

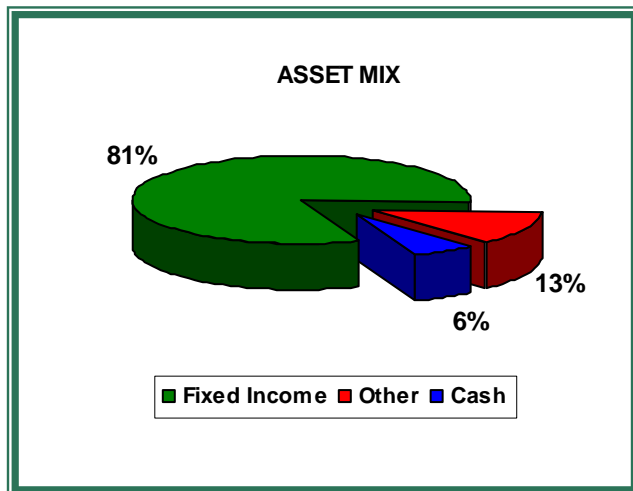
NEXUS NORTH AMERICAN INCOME FUND

QUARTERLY REPORT – December 31, 2007

North American capital markets were roiled in the final quarter of 2007 by the consequences of the sharp deterioration in the asset quality of the global financial system. Although this crisis in credit has been unfolding since late spring, credit and equity markets were particularly volatile in the 4th quarter, lurching higher and lower in reaction to a stream of news releases and rumours. Originally, the problem was believed to be predominantly a result of lax mortgage underwriting standards in the United States. It is now clear that financial engineering, excessive borrowing and inadequate risk controls are pervasive problems in the global financial system. What has been laid bare is that liquidity was overestimated, complexity underestimated, and that the problems were more broadly distributed than almost anyone would have imagined. Virtually no financial institution or investor has been able to avoid being affected by the crisis now unfolding.

Canada has had a more conservative culture for borrowing and lending and, as a result, our system has suffered comparatively less than both the Americans and Europeans. ‘Ground zero’ of the credit crisis was the sub-prime mortgage lending business in the United States but, despite our geographic proximity, Canada’s financial system has been only partly contaminated by this problem. Where it did affect Canadians was with regard to the asset-backed commercial paper market. This ‘made in Canada’ problem arose because a number of issuers of commercial paper in Canada had investments that contained more leverage and more exposure to low quality assets than investors realized. Since August, a committee of bankers, investors, and financial regulators has been working steadily to elicit agreement to what is known as the ‘Montreal Accord’, a plan to restructure almost \$32 billion dollars of frozen Canadian asset-backed commercial paper. On December 23rd, an agreement was arranged in principle

that will turn the short-term debt into longer-term floating rate notes - a small, tentative sign of progress. Following this agreement, the tone in Canadian money markets improved. However, it is not clear that this improved sentiment will help the bond market. There remain many more credit challenges globally.



The Fund has avoided any direct exposure to the most egregious excesses and damaging write-offs in both the U.S. and Canada. Thankfully, we watched the negotiations of the Montreal Accord from the sidelines, unscathed by any exposure to the affected commercial paper, and our list of Canadian bank holdings does not include the CIBC which has had far more exposure to global credit problems than any other Canadian institution.

As the quarter ended, unlike the light at the end of the tunnel suggested by the Montreal Accord here in Canada, the global financial system remained in turmoil, without any clear end in sight. The problems of the global banking system have led to a significant reduction in lending activity and a slowdown in personal spending and corporate investment. It appears that concerns about the integrity of the financial system have undermined consumer and business confidence in North America and Europe. As economies in the developed world decelerate, the theory that the emerging economies of China and India can continue to grow in the face of a slowdown in the developed world will be tested.

Over the quarter, the Fund returned 1.3%¹ - predominantly a combination of interest and dividend income, offset by some capital loss in the portion of the Fund allocated to "other income securities". Our investment results trailed the performance of the DEX Universe Bond Index (DBUI) which rose 2.8% over the same period. Although the Fund continues to maintain its out-performance relative to the DBUI over longer time periods, in the past twelve months, the Fund slightly trailed the DBUI, generating a return of 3.3%, while the DBUI has returned 3.7% over the same period.

Asset Mix

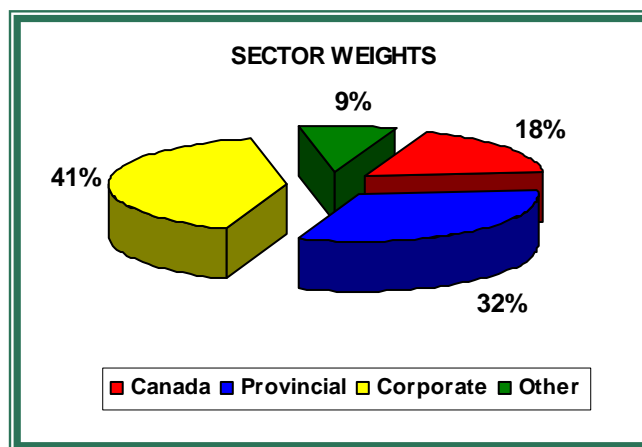
We reduced our cash position to more normal levels, deploying the funds in the bond market. Our cash position is now 5% of the portfolio and our weighting in traditional high-quality fixed income is over 80%. We are positioned conservatively with room to take advantage of widening spreads in the credit markets or attractive opportunities with solid dividend paying stocks.

Fixed Income Summary (81% of Assets)

Government of Canada bond yields, from two years to thirty years, declined between 33 and 35 basis points this quarter. This uniform decline belied the incredible volatility and nervous trading that was experienced. The pricing of provincial and corporate bonds that trade on a spread to Canada bonds of a similar maturity was especially volatile.

The composition of the Canadian corporate bond market is dominated by financial companies – particularly Canadian banks and the Canadian subsidiaries of U.S. lenders, such as Wells Fargo Finance or JP Morgan Chase. In many instances, despite the credit ratings of the foreign institutions being judged to be superior to their Canadian counterparts, their bonds still trade at higher yields. We have a number of holdings issued by foreign financial institutions. We are comfortable that, over time, we will benefit either by an improvement in the spreads of our international holdings or in the higher rates of interest they provide.

Spreads between corporate and government bonds widened over the quarter, driven by two key factors. The first was a basic concern regarding the integrity of the financial system and the damage to credit quality that might occur as banks and other financial institutions recognized the losses buried in their balance sheets. Investors perceived there to be heightened risk and wanted a higher return as a result. The second is related, but subtly different. In anticipation of coming problems, many financial institutions rushed to raise capital in the bond markets. In some instances this was done to shore up their regulatory capital; for others, it was in preparation for having to fund loans that previously they would have sold to other investors; for others still, it was in order to have the financial flexibility to participate in any coming consolidation of the global banking sector. With the exception of the Royal Bank, which was an active issuer in September, every major Canadian bank and many international financial institutions raised money in the Canadian bond market this past quarter, with the result that spreads were pressured wider.



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

Although the Canadian dollar finished the quarter very close to the level it had closed the 3rd quarter, it did spend much of the 4th quarter at a significant premium to the U.S. greenback. After briefly touching US\$1.10 intra-day on November 6th, it made a record high close on November 7th of \$1.0905. As exciting as this was, the run-up proved speculative, and likely took advantage of thin market conditions around the Canadian banks' year-ends at the end of October. It was not just cross-border shoppers who moved to take advantage of their temporarily powerful loonie. Currency markets are terribly efficient and currency traders and hedgers were willing sellers at these extreme high levels. One week after making its closing high, it was back to \$1.02 - the level it closed the year at.

Obviously, Canadian dollar strength is creating a terrific strain on export-oriented industries in central Canada. What is less well appreciated, is the drag it is having on the natural resource exporting industries of western Canada. Although global energy and materials prices have been very strong, the realized prices to Canadian producers when translated back from U.S. dollars into Canadian dollars has been less than many people think. Over the course of the year, the C\$ appreciated almost 17% against the U.S. dollar. Both the amount, and the pace of the change, were a crushing drag on economic performance, and the full effects of this unprecedented climb have yet to be fully reflected in economic activity. We believe that the strength in the currency will take at least 18 months to work its way through the economy.

The U.S. Federal Reserve is expected to aggressively lower interest rates to offset the problems in their credit markets. We expect the Bank of Canada will also need to lower interest rates, both because economic performance in Canada is beginning to lag, as well as to avoid a change in interest rate differentials between the countries that would put upward pressure on our currency. Specifically, we expect a 75 basis point reduction in the bank rate in the coming six months.

Other Income-Oriented Securities (13% of Assets)

For the first time in a long while, our holdings in this sector generated negative returns. Most of the weakness emanated from our holdings in bank shares, but equities in general were down over the quarter and our other holdings were not immune. As anticipated, we tendered our holding of CCS Income Trust to a take-over offer early in the 4th quarter. As a result we now have only four income trust holdings in the Fund representing 3.6% of Fund assets. Our other holdings remain concentrated in banks and utilities, many of which we added to as the Fund grew over the quarter.

