NEXUS

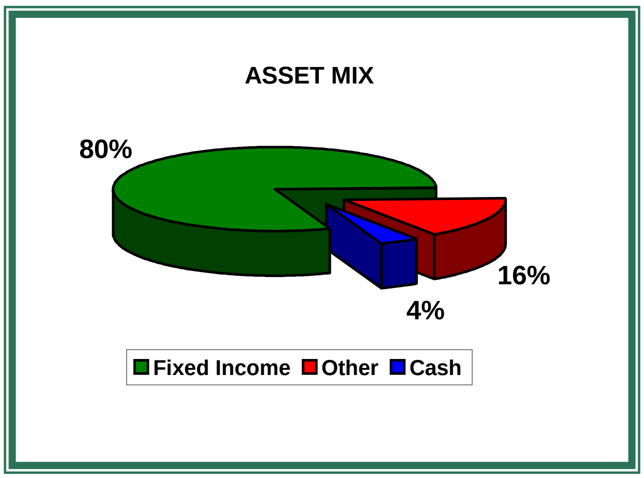
Portfolio Management & Financial Counsel

NEXUS NORTH AMERICAN INCOME FUND

QUARTERLY REPORT – September 30, 2006

Interest rates in both Canada and the United States moved sharply lower in the third quarter, retracing the bout of weakness they had experienced earlier in the year. The move occurred as economic evidence surfaced showing a moderation in economic activity in both Canada and the U.S.. This slowdown has caused both the Bank of Canada and the U.S. Federal Reserve to step to the sidelines and await greater clarification as to whether their previous tightening moves have had the desired effect of slowing economic growth.

If there is one trend that has remained intact this year, it is the continued flattening of the yield curve. In the last quarter, Canadian ten year bonds fell 55 basis points, while rates on one year bonds dropped 40 basis points. In fact, short-term interest rates now slightly exceed the yields for longer maturity instruments. Historically, inverted yield curves have almost always presaged a soft economic period, including periods of recession. As a result, market strategists ascribe some significance to this recent development and what it might mean for the economic outlook in the period ahead. However, in our opinion, the latest curve (see graph on page 3) is best still described as flat rather than inverted and we continue to believe that what lies ahead is a period of moderate, but positive, economic growth. As we have believed for some time, we forecast little change in the general direction of interest rates in the period ahead.



Despite a moderation in energy prices late in the summer, the C$ remains at close to its recent highest levels. We have acknowledged previously that the basis of our strong currency is sound economic fundamentals - most notably, an attractive investment climate both for portfolio and direct investments, as well as trade and current account surpluses arising from the strength in commodity exports. However, as energy prices eroded over the course of the summer, we were surprised at how well the C$ has stood up. Perhaps the strength relates to the large recent flows related to foreign takeover activity in our mining and property sectors. If this is the case, as we suspect, it would not be surprising to see the C$ weaken somewhat in the weeks ahead. This would assuredly be welcomed by the beleaguered manufacturing base in Ontario and Quebec.

The major cause of worry regarding a slowdown in growth emanates from the U.S. housing sector. Long expected, it is now apparent that a major slowdown is at hand. After years of price increases, record levels of construction and quality job creation, it is clear that many of those trends have now reversed. How it will affect Americans is up to debate, but we certainly feel that a period of consumer retrenchment is likely. The stock of housing in the United States is now worth $22 trillion. At almost 160% of U.S. GDP, its relative size greatly surpasses any historical precedent. According to Merrill Lynch, the real value of housing has increased 90% in the last six years, but the book value has increased only 20%. It is quite likely that some price adjustment (lower prices) needs to take place. Declines in home prices, although uncommon, have actually begun in many localities and, in August of this year, the average selling price of a home in the Unites States fell on a year over year basis for the first time since 1993. A decline in the value of housing reduces the equity owners have in their homes, and this restricts the ability of owners to borrow against their homes and fund consumption. Second order effects associated with a slowdown in housing construction, such as weaker employment levels in this sector, will also moderate economic activity as consumers adjust to a softer economy.

The effects of a weaker U.S. consumer will spill over to Canada in the months ahead, if in fact it has not already begun. Likewise, a softening in commodity and energy prices such, as we are experiencing, portends a cooling in Canadian economic activity as well. After a series of interest rate hikes earlier in the year, the Bank of Canada now looks to have been very wise in stepping to the sidelines in early July to watch how the economy would adjust to the effects of previous interest rate hikes.

The disparity in economic performance between the Western provinces and Central Canada remains a thorny issue. In the details beneath the surface of many nationwide economic releases lies evidence that this remains an unresolved problem. As examples, employment statistics evidence that Ontario is losing higher quality manufacturing jobs and that Alberta and the west are creating jobs, predominantly in construction. Likewise, the national trade surplus would in fact be a deficit were it not for the export of energy to the United States. This suggests to us that the Bank of Canada will likely stay on the sidelines and that interest rates are likely to trend sideways in the period ahead.

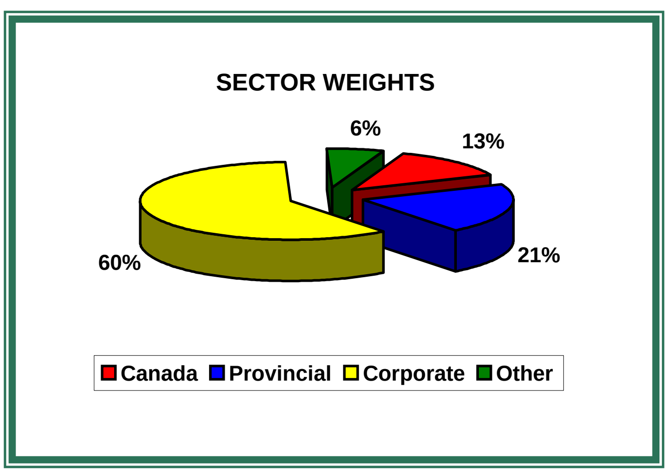
Over the quarter, the Fund returned +5.1%[1] - a heady quarterly performance in the world of fixed income! This was better than the return of +4.9% from the Scotia Capital Bond Universe Index (SCBU) for the same period. The Fund continues to maintain its out-performance relative to the SCBU over longer time periods as well. In the last year, the Fund has generated a return of 5.1%, while the SCBU has returned 4.0% 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. On a temporary basis, we have allowed the cash position to grow to 4% of the Fund. The allocation to other income producing securities remains slightly below our guideline of 20%.

Fixed Income Summary (80% of Assets)

Corporate bond issuance remained active this quarter, and we continued to add to our holdings in this sector. Many of our purchases were funded by deploying cash from new subscriptions, but we also have switched some of our provincial exposure into higher-yielding corporates as well.



We lengthened the term of the portfolio from a duration of 5.8 years to 6.0 years. This remains considerably less than the Scotia Capital Bond Universe which now has a duration of 6.6 years. We remain heavily concentrated in holdings with maturities of between six and ten years. Normally, bonds of longer duration yield more than shorter duration bonds. However, given the current shape of the yield curve there is very little difference in yields

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

between longer bonds and shorter bonds. As a consequence, by holding shorter maturities than the index, we are not giving up much in 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”.

Although our weighting of corporates has increased, our emphasis on quality remains unchanged – many of our holdings are rated AA or better. 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.

Income Trusts and Equities (16% of Assets)

The return this quarter to substantially lower interest rates underpinned a strong performance from our higher yielding equity holdings. Banks, utilities and income trusts all are supported in an environment of lower rates. Our holdings of income trusts and higher yielding common stocks have substantially out-performed the bond market in the past year and, if our forecast of generally unchanged interest rates comes true in the months ahead, we would expect this outperformance to continue. At 16% of the Fund, we have room to add in this area.

Our equity holdings remain heavily concentrated in banks and utilities. We own eight income trusts, diversified across a broad array of industries, totaling 7.0% of the total portfolio at this time.