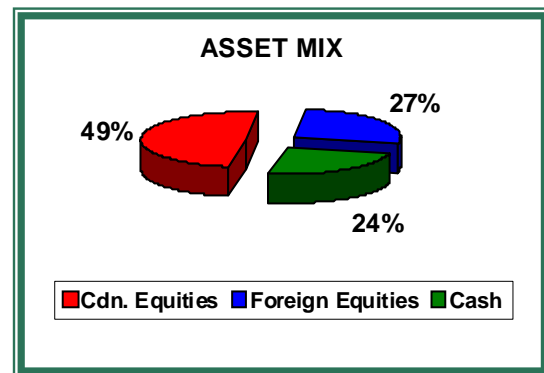


NEXUS NORTH AMERICAN EQUITY FUND

QUARTERLY REPORT – December 31, 2008

Thankfully, 2008 is now in the history books. Economic historians describing this period will surely relish the rich trove of problems made manifest in the global economy over the year, as well as the severity of the reactions in the commodity, equity and bond markets. On the other hand, investors, worn down by the many catastrophic developments of the year, are anxious to put the year behind them. Unfortunately for investors, it seems likely that the unsettled markets and difficult conditions which have prevailed in 2008 are unlikely to fade quietly into the background.

On the brighter side, after more than a year of convulsions and disruption, the credit markets may at last be coming to a period of relative stability. Optimism in this sector is premised almost entirely on the worldwide commitment of governments and their agencies to backstop almost any financial institution in distress. The list of actions undertaken is too lengthy to cite comprehensively, but two are worth noting. The first is truly global in nature, and that is the recapitalization of the banking system by governments. For the most part, this has been achieved by the direct investment of taxpayer monies in the institutions themselves, but it has also been enhanced by the relaxation of the applicable rules regarding what regulators require for capital. The second action worth highlighting is the abrupt and steep declines in interest rates orchestrated by central banks around the world. In Canada, the Bank of Canada's target for the overnight lending rate is now 1.5%, half the level it was in June. Yet this pales in comparison to the U.S. Federal Reserve which has lowered their policy rate to a level just above 0%.¹ Like Japan in the early part of this decade, the U.S. has instituted a ZIRP (Zero Interest Rate Policy).



Turning to the economy, in the final quarter of the year, global economic news continued to deteriorate. In Canada, the effect of falling commodity prices and the sagging economic performance of our major trading partners is the primary source of weakness. For now, our economic woes are less severe than in the U.S. In the U.S., there are many sources of weakness: economic reports from the housing and construction sector are unrelentingly bad and measures of consumer and business confidence are at record low levels. Further afield, it is clear that the economic slowdown is truly global. The U.K. and European economies are also in retrenchment and, increasingly, it is clear that both China and India are growing at much slower rates than what was predicted.

The cure for this malaise is complicated. Whether we get the right policy prescriptions is very much up in the air at this time. After many years of excess spending and borrowing, consumers in the developed world (particularly North America) need to repair their household balance sheets by spending less and saving more. This process is now underway as individuals realize that the idea of building wealth through home ownership is insufficient. This will take time – perhaps years. To replace lost consumer demand, governments will need to spend more. Properly done, there is a large opportunity for governments in Canada and the U.S. to make important investments in renewing and expanding the transportation, technology and education infrastructure in North America, truly enhancing our global competitiveness.

¹ On December 16th, the Federal Reserve Open Market Committee established a target rate for the Federal Funds rate of between 0 and ¼ of a percent.

Unsurprisingly, the politicians and special interest groups are lined up and ready to go. At the time of writing, the U.S. seems ready to commit to \$1 trillion of stimulus and our own Conservative government is rumoured to be considering deficits of as much as \$30 billion.² Sadly, we don't have great confidence that our partisan politicians, influenced by the usual vested interests, will allocate such large sums of capital and make investment decisions wisely. If you watched any of the congressional and senate hearings regarding the bailout of the 'big three' automakers, or followed our own recent parliamentary debacle in Canada, even the most optimistic person would worry about the risks that lie ahead.

As we survey the investment landscape for 2009, we expect that the economic news will continue to deteriorate. The early read on holiday sales was soft. While sales levels were better than the direst of forecasts, it was largely due to aggressive price discounting throughout the Christmas season. As well, in both Canada and the U.S. employment continues to deteriorate. The travails of the auto industry and their parts suppliers are indicative of what many industries will be going through. Even with generous bailouts or rescue packages, industry will need to make adjustments to the size of their workforce in order to be competitive. We are prepared for more bad news.

Just as we are prepared for more bad news, so too in many respects is the market. Interest rates on government bonds are low, reflecting an investor preference for absolute safety as well as a period ahead of subdued inflation or even the risk of deflation. Likewise, share prices reflect valuations that in many instances incorporate an almost never-ending run of bad economic and corporate news. If we take for granted that the economic news in 2009 will be weak, then the key to navigating through this period will be to position portfolios to take advantage of sectors and companies where more bad news is anticipated than what unfolds, and to avoid sectors of the capital markets that may yet feel the brunt of the coming recession. 2009 will undoubtedly be a difficult year, but not without opportunity.

Obviously, it remains a most challenging environment. Despite outperforming our benchmark the Fund declined 11.3%³ last quarter to be down 19.7% for the year.

Asset Mix

The fund remains very defensively positioned, with substantially the same weighting in cash (24%) as we had closed the 3rd quarter. We believe our positioning reflects the necessary prudence suitable for current market conditions.

Canadian Equity Summary (49% of Assets)

We reduced our allocation to Canadian equities this quarter by 4%. As we discussed in our previous quarterly report, our holding of Teranet Income Fund was the subject of a takeover which was completed in November. Despite the unsettled times and even though the offer price was at a premium to where the units were trading in the market, we had hoped that other shareholders like us would have been reluctant to sell at the offer price of \$10.25, and that the buyer would have been forced to pay more. Unfortunately, this did not occur.

Also in November, we liquidated two small positions in the commodity sector. In both instances the holdings, Teck Cominco Ltd. and Opti Canada Inc. had developed more balance sheet risk than we were comfortable with. In the case of Teck, it had made an acquisition of Fording Canadian Coal Trust at the height of the commodities market in the summer. Arranging long-term financing for the acquisition at reasonable rates proved difficult, given the abrupt decline in coal prices and the troubles in credit markets. Opti Canada is an early stage oilsands company whose primary asset is a stake in the Long Lake oilsands project, with Nexen as the operating partner. Although the Long Lake project is near completion, it is feared that a pending debt maturity may not get refinanced on economic terms. In both cases, insolvency or significant dilution were risks we wanted to avoid.

² National Post, December 23, 2008.

³ Fund returns are shown before the deduction of management fees but after the deduction of direct expenses.

| Ten Largest Holdings | |
|------------------------------|-------------|
| Toronto Dominion Bank | 4.0% |
| Manulife Financial | 3.8% |
| Bank of Nova Scotia | 3.4% |
| TransCanada | 3.4% |
| Enbridge | 3.1% |
| Royal Bank of Canada | 3.0% |
| EnCana | 2.1% |
| Rogers Communications | 1.9% |
| Talisman Energy | 1.9% |
| CAE | 1.9% |

In late November we added to a number of established positions in the energy and financial sector. The primary motivation was that the valuations had become exceedingly attractive for a number of companies that we felt offered excellent opportunity. More importantly, we have established a new holding in Research In Motion, the maker of the popular BlackBerry smart phone. For years, RIM has been a darling of the stock market and valued in a similarly rich fashion. It is an exceedingly profitable company, with no debt and an ability to finance its rapid growth without resorting to borrowing. For many years it traded at a price-earnings multiple of approximately 30x earnings, but the recent dramatic sell-off in the stock allowed us to establish our position at about 10x earnings. Growth companies at value prices are the opportunities of markets like these.

Share prices declined notably in the final quarter of the year. Our holdings outperformed the benchmark by a slight margin, declining 20.9%, as compared to the TSX Index which declined 22.7%. Over the course of the year we had a small margin of outperformance with our holdings falling 31.3% and the TSX Index declining 33.0%.

U.S. Equity Summary (18% of Assets)

Our exposure to U.S. equities remains low and well below long-term target levels. We remain heavily concentrated in the healthcare sector with six of our positions in healthcare or drug companies.

This quarter we established a new position in Cisco Systems Inc. Cisco designs and manufactures Internet Protocol (IP)-based networking and other products for the communications and information technology industry worldwide. It is the dominant company in this industry. Its products and services are sold to telecommunications companies, commercial businesses, and consumers. The company was founded in 1984 and is headquartered in San Jose, California. It has an unparalleled record of profitable growth and, while the current economic slowdown will surely impact its business, we remain convinced that Cisco's growth prospects are solid. Like our purchase of RIM, Cisco has been purchased at a fraction of its historical valuation. It has \$25 billion of cash on its balance sheet (about \$4.50 per share) and generates \$2 to \$3 billion more each quarter. Acquisitions are a significant part of their growth strategy.

| Largest Holdings | |
|----------------------------|-------------|
| Lincare Holdings | 2.9% |
| Edward Lifesciences | 2.8% |
| DaVita | 2.5% |
| CVS / Caremark | 2.3% |
| Pfizer | 2.2% |
| Covidien | 2.2% |
| Cisco Systems | 2.2% |
| Walter Industries | 0.7% |

Over the quarter, our Fund's U.S. returns decreased 9.3% while the S&P 500 (C\$) index declined 9.8% for the same period. For 2008, our U.S. holdings have declined 15.6% while the benchmark index fell 21.9% over the same period.

Other Investments (9% of Assets)

Our 9% weighting is unchanged from the start of the quarter and reflects a 6.4% weighting in the JPMorgan *Equity International Investment Trust* (EQIT), with the balance invested in Wal-Mart de México (Walmex). Stock markets outside North America fell less than in Canada in the past quarter, but on the year they were down significantly. EQIT again outperformed the benchmark EAFE Index and remains an excellent source of diversification for the Fund. We continue to view it as a core holding.