

## NEXUS NORTH AMERICAN BALANCED FUND QUARTERLY REPORT – June 30, 2005

Investors enjoyed positive returns across all asset classes last quarter. Notably, interest rates moved sharply lower and as a result fixed income markets outperformed the major equity indices. While some strength in equity markets was attributable to the support that low interest rates provide, positive performance relied largely on the strength of the energy sector. Equity indices continue to trade in a narrow range without a clear trend in place. Those who reduce the investment analysis into a point of view that is either bullish or bearish, can find an abundance of data to support their argument. Despite lackluster index returns, the Fund has had a very good quarter and an exceptionally strong last 12 months – led by particularly strong performance in Canadian equities.

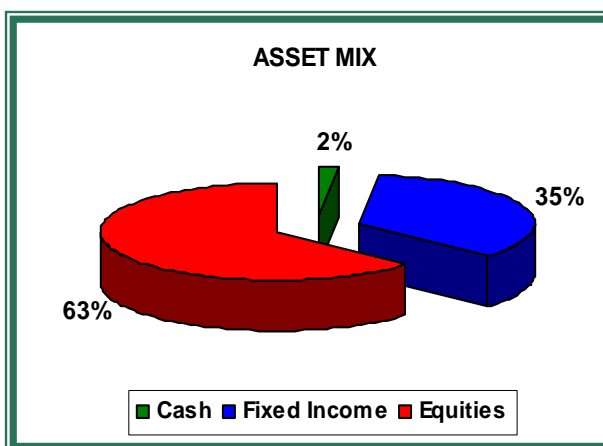
Economic growth in Canada and the U.S. looks to be positive and steady – likely between 2% and 3½% in the coming year. This is a satisfactory pace, neither too robust to generate much investment excitement (for bulls) nor too weak to lead to worry (for bears). It is worth noting that this middle of the road performance is the envy of European and Japanese policy makers.

Rather than declare ourselves on the side of the bulls or bears, we would prefer to acknowledge that this sort of investment environment is often characterized as a “stockpickers’ market.” Interest rates are stable and at historically low levels, and equity performance will be largely driven by specific corporate developments, not by a discernible market-wide trend.

During the quarter, the Fund's unit value increased 5.8%<sup>1</sup>. The fund is up 18.3% in the last 12 months.

### ASSET MIX

Measured simply by the balance between equities, bonds and cash, our current asset mix remains very close to our long-term guidelines. However, within our equity allocation, we have underweighted the U.S. and overweighted Canada – just as we have for more than a year. This decision, when combined with our strong returns in Canadian equities, has made an important contribution to the Fund's record of outperformance.

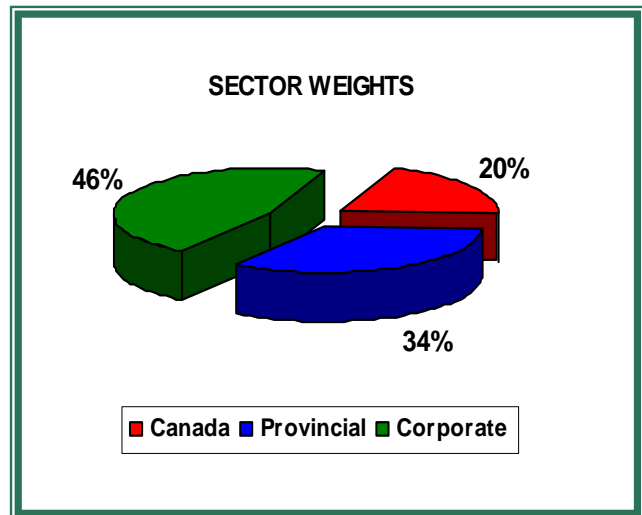


<sup>1</sup> Fund returns are shown before the deduction of management fees but after the deduction of direct expenses.

## FIXED INCOME SUMMARY (35% of Assets)

After a run-up in bond prices such as we have had, and a consequent decline in yields to historic lows, it is worth wondering if interest rates could still go lower. Despite the substantial reduction in interest rates this past quarter, in a global context North American interest rates actually appear high. In Europe, 10 year bonds issued by Germany and France and denominated in euros yield about 3.2%. In Japan, 10 year bonds denominated in Yen yield only 1.25%. Not surprisingly, U.S. 10 years yielding 3.91% look attractive, as do Canadian 10 years yielding 3.74%. Despite the ultra-low interest rates abroad, both the Japanese and European economies continue to deliver sub-optimal economic performance. Indeed, recent developments in Europe reflect a softening of their economy, and policy makers at the European Central Bank seem to be preparing the markets for an interest rate reduction. As hard as it may seem for investors who cut their teeth in the '70s and '80s, there is evidence that still lower rates are not without precedent.

It is somewhat perplexing that these ultra-low bond yields have come at a time when both the Bank of Canada and the U.S. Federal Reserve are widely understood to be in a process of raising short term-interest rates. Although the economic picture is far from clear, central bankers in North America believe that monetary policy is too stimulative at current levels and that low rates are encouraging consumers to assume more debt than is otherwise responsible and creating bubble-like asset inflation in real estate. Real estate bubbles and towering debt levels create systemic risk to the economy and as a result, policy makers want to move pre-emptively, returning interest rates to neutral levels before any problems develop.



The phenomenon of rising short rates and dramatically falling bond rates has been called a "conundrum" by Alan Greenspan and almost certainly defies conventional explanation. Perhaps in part it owes to the relative attractiveness of our North American interest rate structure and the voracious accumulation of government bonds by Asian Central Banks. However, it seems likely that there are other reasons as well.

Greenspan and others have mused that at least part of the reason may be a fundamental mismatch between the assets of pension funds (equities, real estate and bonds) and their long-term liabilities (pension obligations). As many will be aware, there is a growing systemic pension underfunding issue in the U.S. Pension funds have been too heavily weighted in equities during a period of low equity returns and plan sponsors are now being forced to make larger contributions and allocate more of their assets to bonds. It is likely this is at least a contributing factor to the strength in the bond market.

A third and less palatable reason to feel rates should stay at these levels would be that, as the economic picture becomes clearer in the months ahead, the fundamentals will show that we in North America have the same economic problems as the aging populations of Europe and Japan, and that "ultra-low" rates are natural in lower growth economies.

Our positioning in the bond market reflects our middle of the road opinion. We see the sense in raising rates from levels that might be considered artificially depressed, but we also suspect that economic resilience to higher interest rates may be low. It is quite possible that the experience of other developed economies could occur here in North America and that as investors, we will need to learn to live with sluggish economic growth and low bond yields for some time to come. Accordingly we are waiting for further evidence before we declare for one side or the other, and we continue to position our holdings in securities concentrated in 5 to 10 year maturities.

The Fund's fixed income returns were +4.5% for the quarter and +11.9% for the year. By comparison, the Scotia Capital Bond Universe Index was +4.5%, and +12.0% for the same periods.

## CANADIAN EQUITY SUMMARY (48% of Assets)

We have maintained a significant weighting in the energy and financial services sectors, both of which performed well in the past quarter. Fearing overexposure to the latest mania, early in the year we had reduced our exposure slightly to energy. However, this past quarter, we reversed direction and added two new small holdings, UTS Energy and OPTI Canada in this sector. We now have a 21% weighting across 7 different holdings.

Up over 30% in the first six months of the year, the energy sector is perhaps the only area in the capital markets with clear short-term, upward momentum. Our attraction to this area rests on our long-term opinion that the supply-demand balance is likely to favour still higher prices for oil and natural gas as well as higher valuations for companies in this sector. Our two new holdings share two important similarities. They are early stage oil sands projects and they each have a strong partner. In the case of OPTI, it is a 50:50 partner with Nexen in the Long Lake Project south of Fort McMurray. Once operational in 2007, OPTI will have dramatically lower operating costs than other projects in the oil sands arena due to technological innovation in the recovery process. In the case of UTS, it is a 40:60 partner with Petro-Canada in the Fort Hills project north of Fort McMurray. It is a relatively small scale project and is not estimated to begin production until 2011.

Ten Largest Holdings	
<b>Manulife</b>	<b>2.6%</b>
<b>Bank of Nova Scotia</b>	<b>2.5%</b>
<b>Telus</b>	<b>2.1%</b>
<b>EnCana</b>	<b>2.1%</b>
<b>Royal Bank</b>	<b>2.0%</b>
<b>Enbridge</b>	<b>2.0%</b>
<b>TD Bank</b>	<b>2.0%</b>
<b>Suncor</b>	<b>1.8%</b>
<b>Trican Well Services</b>	<b>1.6%</b>
<b>Talisman</b>	<b>1.5%</b>

In financial services, our weighting (26%) remains substantial – concentrated in bank and life insurance holdings. Keen observers of these reports will notice that Manulife and the Bank of Nova Scotia remain our largest holdings but, due to price appreciation, EnCana and Telus are now larger holdings than the Royal Bank.

In our first quarter report we wrote briefly on our expectation (and hope!) for management change at MDS. Early in April the company announced the appointment of Stephen DeFalco as COO, with the understanding that he would subsequently assume the role of President and CEO later in the year. In June the decision was made for this transition to happen even sooner. It would be wrong

to ascribe too much importance to one management change but, having held senior positions at United Technologies, PerkinElmer as well as U.S. Genomics, Mr. DeFalco has excellent experience in the healthcare and industrial sectors. In the short run his appointment has had a favourable effect on the share price. We expect that as he settles in and assumes greater control of the company, important strategic decisions will be made that help realize the underlying value of their various business divisions.

The Fund's Canadian equity returns were strong this past quarter, and substantially better than market benchmarks. Canadian equity returns were up +8.2% for the quarter and +34.9% for the year. By comparison, the TSX Composite was +3.6% and +18.0% for the same periods.

## U.S. EQUITY SUMMARY (11% of Assets)

Investors in U.S. equities have needed to exercise patience and selectivity for some time, and this past quarter was no exception. The overall market has languished this year, trapped in a fairly narrow trading range with no obvious catalyst on the horizon that would act to move it higher or lower. In US\$ terms, the S&P 500 is basically unchanged (-0.8%) for the year to date and, of the ten industry sectors that constitute the index, only two have shown positive returns. Even casual readers of the business pages could likely guess which sectors are higher – energy (due to surging oil prices) and utilities (due to declining interest rates). It is clearly the type of market that breeds frustration!

In flat markets such as this, it can be tempting to “try and make things happen” by being opportunistic or by more active trading of short-term price movements. We have not yet given into such temptation and, in the quarter just past, we neither added any new holdings nor did we sell out of any positions. However, we did add a small amount to our current holding of Washington Mutual in April.

Our returns were relatively strong this quarter and continued to be ahead of the benchmark. The Fund's U.S. equity returns in C\$ were +4.0% for the quarter, and +0.4% for the year. By comparison, the S&P 500 (in C\$) was +2.7% and -2.8% for the same periods.

Ten Largest Holdings	
<b>Renal Care Group</b>	<b>1.5%</b>
<b>Edwards Lifesciences</b>	<b>1.1%</b>
<b>Exxon Mobil</b>	<b>1.1%</b>
<b>Tyco International</b>	<b>1.1%</b>
<b>Bank of America</b>	<b>1.1%</b>
<b>Pfizer</b>	<b>1.0%</b>
<b>Washington Mutual</b>	<b>1.0%</b>
<b>Baxter International</b>	<b>1.0%</b>
<b>Home Depot</b>	<b>0.8%</b>
<b>Wells Fargo</b>	<b>0.7%</b>

## OTHER INVESTMENTS (4% of Assets)

This quarter, the JPMorgan *Equity International Investment Trust* (EQIT) improved slightly, increasing 0.5%. In the past year it has increased 4.3%. We continue to view this as a core holding – providing attractive returns and diversification to our equity selections.