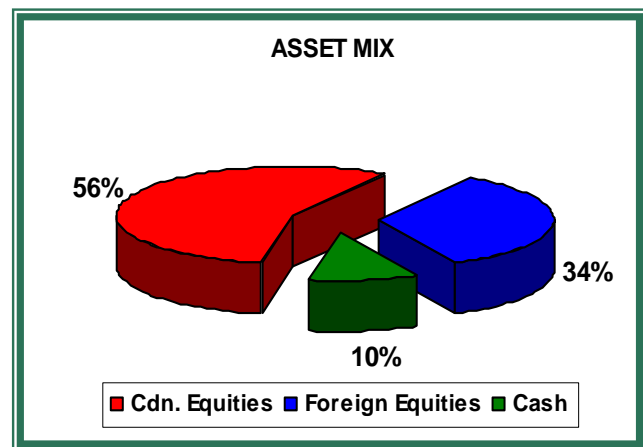


## NEXUS NORTH AMERICAN EQUITY FUND QUARTERLY REPORT – March 31, 2007

Although there was a flurry of activity in late February (see below), equity markets have behaved reasonably calmly to begin 2007. Stock index returns were slightly positive in Canada and very slightly negative in the U.S. These circumstances are consistent with our long-held view that returns from equity markets would be positive, but modest. First quarter Fund performance exceeded our benchmark objective by a small margin as all asset classes ran slightly ahead of their comparative benchmark indices.

An economic slowdown is underway in North America, and capital markets in Canada and the U.S. have spent the past quarter trying to come to terms with whether it will be moderate or perhaps something worse. In late February, while speaking in Hong Kong, former chairman of the U.S. Federal Reserve, Alan Greenspan, mused about the potential for recession in the United States. This casual reference sparked a flurry of excitement in both debt and equity markets. Bonds rose, stocks fell and market volatility jumped noticeably for a period of time. Eventually, both markets reverted to their previous trends and volatility subsided. However, it demonstrated that over the past few years, investors have been lulled into a sense of comfort that slow and steady economic growth would lead to equally predictable positive returns. We share the general opinion that a recession is unlikely (particularly in Canada) but are mindful that expectations and positioning for a recession are not priced in to markets at this time.



If there are risks to the general opinion that economic growth will remain positive and modest, it most surely emanates from the U.S., and particularly the continued unraveling of mortgage lending in the 'sub-prime' housing market. Nexus has long worried about the disruptive effect that rapid house price escalation was having in the U.S. economy. The bubble mentality that swept America created significant distortions in its economy. As homeowners perceived the value of the equity in their homes to have risen, they financed extra consumption by borrowing against their homes with lines of credit (HELOCs) and second mortgages. Originally, our worry centred around the dampening effect on consumer spending that would occur once home prices stabilized or even subsided to values more in keeping with long-term demographic and economic trends. However, a new concern has arisen in the last few months which could be more de-stabilizing, and this concerns the amount of debt loaned to people of lower credit quality, an area called the 'sub-prime' market.

During the feverish run-up of housing prices between 2003 and 2005, many people of limited means, or with checkered credit histories, clearly felt that the prospect of ever owning a house was getting out of reach. At the same time, financial intermediaries, primarily banks but other lenders as well, began to feel the pressure to maintain their growth rates. As a result of these complementary circumstances, mortgage loans were made to people who historically would not have qualified for credit. What was once a small section of the market mushroomed in size. In 2000, mortgage lending to sub-prime borrowers was 2% of total mortgage loans outstanding, by the end of 2006, it accounted for almost 14%.<sup>1</sup> Unsurprisingly, when a niche market grows this quickly, errors and abuses of standard loan underwriting procedures occurred. Two greatly simplified examples: first, loans have been made based on little or no proof of income and, second, in order to encourage borrowers to take on larger loans, interest rates were set to begin at very

<sup>1</sup> NBF Financial.

low levels, creating artificially low monthly payments. As these payments re-set to normal levels, the borrower is frequently unable to repay.

At this time, the problem continues to get worse. We will watch whether it remains confined to the sub-prime market or whether it insidiously creeps into other areas of the housing market and contributes to a decline in confidence and a slowdown in consumer spending. It is tempting to draw a comparison in Canada given that we have had our own boom in housing prices. Thankfully, it appears that excesses have been largely avoided here and prospective weakness in our housing sector is not nearly the concern for either lenders or the economy that it appears to be in the U.S.

After weakening to begin the year, the C\$ has since recovered to the level it was in early January. The currency remains a drag on those sectors of the economy oriented to manufacturing exports. However, firm pricing for commodities, which represent approximately 50% of merchandise trade, has kept the currency well supported. Although our close ties to the U.S. economy remain very much a factor in determining Canada's economic fortunes, as one of the most open economies in the G8, Canada continues to benefit from the positive trends in global growth - not only a recovery in Europe and Japan, but also the more secular growth story in China, India and much of the developing world.

During the quarter, the Fund's unit value increased 2.0%<sup>2</sup>. The Fund is up 10.7% in the last 12 months.

## Asset Mix

There was not much change to the asset mix this quarter. There has been a slight reduction in our foreign equity exposure and we have let our cash position grow to 10% of the Fund.

## Canadian Equity Summary (56% of Assets)

It has been a quarter of positive returns for our holdings. As we discussed in our last report, two factors are contributing to create an investment climate brimming with the real and imagined possibilities of take-over activity. The first is low levels of real and nominal interest rates and, for the time being, we expect this world-wide surfeit of liquidity to continue. The second is low volatility and risk. Here, it is not nearly as clear that the demand for higher returns will continue without greater consideration of the risks that are being taken to achieve them. The idea that almost any company, regardless of size, is more valuable as a highly-leveraged private entity rather than as a sensibly capitalized public company is overdone at this moment. It is but another example of how markets can be prone to excess. Although we hold the view that interest rates will remain basically unchanged in the months ahead, it is far from clear that the period of low volatility is as enduring. We were surprised by the furor in the markets in late February when a temporary bout of weakness in China and the casual musings of Alan Greenspan concerning the possibility of a U.S. recession sent global equity markets into a tailspin. As we have felt for many quarters, our emphasis on quality will pay big benefits if and when investors prefer less risk to more risk.

Ten Largest Holdings	
<b>TD Bank</b>	<b>3.5%</b>
<b>Royal Bank</b>	<b>3.5%</b>
<b>Bank of Nova Scotia</b>	<b>3.4%</b>
<b>Manulife</b>	<b>3.2%</b>
<b>Bank of Montreal</b>	<b>3.0%</b>
<b>Suncor Energy</b>	<b>2.7%</b>
<b>Rogers Communications</b>	<b>2.5%</b>
<b>CAE Inc</b>	<b>2.2%</b>
<b>Finning International</b>	<b>2.2%</b>
<b>Rona Inc</b>	<b>2.0%</b>

We made few changes to the portfolio this quarter, keeping our concentration in the financial service, energy and utility sectors. As the fund has grown in size, we have added to a number of holdings. Most notably this quarter, we added to our holding of Teranet Income Fund, a position that had been

<sup>2</sup> Fund returns are shown before the deduction of management fees but after the deduction of direct expenses.

established before the changes to the tax treatment of income trusts was announced last Halloween. The most recent purchase was made at levels below where we had originally established our position, and well below its level at the end of October. Teranet was established in 1991 in order to convert Ontario's land registry system from paper to digital form. It went public in September 2006, on the back of an excellent operating record and a stable business model that we felt was well suited to an income trust structure. By virtue of an exclusive right to the land title data until 2017, it operates as a monopoly. Competitively its hold on the market is further secured as a result of its incorporation into the training of all paralegals in Ontario who search title as part of their work. The business has very high margins and there remains some room to grow in the years ahead, both as remaining land parcels still handled with the old-fashioned paper land registry are transferred to digital format and, as Teranet's expertise in manipulating data is considered for other applications, perhaps in the healthcare sector.

This quarter, the Fund's Canadian equity returns were +3.5% compared to a return of the TSX Index of +2.6%. In the past year, we trailed the index; our Canadian equities have returned +9.3% in the last 12 months and, by comparison, the TSX Composite was + 11.4% for the same period.

## U.S. Equity Summary (22% of Assets)

We chose to make no changes to our U.S. holdings this past quarter, and were pleased that returns continued to outpace the S&P 500.

Over the past quarter, one of our largest U.S. holdings, CVS, completed a major corporate transformation when it closed on its acquisition of Caremark. For several months it was uncertain whether CVS would succeed in its battle for Caremark as another bidder was in active competition. The new entity, cleverly named CVS / Caremark, is one of the leading integrated pharmacy service providers in the U.S. It combines CVS's retail drug store business with Caremark's pharmacy benefit management business. As this was a hotly contested takeover, there is some worry that CVS has overpaid to complete the deal, and CVS faces a challenging period ahead digesting and integrating this large acquisition. Nevertheless we believe the long-term opportunity arising from the ability to provide a broader range of services makes it a compelling acquisition for CVS. Since closing the deal, CVS / Caremark has appreciated nicely.

Ten Largest Holdings	
<b>Bank of America</b>	<b>2.4%</b>
<b>CIT Group</b>	<b>2.3%</b>
<b>Baxter International</b>	<b>2.0%</b>
<b>CVS / Caremark</b>	<b>2.0%</b>
<b>Exxon Mobil</b>	<b>2.0%</b>
<b>Edwards Lifesciences</b>	<b>1.9%</b>
<b>Pfizer</b>	<b>1.9%</b>
<b>Tyco International</b>	<b>1.8%</b>
<b>DaVita Inc</b>	<b>1.6%</b>
<b>Lincare Holdings</b>	<b>1.6%</b>

Investment returns from U.S. equities were basically flat this quarter, lagging a little behind the returns from the TSX. Our Fund returns were better than the S&P 500 index this quarter and remained well ahead over the last 12 months. The Fund's U.S. equity returns in C\$ were +0.4% for the quarter, and +15.5% for the last year. By comparison, the S&P 500 (in C\$) was lower to begin the year – 0.4% but up 10.5% in the past year.

## Other Investments (12% of Assets)

Our 12% weighting consists of a 10% weighting in the JPMorgan *Equity International Investment Trust* (EQIT), with the balance invested in Wal-Mart de México (Walmex), a security with continued attractive prospects.

This quarter EQIT returned +1.5% and, in the past year, it has increased 13.9%. This continues to be an excellent investment for the Fund, providing both diversification and strong outright returns. We continue to view this as a core holding.