

NEXUS NORTH AMERICAN BALANCED FUND

QUARTERLY REPORT – September 30, 2006

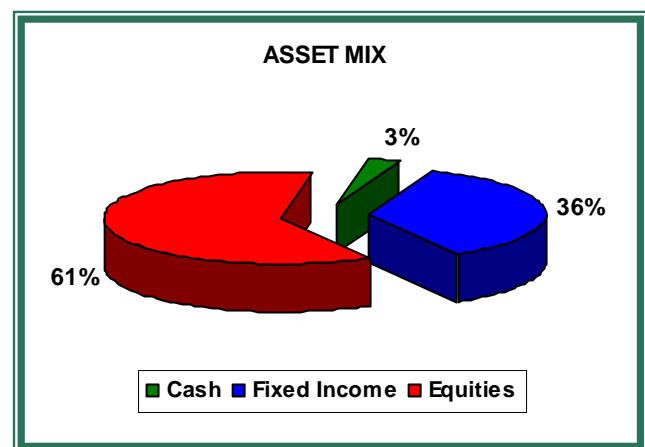
Interest rates in both Canada and the United States moved sharply lower in the third quarter, retracing the bout of weakness they had experienced earlier in the year. The move occurred as economic evidence surfaced showing a moderation in economic activity in both Canada and the U.S. This slowdown has caused both the Bank of Canada and the U.S. Federal Reserve to step to the sidelines and await greater clarification as to whether their previous tightening moves have had the desired effect of slowing economic growth.

The move lower in interest rates was accompanied by a move lower in energy and commodity prices. Some of the commodity and energy price weakness reflected a softening in demand that would be associated with a slowing economy, but some also related to investors (and speculators) reducing their expectations of hurricane-related supply disruptions in the Gulf of Mexico, and an easing of political upheaval in the Middle East, Venezuela and other parts of the world. Equity investors viewed the weaker energy and commodity prices as being positive for consumer spending power and helpful to corporate profitability. Both the Canadian and U.S. stock markets were stronger this quarter, reversing the weakness of the previous quarter. In fact, at the end of the quarter, the S&P 500 was set to move with great fanfare to a new “all-time high”.

Equity and debt markets have traded without a noticeable trend this year; however, if there is one trend that has remained intact, it is the continued flattening of the yield curve. In the last quarter, Canadian ten-year bonds fell 55 basis points, while rates on one-year bonds dropped 40 basis points. In fact, short-term interest rates now slightly exceed the yields for longer maturity instruments. Historically, inverted yield curves have almost always presaged a soft economic period, including periods of recession. As a result, market strategists ascribe some significance to this recent development and what it might mean for the economic outlook in the period ahead. However, in our opinion, the latest curve is best still described as flat rather than inverted, and we continue to believe that what lies ahead is a period of moderate, but positive, economic growth. As we have believed for some time, our forecast expects little change in the general direction of interest rates in the period ahead.

Despite a moderation in energy prices late in the summer, the C\$ remains close to its recent high. We have acknowledged previously that the basis of our strong currency is sound economic fundamentals - most notably, an attractive investment climate both for portfolio and direct investments, as well as trade and current account surpluses arising from the strength in commodity exports. However, as energy prices eroded over the course of the summer, we were surprised at how well the C\$ has stood up.

Perhaps the strength relates to the large recent flows related to foreign takeover activity in our mining and property sectors. If this is the case, as we suspect, it would not be surprising to see the C\$ weaken



somewhat in the weeks ahead. This would assuredly be welcomed by the beleaguered manufacturing base in Ontario and Quebec.

The major cause of worry regarding a slowdown in growth emanates from the U.S. housing sector. Long expected, it is now apparent that a major slowdown is at hand. After years of price increases, record levels of construction and quality job creation, it is clear that many of those trends have now reversed. How it will affect Americans is up to debate, but we certainly feel that a period of consumer retrenchment is likely. The stock of housing in the United States is now worth \$22 trillion. At almost 160% of U.S. GDP, its relative size greatly surpasses any historical precedent. According to Merrill Lynch, the real value of housing has increased 90% in the last six years, but the book value has increased only 20%. It is quite likely that some price adjustment (lower prices) needs to take place. Declines in home prices, although uncommon, have actually begun in many localities and, in August of this year, the average selling price of a home in the United States fell on a year over year basis for the first time since 1993. A decline in the value of housing reduces the equity owners have in their homes, and this restricts the ability of owners to borrow against their homes and fund consumption. Second order effects associated with a slowdown in housing construction, such as weaker employment levels in this sector, will also moderate economic activity as consumers adjust to a softer economy.

During the quarter, the Fund's unit value increased 4.6%.¹ The Fund is up 6.0% in the last 12 months.

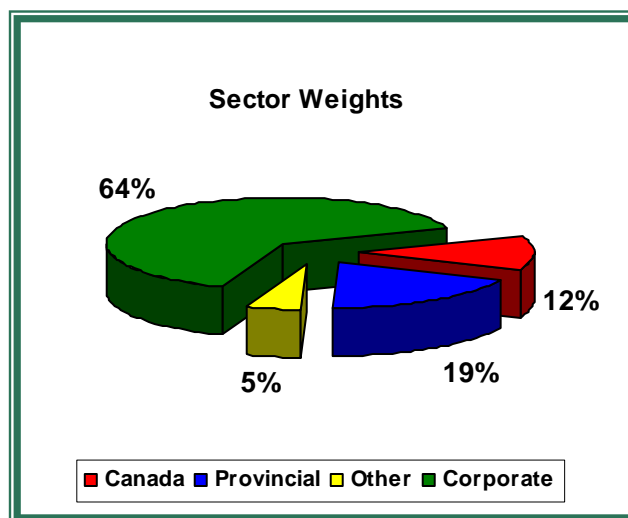
ASSET MIX

Allocations between fixed income and equities did not vary much this past quarter, so we remain close to our long-term guidelines. However, we did lighten our exposure to Canadian equities and add to both our U.S. investments and our weighting outside North America. We remain underweight the U.S. equity market and are maintaining a very modest cash position.

FIXED INCOME SUMMARY (36% of Assets)

Corporate bond issuance remained active this quarter, and we continued to add to our holdings in this sector. Many of our purchases were funded by deploying cash from new subscriptions, but we also have switched some of our provincial exposure into higher-yielding corporates as well.

We lengthened the term of the portfolio from a duration of 5.8 years to 6.0 years. This remains considerably less than the Scotia Capital Bond Universe which now has a duration of 6.6 years. We remain heavily concentrated in holdings with maturities of between six and ten years. Normally, bonds of longer duration yield more than shorter duration bonds. However, given the current shape of the yield curve there is very little difference in yields between longer bonds and shorter bonds. As a consequence, by holding shorter maturities than the index, we



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

are not giving up much in yield. Our holdings will also be subject to less capital fluctuation as well. Given our continued neutral outlook for the bond market, it seems sensible to remain with our core concentration in the “belly of the yield curve”.

Although our weighting of corporates has increased, our emphasis on quality remains unchanged – many of our holdings are rated AA or better. There remains very little extra income to be earned by owning lesser quality credits, and certainly not enough to compensate for the risk of a widening of interest rates spreads that would occur should the economy weaken more than expectations.

The Fund’s fixed income returns were +4.7% for the quarter and +3.9% for the year. By comparison, the SCBU Index was +4.9%, and +4.0% for the same periods.

CANADIAN EQUITY SUMMARY (42% of Assets)

Weakness in the Basic Materials and Energy sectors was offset by strength in interest rate sensitive sectors such as Financials and many income trusts. Our list of largest holdings is largely unchanged, but we did make a few changes in the quarter that are worth noting.

Ten Largest Holdings	
Royal Bank	2.9%
Bank of Nova Scotia	2.9%
TD Bank	2.4%
Manulife	2.4%
Bank of Montreal	1.9%
Enbridge	1.8%
Suncor	1.8%
EnCana	1.7%
Trican	1.5%
Talisman	1.5%

After a long and very successful period, we sold our holding of H&R REIT. Like almost every REIT, H&R was interest rate sensitive and had benefited from the decline in interest rates. Conservatively capitalized and conservatively managed, the markets had ascribed a premium valuation that left very little potential for upside surprise. We felt there were other income producing opportunities with superior return potential.

Another disposition was Canadian Western Bank. CWB has a small market capitalization (\$1.3 billion) and operates in a narrow geographic niche. It does not trade particularly actively. Over the years, it has compiled a fine operating record and in the process, like H&R, commanded a premium valuation. As is the case with all small capitalization stocks, you have to, “sell when you can, and not when you want to”. CWB was a very successful investment for the Fund, however, when adjusted for the trading liquidity, the narrowness of its operating base, and its valuation we felt that we could find more attractive

opportunities.

In August, we purchased a small position in Teranet Income Fund. Teranet operates the electronic land title system in Ontario under an exclusive arrangement with the Province. Over the last decade, Teranet has been responsible for converting the dusty files in land registry offices into a web-based system of land title. From their desktops, lawyers and others needing access to land ownership information may now do so through Teranet’s network. Teranet has a stable base business, and the opportunity to grow by selling related services to users of land title data.

Over the quarter, the return from our Canadian equity investments outperformed the TSX index. The Fund’s Canadian equity returns were +4.3% for the quarter and +6.7% in the last 12 months. By comparison, the TSX Composite was 1.9% and +9.2% for the same periods.

U.S. EQUITY SUMMARY (13% of Assets)

We made two additions to the portfolio and one disposition this quarter resulting in an increase in our weighting in U.S. securities to 13% of assets. Both purchases were in the healthcare services sector, and represent relatively large allocations within our limited U.S. exposure.

Lincare Holdings Inc. is a provider of oxygen and other respiratory care services to patients with Chronic Obstructive Pulmonary Disease (COPD). This affliction (think shortness of breath, emphysema and other lung disease) is already a large market and it is growing at about 6% per year. Lincare operates in 47 states and is the largest player in this niche by a wide margin. The provision of medical services, and the re-imbusement for those services, is under constant scrutiny. As the largest and most efficient operator, we believe Lincare has the opportunity to consolidate a very fragmented industry and deal with the challenges of the American health care system better than its competitors. This is a company with modest leverage and a strong record of growth, both by acquisition and organically.

Ten Largest Holdings	
CVS Corporation	1.5%
DaVita	1.5%
Lincare	1.3%
Bank of America	1.1%
Pfizer	1.1%
Edwards Lifesciences	1.1%
Baxter International	1.1%
Waters Corporation	1.0%
Exxon Mobil	1.0%
CIT Group	0.9%

Our other new addition is DaVita Inc, which is a large nationwide provider of dialysis services to people with End-Stage Renal Disease (ESRD). Like COPD, ESRD is growing steadily, with demand correlated to higher levels of diabetes, obesity as well as ageing. Like Lincare, DaVita is a large player in the field, but unlike the market for COPD, this is an area of the healthcare system that is already well-consolidated. In fact, DaVita completed a large acquisition in late 2005 to become the second largest player in the field with more than a 30% share of the market. As a consequence of the acquisition, the company assumed a lot of debt. In the course of the past year, execution on the operating side of their business has been excellent, and the outlook for the company reducing their debt load and freeing up cash flow for such shareholder friendly activities as share buy-backs and dividends seems likely. Given the characteristics of the affliction that they treat, we believe that this is an investment with excellent prospects in the years ahead.

After many years, we parted with our holding of Washington Mutual. Over the years it has been making a steady transformation from being almost exclusively a mortgage lender into a more integrated financial services company. It has strong leadership and is often spoken as a suitable acquisition target for either a large foreign bank wishing to enter the U.S. market or to be integrated with an enterprise such as JPMorgan Chase or Citigroup. Despite its many attractive qualities, we felt that it was over-exposed to mortgage banking and that it was prone to earnings disappointment in the event of a continued sharp slowdown in the real estate market. As our fund already has substantial exposure to the financial sector we felt it best to sell this holding.

Investment returns from U.S. equities were stronger this quarter, and the Fund's performance was stronger than the S&P 500 index. The Fund's U.S. equity returns in C\$ were +6.0% for the quarter, and +8.0% for the last year. By comparison, the S&P 500 (in C\$) was +5.7% and +6.4% for the same periods.

OTHER INVESTMENTS (7% of Assets)

We maintained our investment in the JPMorgan *Equity International Investment Trust* (EQIT) over the course of the quarter. This quarter EQIT returned +3.6% and, in the past year, it has increased 14.0%. We continue to view this as a core holding.

In addition to EQIT, we also made a new investment during the quarter in Wal-Mart de México. Walmex is a Mexican company (owned 66% by Wal-Mart) that operates Wal-Mart Superstores, Sam's Clubs, and a variety of other food and clothing chain stores in Mexico. The Mexican population is young, and the middle class is growing rapidly. Generally speaking, the retail environment is fragmented and dominated by family-run enterprises employing little technology. Accordingly, we think the opportunity for Walmex to compete effectively, using the vast technological and merchandising expertise of its U.S. parent, is enormous. If we're right about Walmex, it could be analogous to investing in Wal-Mart 20 years ago.