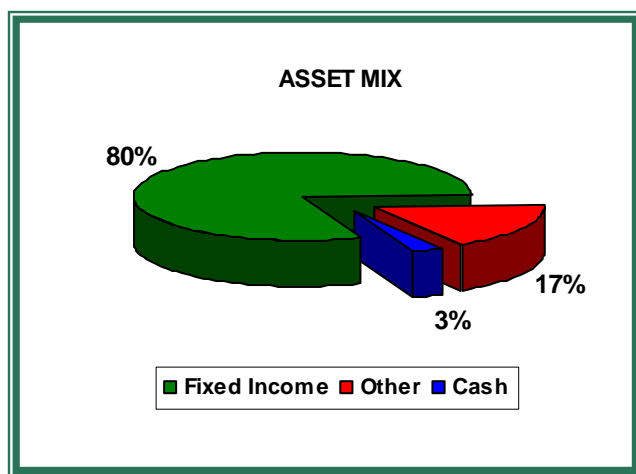


NEXUS NORTH AMERICAN INCOME FUND

QUARTERLY REPORT – June 30, 2006

Interest rates in both Canada and the United States continued to move higher over the course of the quarter and, as a result, returns in the bond market remained under pressure. As they have been for some time, short-term interest rates have been led higher by central banks, and the consequence has been a continued flattening of the yield curve. Both the Bank of Canada and the U.S. Federal Reserve raised rates twice this past quarter. In Canada, one year treasury bills and 30 year bonds are only 10 basis points apart, and in the United States, long rates actually are less than rates of shorter-term maturities. Further out the yield curve, Government of Canada ten year interest rates increased 32 basis points, to 4.58%, slightly more than the increase of 30 basis points that was the case in the same period in the U.S. market.



After having finished the first quarter somewhat weakly, the C\$ has spent this quarter grinding higher. At U.S.\$ 0.90, it ended the quarter very close to record levels. In our opinion, a number of important fundamental factors are contributing to the currency's strength - simple speculation is less of a factor. Most noticeably, energy rich western Canada is attracting copious amounts of overseas investment capital, the Harper government has surprised outsiders with the progress it has made on economic issues, and Canada's budgetary and trade surpluses compare very favourably to the situation that exists in the U.S. Although the strong currency is making things difficult for the export-oriented economies of Ontario and Quebec,

increasingly it appears that business is coping with a stronger currency and that a stronger currency can be accommodated in our industrial and manufacturing sectors.

As is often the case, Central Bank policy makers are facing difficult choices. Simplistically, both the Bank of Canada and the Federal Reserve must determine whether the steady increases in interest rates that have already been administered have been enough to moderate economic growth and dampen the inflationary pressures caused by higher energy prices and strong employment.

In the U.S., a number of indicators (particularly housing and employment growth) suggest the economy is cooling, but the headline inflation rate is running at 4.2% and presents a problematic issue. Complicating the situation is that Ben Bernanke, the Chairman of the Federal Reserve, along with two other members, are new to their positions. After years of Alan Greenspan, investors need to be convinced that the new regime at the Fed is up to the job. There is a general concern that the Fed won't be tough enough, and may allow inflation to re-ignite. On the other hand, there are pundits who fear that, in establishing its inflation fighting credibility, the Fed will tighten too much and the U.S. will slide into recession. To state the obvious, neither a new round of inflation nor an economic recession would be good for U.S. markets. Mr. Bernanke and his colleagues need to find a middle course between these two outcomes. The stakes are actually quite high if their decisions go awry. Until recently, U.S. dollar investments were the "ne plus

ultra” on the international stage. Increasingly, as Europe and Japan get their respective economies in order, assets denominated in Euros or Yen are legitimate alternatives. The United States, which now relies so heavily on external financing, must maintain international confidence in the stability of the U.S. economy and avoid any perceived acceptance of a weaker U.S. dollar. As a final wrinkle, leadership of the U.S. Treasury has just changed. The new appointee is Hank Paulsen, formerly senior partner at Goldman Sachs. He is an accomplished businessman with credibility in financial markets, but his policy positions on most economic issues are basically unknown. Clearly, Bernanke, his new colleagues at the Fed, and Mr. Paulsen will be closely scrutinized on the international stage.

In Canada the economic situation is different. Canadian economic activity continues to be strong, evidenced most noticeably by high levels of job growth and capital investment. As compared to the U.S., the inflation rate is still well controlled (core inflation is running at 2%) and, with its strong trade and current account surpluses, Canada does not rely on foreign capital to keep the economy running. As a result of being less dependent on the international financial community, our central bank has more flexibility, and has more control of the timing of its actions. The semi-annual Monetary Policy Report from the Bank of Canada was broadly acknowledged to have built the case for the Bank of Canada pursuing a “wait and see” approach before raising rates any further. Indeed, despite a series of strong economic reports since its publication in April, early in July the Bank of Canada chose to leave rates unchanged while it waited to see the consequences of previous interest rate increases and the strong Canadian dollar.

Upward pressure on interest rates remains a factor in international markets. Surprising to many, the official Bank Rate in Japan has been zero for five years. This arose as a means of dealing with the complicated problem of deflation that Japan has suffered from for at least a decade. More recently, in order to drain liquidity from the markets, the Bank of Japan has engineered a reduction in the monetary base as a pre-cursor to a change in the highly public “zero interest rate” policy. It seems likely that by August, the rate will have risen to 0.25%. While still representing only a meagre cost for borrowing, the effect of the change will be felt as much psychologically as it will be financially.

In Europe rates too are moving higher, again from a low base. In early June, the European Central Bank raised its policy rate from 2.50% to 2.75%. The accompanying press release stressed the move was to head off incipient inflation and acknowledged that European economic growth was beginning to accelerate after a long period of sub-standard performance.

Over the quarter, the Fund returned -0.8%¹. This was better than the negative return of -1.0% from the Scotia Capital Bond Universe Index (SCBU) in the same period. In the last year, the Fund has moved sideways, up 0.2%. As uninspiring as this may seem, it has outperformed its SCBU benchmark over the same period, which has had a return of -0.7%.

Asset Mix

On a temporary basis, we have allowed the cash position to grow to 3% of the portfolio, but otherwise, the allocation between bonds and other income producing securities remains at about the level it has been for the past six months.

Fixed Income Summary (80% of Assets)

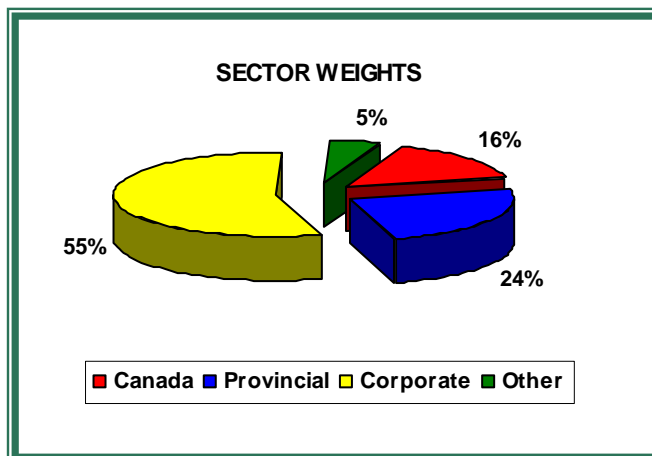
There continued to be a stream of new issues coming to market this quarter. Although the issuance remains concentrated in companies in the financial services sector, we took advantage when possible, and broadened our list of corporate security holdings to improve diversification.

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

The maturity of our holdings remains very heavily concentrated in the belly of the yield curve - maturities between five and ten years. The duration of our holdings (5.8 years) remains less than the Scotia Capital Bond Universe (6.3 years).

Our emphasis on quality remains unchanged. There remains very little extra income to be earned by owning lesser quality credits, and certainly not enough to compensate for the risk of a widening of interest rates spreads that would occur should the economy weaken more than expectations. Although it appears that we have a large weighting in the corporate bond sector, many of our selections are rated AA or better.

We continue to believe that longer-term interest rates will not vary significantly from their current levels in the next 18 months. In our estimation, we are likely to see a pause in policy rate increases until the fall, and then it is likely they will be pushed slightly higher to finish the year. This middle of the road scenario should generate modestly positive bond returns and provide a favourable backdrop for investors in other income producing securities such as higher dividend paying stocks and income trusts.



Income Trusts and Equities (17% of Assets)

While our holdings of Income Trusts and higher yielding common stocks have substantially out-performed the bond market in the past year, weaker equity markets undermined the returns from these holdings this past quarter. Our equity holdings remain heavily concentrated in banks and utilities. Our holding of nine Income Trusts, diversified across a broad array of industries, totals 7.0% of the total portfolio at this time.

