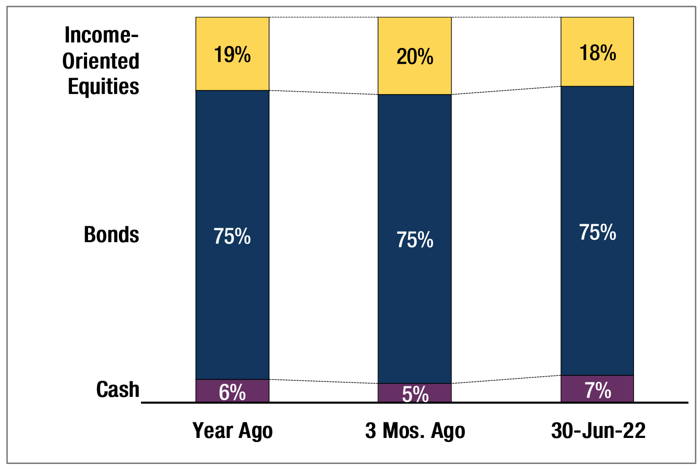
The income-oriented equities we own in the Fund declined in the second quarter. The Canadian stocks fell 10.9% while our U.S. holdings fared better, but still declined 5.7%. Over the last 12 months, our Canadian and U.S. stocks gained 3.6% and 4.5% respectively, holding up well during a particularly tumultuous period for markets worldwide.

At the end of the second quarter, the Fund's cash position was 7%, income-oriented equities accounted for 18% and the balance, 75%, was in our core bond holdings.

	Income Fund	Bonds	Cdn Stocks	U.S. Stocks
Quarter				
Fund	-3.2%	-2.0%	-10.9%	-5.7%
Benchmark	*-5.7%*	*-5.7%*		
One Year				
Fund	-4.1%	-6.4%	3.6%	4.5%
Benchmark	*-11.4%*	*-11.4%*		

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, 2022



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).[8]

The Fund declined 10.8% in the second quarter. EQIT fell 11.6% in the period and EMEC fell 9.7%.

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

Following a difficult first quarter for international markets, trends in the second did not improve. Europe continues to reel from the conflict in Ukraine, where the war has upended supply chains, sent inflation galloping, threatened the reliable flow of energy supply, and put a significant proportion of the world's food supply at risk. However, it is important to bear in mind that while EQIT does invest in European-headquartered companies, most of these companies are highly-diversified global businesses. In fact, only 16% of the revenue produced by EQIT's portfolio companies is generated from Europe.

Separately, emerging markets have been caught in the crosscurrents of inflation, rising rates and slowing economic growth. What's more, many developing economies have been buffeted by commodity volatility and the continuing challenge of fighting COVID. China, in particular, has been held back by the government's strict zero-COVID policies.

While the near-term outlook remains under pressure, the long-term growth outlook for our international holdings remains solid, supported by positive, multi-decade demographic trends and a broad set of economic development opportunities in regions outside North America. In addition, today's valuations are attractive and we remain confident that the addition of international holdings will add important diversification benefits to our portfolios over time.

At the close of the second quarter, the International Equity Fund's investment in EQIT accounted for 60%, while EMEC accounted for 40%.

	International Equity Fund	EQIT	EMEC
Quarter			
Fund	-10.8%	-11.6%	-9.7%
Benchmark	*-11.1%*	*-11.8%*	*-8.7%*
One Year			
Fund	-20.8%	-17.4%	-25.4%
Benchmark	*-16.5%*	*-14.5%*	*-22.3%*

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$); and (c) for EMEC: MSCI Emerging Mkts (in C$).

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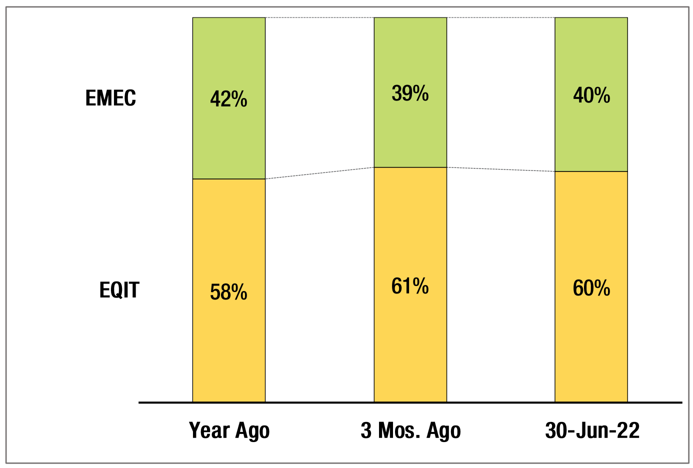

International Equity Fund Asset Mix

[8] International developed markets or "EAFE" includes Europe, Australasia and the Far East. Emerging markets include 24 developing countries. EQIT and EMEC are managed by JPMorgan 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.