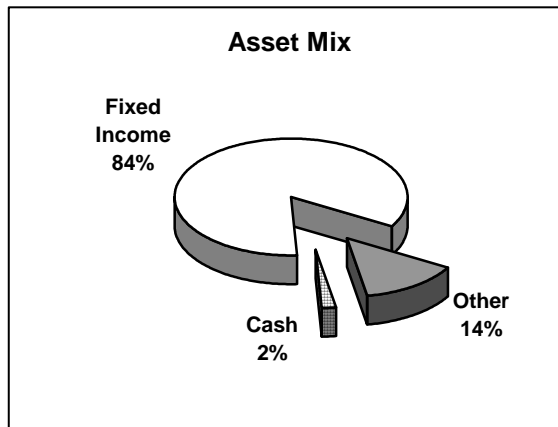


**NEXUS NORTH AMERICAN INCOME FUND  
QUARTERLY REPORT – March 31, 2005**

Looking back on the quarter just concluded, with the exception of the energy sector, it was an unexciting and uninspiring period for investors. Nowhere else was this more true than in the fixed income markets which concluded the quarter at very similar levels to where they had begun. In North America, the economy continued its uneven recovery, with Canada generally lagging behind the performance of the United States. While the U.S. Federal Reserve has continued on its program of systematic interest rate increases, the more moderate economic performance in Canada has encouraged the Bank of Canada to remain on the sidelines - leaving the Bank Rate unchanged this past quarter. As a result, despite an exceptionally strong backdrop of energy and commodity prices, the C\$ is virtually unchanged in value as compared to its U.S. counterpart over the quarter.

We would expect that interest rates will gradually drift higher over the course of the coming year, but it is clear that the Canadian economy, especially the manufacturing sector, is stumbling due to the strength of the currency. As a result, we have felt for some time that the Bank of Canada will need to be cautious in moving rates higher, something that is justified given the economic landscape that is unfolding.

The Canadian bond market strongly outperformed the U.S. market this quarter as the yield curves in both markets flattened. Shorter maturities actually fell in price, while bonds with maturities longer than 10 years generally rose in value. Notably, interest rates in Canada are now less than U.S. interest rates at all maturities. Since the beginning of the year, the benchmark Government of Canada 10-year bond yield increased by 1 basis point, finishing at a yield of 4.31%.



Over the quarter, the Fund returned 0.6%<sup>1</sup> an underperformance compared to the Scotia Capital Bond Universe Index (SCBU) which increased 1.1%. Performance was hampered by weakness across most of our income trust and equity holdings. The Fund is up 5.5% in the last 12 months, slightly above the SCBU's return of 5.0%.

**Asset Mix**

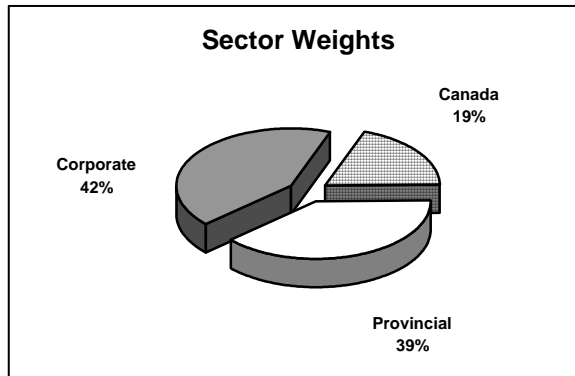
There has been good growth in new subscriptions to the fund, and we have generally used new monies to add to bond holdings. As a result, our weight in other income producing securities, such as trusts and stable dividend paying stocks, has declined somewhat. Cash remains low.

**Fixed Income Summary (84% of Assets)**

Not surprisingly, rates have been tracking sideways so far this year. A steady stream of economic reports over the quarter has generated an inconsistent picture of the degree of strength or weakness of the Canadian and U.S. economies. Accordingly, bond markets have been relatively trendless to start the year. Without a clear economic trend in place, support for the bond market, particularly in the United States, continues to rely heavily on the investment of foreign exchange reserves by a few key Asian central banks. It is worth worrying about the sustainability of this behaviour and whether other currencies and other bond markets might one day prove more attractive. Should these key central banks develop a preference for holding foreign exchange reserves in currencies other than the U.S. dollar, then it would certainly force the US\$ lower and interest rates higher. While the towering U.S. trade deficit is a worry, it is also clear that economic recovery and the prospects for growth in both Europe and Japan remain well below those in North America. As a result, we do not expect that there is any real alternative for the

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

central banks at the present time other than to keep accumulating US\$ assets, but it is a situation that warrants continued vigilance.



The primary motivation behind the recent increase in administered rates by the Federal Reserve and the Bank of Canada has been to move short-term interest rates to less stimulative levels more than to head off any incipient increase in the CPI. In fact, while administered rates have been rising, long-maturity bonds have remained very stable and have actually fallen in yield. This reflects investor comfort that policy makers are moving quickly enough to normalize interest rates at an appropriate level. Canada maintains a better record on inflation than does the U.S., an important factor in keeping interest rates lower here than in the U.S., but it is clear that inflation has picked up from the low levels of a year or so ago. In Canada, headline rates of inflation are still

about 2%, while, in the U.S., inflation has been running a little more than 3%.

For some time we have thought that spreads between corporate bonds and government bonds were too tight. As a result, our portfolios have had an overweighting in government guaranteed and AAA rated securities. These securities pay less generous rates of interest than do bonds of lower rated entities, but the certainty of timely payment of interest and principal is higher. We will profit from this positioning if interest rate spreads on lower rated securities widen out on heightened fears of their riskiness, and we are able to redeploy our funds at more attractive levels without having suffered any capital loss. In mid-March, General Motors, one of the largest borrowers in the world, announced that its corporate profit forecast would fall well below expectations. As a result, spreads on GM bonds and those of its affiliates widened dramatically. Fear of similar developments at other borrowers has begun to widen corporate bond spreads and, as the quarter drew to a close, there is evidence that spreads are widening out after a long period of compression.

**Income Trusts and Equities (14% of Assets)**

It was tough quarter for the income trust market and our holdings were not spared in the general trend to lower prices that played out over the quarter. The income trust sector generated returns of 30% last year, so a minor setback is quite understandable. Early in the quarter we trimmed our exposure to this area, and we have refrained from adding to positions as new subscriptions to the fund have been received.

A number of income trusts will be eligible for inclusion in the TSX Composite Index at mid-year. Currently there are more than 60 names that might be considered, but we expect only a small sub-set to be included in the early going. This should broaden the investor base by encouraging pension funds and other institutions to be involved, and it will also enhance liquidity in the sector. We own 10 different income trusts and 8 common stocks.

