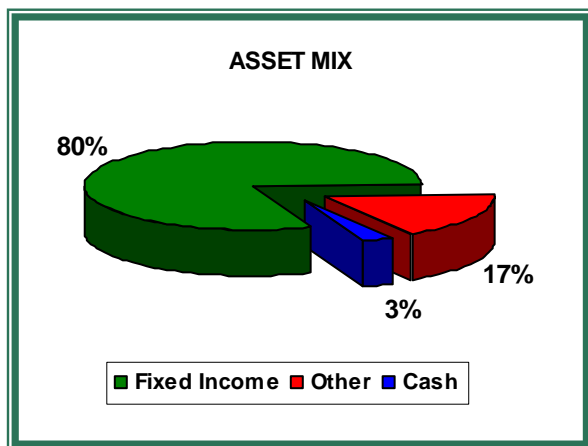


NEXUS NORTH AMERICAN INCOME FUND

QUARTERLY REPORT – December 31, 2006

After fluctuating noticeably in the previous two quarters (up in Q2, then down in Q3), the general level of interest rates changed very little over the course of the past quarter. Furthermore, looking back a full year, it is remarkable how little rates have changed. In the money market, rates have risen by 0.50%, but interest rates for bonds with maturities longer than two years have generally risen about 10 basis points. This outcome was consistent with our view expressed a year ago that interest rates would trend sideways over the course of the year. As a natural consequence, returns from being a bond market investor were just as unexciting. Our bond performance narrowly exceeded the Scotia Capital Bond Universe and, thanks to the positions in income trusts and equities, the total return of the Fund comfortably exceeded that of the Universe.

Just as interest rates were basically unchanged on the year, so too was the level of the Canadian dollar. At the end of 2005, it was trading at US\$0.86 and that is approximately where it closed 2006. However, while interest rates were steady this past quarter, the C\$ has actually fallen quite sharply from almost US\$ 0.90 in September to its present level. The currency decline matches a softening in commodity and energy prices as well as increased evidence of a North American economic slowdown. In our last quarterly report, we remarked that we were surprised at the resiliency of the currency and that some erosion of its value would be unsurprising. Indeed, this decline in the currency has brought some needed relief to beleaguered exporters and manufacturers working hard to make the necessary competitive adaptations to a stronger currency. For policy-making central bankers, this break in the strength of the currency is likely welcomed as well. At this level (US\$0.86) we expect the currency to stabilize and to trade in a narrow range.



Over this past quarter, Canadian economic news has been decidedly mixed. It is clear that economic growth has moderated, but only a little more than was generally predicted. Indicators of economic output, business investment and retail consumption tell a consistent story of moderating growth, without particular risk of a sharp slowdown or recession. On the inflation front, consumer price increases have moderated from their mid-summer levels, but again at no greater a pace than has been expected. As a result, the Bank of Canada seems set to continue its hands-off approach. In fact, in December, Governor Dodge noted that inflation in Canada continued to read slightly above the Bank's target, while at the same time he noted that economic growth in Canada was likely to trail the Bank's previous forecast. As a consequence of all this, we expect no change to official interest rate policy in Canada (or the U.S.) until at least the summer.

Against a solid global economic backdrop, the major source of worry continues to emanate from the U.S. housing sector. Over the last quarter, the correction in this economic sector (lower prices, lower unit sales, reduced construction activity) continued to play out in a reasonably orderly fashion. What remains unknown is the degree of detrimental impact that will spill over to consumer spending. While it appears that measures of consumer sentiment have noticeably declined, spending has not fallen to the same degree. Anecdotal, as well as statistical, reports of sales during the Christmas season suggest that consumers are spending a little less, and are more price conscious. However, there is no evidence that they have put away their wallets and have fundamentally made the decision to save more and consume less.

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Another issue to watch is the unfolding performance disparity between the goods producing and the service sectors of the economy. Goods producing industries (think autos) remain very much under the gun from the effects of global competition. One of the most important surveys of this sector of the U.S. economy is the monthly survey of purchasing managers by the Institute of Supply Management. In early December, this index fell below 50, its lowest level since the spring of 2003, and a level associated with economic recessions. Although it has made a slight rebound in January, it is clear that this sector of the economy is operating in very challenging times. On the other hand, the service sector (think Wall Street) is thriving. In contrast to the goods producing sector of the economy, this sector is expanding and adding jobs. As a result, what looks to be unfolding is what economists describe as a mid-cycle slowdown - a development that would be a great relief to central bankers and to long-term investors. For the bond and equity markets it likely portends at least another six months of interest rate stability.

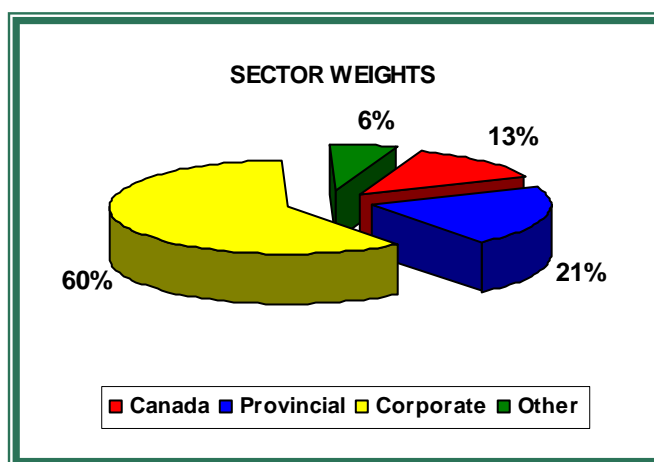
Over the quarter, the Fund returned +1.4%¹, made up of interest earned on bonds, some appreciation from our equity holdings, and offset by a small capital erosion in the value of our bonds. This was better than the return of +0.7% from the Scotia Capital Bond Universe Index (SCBU) for the same period. The Fund continues to maintain its out-performance relative to the SCBU over longer time periods as well. In the last year, the Fund has generated a return of 5.6%, while the SCBU has returned 4.1% over the same period.

Asset Mix

The Fund continues to benefit from new subscriptions. As a result, liquidity and cash equivalents remain somewhat on the higher side of our longer-term pattern. Currently, higher rates of interest are paid on short-term deposits than most bond investments, making the urgency to deploy the new funds somewhat less than the historical norm. The allocation to other income producing securities remains slightly below our limit of 20%.

Fixed Income Summary (80% of Assets)

Credit spreads, the difference in yield between where corporates and provincials borrow as compared to Canada bonds, continued to narrow. These spreads are certainly getting to levels where it can be argued that investors are not earning enough incremental yield, and that one might be better off earning a little less holding highly liquid Canada bonds. We will be monitoring this trend very closely in the months ahead. Our corporate holdings continue to be at the higher end of the quality spectrum and over the course of the quarter we switched certain lower-rated issues for higher-rated ones in an effort to maintain a very high quality approach.



Interest rates rose modestly this past quarter with rates in the middle of the yield curve rising a little more than at the long end. This continued the flattening trend in evidence all year and rates in the money market (less than one year in maturity) now exceed 30-year bond rates. We have maintained a portfolio duration of 6.0 years despite the lengthening of the benchmark Scotia Capital Bond Universe to a duration of 6.7 years. Our holdings remain concentrated in maturities of between six and ten years. The relative allocation between Canada, provincial and corporate bonds was unchanged over the quarter.

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

As we wrote in our last report, 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 are not giving up 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”.

Income Trusts and Equities (17% of Assets)

Our return from investing in this sector of the markets was positive despite Finance Minister Flaherty's Halloween announcement of changes to the tax treatment of income trusts. While some of our income trust holdings declined by as much as 20%, others such as bank and utility shares benefited from renewed investor interest. Wholly unpredictable, the sudden turn-around in Ottawa underscores the wisdom of maintaining a diversified portfolio. As we cast forward as to what might happen in the income trust market, it is our opinion that the resolve of both the government and policy makers in the Department of Finance is very strong on this issue. With one exception, TimberWest Inc., we have kept our positions, believing that the bad news is fully incorporated in the valuations at this time. In the case of TimberWest, although thought of and categorized as an income trust, it is actually a “stapled unit”, a form of security currently thought to be outside the changes to the legislation. As a result it was mostly unscathed by the changes, and in fact had appreciated during this period. Not wanting to risk a stricter interpretation by the government when the legislation is ultimately written, we decided to sell our position in late December. Currently, we own seven income trusts, diversified across a broad array of industries, totaling 5.5% of the total portfolio at this time.

The rest of our equity holdings remain concentrated in banks and utilities, which continue to fare well in a low interest rate environment. With the decline in the C\$ during the quarter, our two U.S. holdings, Bank of America and Wells Fargo, had a little extra tailwind for support.

