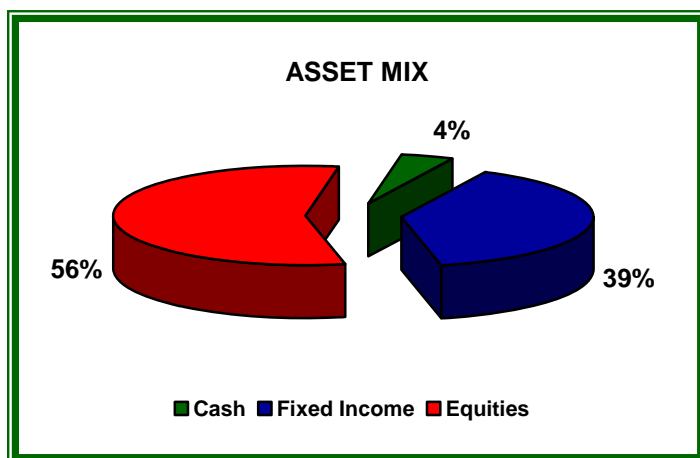


## NEXUS NORTH AMERICAN BALANCED FUND

### QUARTERLY REPORT – June 30, 2010

The first half of 2010 has proven to be as challenging a start to a year as any in recent memory. After quietly building strength in the first quarter, the global economy appears to have lost momentum, renewing the worry of a second leg of economic contraction. The causes of concern are many. As the quarter unfolded, a range of economic indicators proved disappointing: employment, particularly in the U.S., was weak; consumer confidence and business sentiment both subsided; and the U.S. housing market showed no sign of recovery.



We are in a period of economic transition. For much of the last 12 months, the economic recovery in Europe, the U.S. and Canada was led by government fiscal stimulus and private sector inventory rebuilding. As the fiscal stimulus subsides (and it must) and as businesses restore inventories to desired levels, growth in economic activity will have to come from increases in personal consumption and business spending on capital equipment. This hand-off from government to the private sector is never easy, and in an environment where individuals are deleveraging (saving more and spending less) it is proving to be more difficult than

usual. The state of the labour force will remain the key determinant of whether the transition from public to private sector is successful, and this will be judged not just by the number of new jobs created, but also by the length of the workweek and the wages earned.

In our assessment, particularly in the U.S., corporate profitability and balance sheets are in very good shape. Businesses are lean. However, the work-week has lengthened, reflecting a pick-up in demand for labour. It is likely that further increases in demand for either goods or services will require the addition of more workers. Interest rates are low, making the acquisition of capital equipment affordable. While the economies of the developed world have stumbled a little, robust growth in South America, India and China remains intact and so, for Canadians, end markets for raw materials remain reasonably healthy.

By conventional economic criteria, these would be the necessary pre-conditions for continued economic recovery. However, the issue of sovereign debt burdens continues to cast a dark shadow over the global economic scene. What started out as a large problem in a small country Greece, now appears to be more widespread. Amidst the mayhem of the G8 and G20 meetings, our political titans managed to craft a resolution to address the growing unease that investors feel for the safety of their capital, acknowledging both the recent unsustainably large fiscal initiatives as well as the necessity for committing to credible plans for correcting the situation. The commitment to halve fiscal deficits by 2013 and to stabilize debt to GDP ratios by 2016 ought to offer some comfort to investors, but only as programs are actually put in place and the intentions are acted upon. Such evidence will unfold over years and not months and so, as we have said for some time, we expect the investing environment to continue to be volatile and difficult.

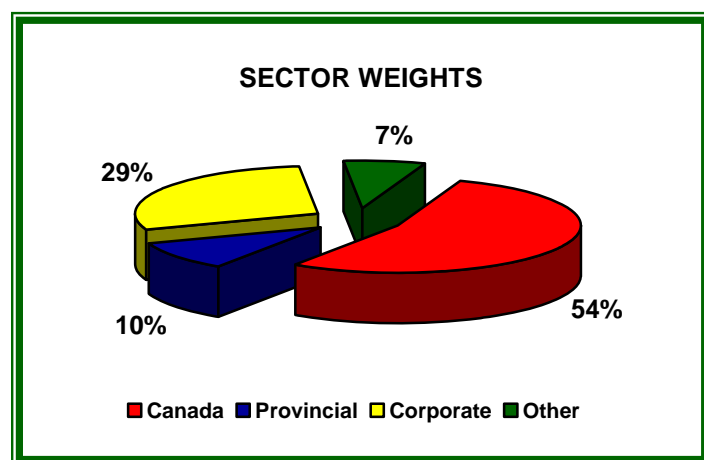
After finishing the first quarter rather strongly, equity markets gave back their gains this quarter and are now down for the year to date. Bond returns remain positive, reflecting the preference of investors, in this kind of environment, for the safety of fixed income investments.

After starting the year positively, Fund performance this quarter reflected the difficult markets, losing 2.5%. In fact, we are basically back to where we began the year, down 0.1%. Over the last 12 months the Fund gained 9.6 %.<sup>1</sup>

## Asset Mix

Allocation to the equity markets remains below our long-term target and less than it was at the end of the first quarter. We remain comfortable that a conservative approach to the asset mix, along with an emphasis on quality in both our bond and equity selections, is the right course in the present environment.

## Fixed Income Summary (39% of Assets)



Bond returns were positive this quarter and although short-term rates were higher, interest rates for bonds with maturities longer than one year declined to levels not seen since the height of the credit crisis 18 months ago.

As anticipated, the Bank of Canada raised the target for the overnight rate on June 1st from 0.25% to 0.50%. At the time, there was widespread opinion that the rise in rates was the start of a normalization of interest rates that eventually could send the policy rate back to a less stimulative level of around 2.0%. The decision to raise rates was really a follow-through from the

Bank of Canada's semi-annual Monetary Policy Report released in April, which noted the favourable global economic growth conditions at that time. Almost since the day of the release, economic data have tended to disappoint. The current strength in government bond markets reflects both a demand for the safety of government bonds, the so-called "flight-to-safety" trade, as well as a growing sense that a softer economic recovery would mean more economic slack in the economy than had been anticipated, leading to reduced inflationary pressures in the future.

A theme of the past quarter, and indeed the past two years, has been Canada's better economic performance relative to other developed economies. Whether it is the state of our public indebtedness, the strength of our financial system, or the relative stability of our housing sector during the crisis, Canadian assets have increasingly been seen as a safe alternative in a dangerous world. Indeed, since the beginning of the year a number of central banks, including those of India and China, have announced that they would utilize Canadian bonds more broadly in their reserve accounts.

Central banks and individual investors have entirely different investment goals. While it is nice as a Canadian to know that foreign central banks are accumulating Canada's bonds, current bond yields present very little investment opportunity. Canadian ten year bonds yield 3.08% and, with the contraction in corporate spreads over the year, good quality corporate bonds yield only 4.25% or so. In our estimation, there is little appeal in longer-maturity bonds, so we have preferred to hold shorter maturity bonds and our portfolio duration is less than the benchmark index. We have also favoured Government of Canada guaranteed bonds over corporate and provincial bonds, content to earn a little less in yield so that we can be more confident in the liquidity of our holdings. As a result, in the last six months we have given up some return due to the safety and quality of our portfolio.

As we look ahead to the end of 2010, we continue to anticipate that Canadian interest rates will rise somewhat from their current levels. However, given the economic weakness, any continued tightening of the Bank of Canada's official target rate above 1% seems unlikely. For now, we expect that all central banks will be watching the effects of fiscal austerity measures as they are implemented. Co-ordination

and co-operation between governments and central banks is essential to ensure that the economic drag of tighter fiscal conditions is not made worse by overly tight monetary conditions.

The decision to de-emphasize the use of corporate and provincial bonds continues to affect the Fund's bond returns this quarter. The Fund's fixed income returns for the first quarter of 2010 were +2.7%, which trailed the DEX Universe Bond Index (DUBI) return of +2.9% for the same period. In the last 12 months, our fixed income return of +7.5% continues to run ahead of the DUBI, which was up 6.9%.

## Canadian Equity Summary (38% of Assets)

The decline in equity markets this quarter has come in the face of a generally solid earnings outlook. In both Canada and the U.S. sentiment regarding equities is so negative that a number of companies with quality capital structures, experienced management teams and very satisfactory levels of current and future profitability are very attractively priced. Despite our concern with a number of pressing economic factors, this is an environment that quite possibly will create some excellent long-term buying opportunities. It is a difficult time to be a 'confident buyer' so we want to make sure that the long-term characteristics and investment thesis of our holdings are such that any short-term market sentiment swings do not overwhelm the positive long-term opportunities.

Accordingly, we have created a little room this past quarter by disposing of some holdings whose quality or valuation did not meet a very high standard. One of the holdings we sold was our position in Bell-Aliant Regional Communications Income Fund (BA). BA is a well-run, high-yielding trust with a realistic and achievable plan to operate as a corporate entity in 2011 when the tax rules for business trusts change. It has an appropriately conservative capital structure and a generous distribution history. It operates the wire-line phone business east of Manitoba and outside the Quebec City to Windsor corridor. Traditionally, it was accepted that its operating territory would be less appealing to the expansion of other wireless and cable competitors but that, inevitably, the march of technology would catch up and BA's business would feel the effects of greater competition. In early May, we decided that time had come and that the level of business risk was increasing. In the time we owned it, BA provided a small capital gain and a payout of close to 12% on an annual basis – quite satisfactory given the environment.

This quarter we also sold our longstanding holding of Manulife Financial. For years Manulife had been a successful Canadian life insurer with large operations in the U.S. and Asia. Along with other products, it had become a leader in the design and sale of guaranteed insurance products, such as variable annuities, which grew to be significant in size and profitability. As the credit crisis unfolded in 2008, Manulife, like a lot of other financial institutions, found itself with more risk on its books than it had imagined. Not only did Manulife have high equity market risk embedded in the insurance business, but also it had sensitivity to a general decline in interest rates. Insurance accounting and financial reporting is complicated at the best of times, but profitability, and indeed solvency, was seriously undermined by the events of late 2008 and 2009. In response, Manulife has raised equity twice (diluting current shareholders), slashed its dividend and, begun to hedge these risks. Unfortunately, the risks are complicated, the price of hedging is high and it is not clear that management has a clear path to reducing the risks to acceptable levels. Despite all the disappointment, in our view the CEO was paid excessively for his contribution in 2009. It became our opinion that this was no longer a situation where we could feel confident that what we owned was a high-quality business. In a better economy and market environment Manulife may recover dramatically, but in a more difficult environment we expect it to be under pressure. Since we sold, it has declined noticeably.

The return from our Canadian equity selections was -4.4% this quarter, better than the TSX performance of -5.5%, but disappointing nonetheless. For the year-to-date, returns of our holdings are -1.2%, against a decline in the index of 2.5%.

TEN LARGEST HOLDINGS	
<b>Toronto Dominion Bank</b>	<b>3.5%</b>
<b>Bank of Nova Scotia</b>	<b>2.8%</b>
<b>Royal Bank of Canada</b>	<b>2.8%</b>
<b>Suncor Energy</b>	<b>2.3%</b>
<b>IESI-BFC</b>	<b>1.8%</b>
<b>Enbridge</b>	<b>1.8%</b>
<b>Rogers Communications</b>	<b>1.8%</b>
<b>TELUS</b>	<b>1.7%</b>
<b>TransCanada</b>	<b>1.5%</b>
<b>Thomson-Reuters</b>	<b>1.5%</b>

## U.S. Equity Summary (12% of Assets)

TEN LARGEST HOLDINGS	
<b>Lincare Holdings</b>	<b>1.7%</b>
<b>J.M. Smucker</b>	<b>1.4%</b>
<b>DaVita</b>	<b>1.2%</b>
<b>Covidien</b>	<b>1.2%</b>
<b>Pfizer</b>	<b>1.2%</b>
<b>Cisco Systems</b>	<b>1.1%</b>
<b>CVS/Caremark</b>	<b>1.1%</b>
<b>Hewlett-Packard</b>	<b>1.0%</b>
<b>Walter Energy</b>	<b>0.9%</b>
<b>Western Digital</b>	<b>0.6%</b>

Our exposure to U.S. equities remains well below the Fund's long-term guidelines and we made no changes to the portfolio, apart from adding a small amount to our established position in Pfizer. The healthcare sector remains at the core of our holdings – attractive because of its defensive characteristics and the diversification it offers to our holdings of Canadian stocks.

Over the quarter there were some sharp moves in a number of our holdings. One such case was Lincare Holdings, our largest position and a solid performer over the last few years. Not only did Lincare split its stock 3 for 2 after a long period of appreciation, but it also instituted a dividend for the first time. In the U.S., Lincare dominates the provision of equipment and services to people who suffer from chronic obstructive pulmonary disease

(COPD). However, these services rely heavily on government reimbursement and unfortunately, early in July, the Centre for Medicare Services (CMS) announced a larger than expected cut to the rate they will pay for these services. Lincare will definitely be affected in the short-run but may be able to consolidate other service providers which lack economies of scale. Due to the uncertainty regarding the outlook, we sold our position in the first week of July.

Despite a difficult quarter, U.S. equities remain our best performing asset class over the course of the past year. In the latest quarter our selections declined 9.7%, as compared the S&P 500 index (C\$) decline of 7.5%. In the past year our holdings in this sector increased 12.7%, while the benchmark advanced only 4.4%.

## Other Investments (7% of Assets)

The allocation to investments outside North America remained unchanged this past quarter. Given the strength in the Canadian dollar, it has been a difficult time and environment for any investing outside of Canada. While our holding of the JPMorgan EQIT Fund outperformed the benchmark EAFE Index again, the outright return – a decline of 9.9% – was a drag on performance of the overall Fund. The benchmark EAFE Index declined 10.2% over the same period.

Diversification, through international investing, remains an important component of a well-constructed investment portfolio. In the last ten years Canadians have been spoiled by the strength of our currency and the concentration of our listed equities in the commodity and energy sectors. It will not always be the case that our relative position will be so favourable. As a generalization, the holdings of the EQIT Fund have more attractive valuations, higher dividend yields and more conservative capital structures than do North American equities. While there is recent evidence to suggest that the behaviour of national stock markets is becoming more alike, we believe that EQIT remains an excellent source of diversification and potential return for the Fund and continues to view it as core holding.

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