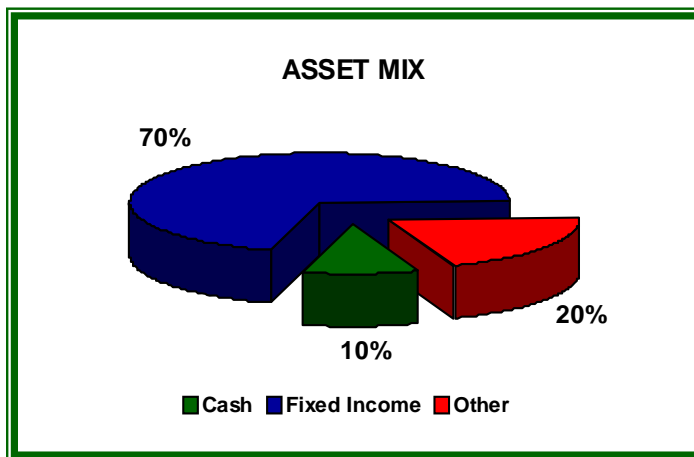


NEXUS NORTH AMERICAN INCOME FUND

QUARTERLY REPORT – March 31, 2011

The first quarter of 2011 has been as eventful as any quarter in recent memory, which says a lot considering the events of the past two years. In a quarter filled with unpredictable political events, natural disasters and mixed economic data, the equity markets in North America sprinted off to a fast start; the S&P 500 and TSX were each up strongly to start the year. On the other hand bond markets, despite the kind of unsettled geo-political conditions that often spark a 'flight to safety' generally marked time this quarter. Fixed income returns were ever so slightly negative to begin the year.



It is hard to imagine that recent developments are being so calmly taken in stride by investors. For instance, the political upheaval in Egypt and Tunisia, the civil war in Libya, and the simmering discontent in Syria, Bahrain and Yemen are deemed, from an investment point of view, as some sort of inconvenient disruption to the global oil supply. While it seems glib to reduce the momentous change in the Middle East to an analysis that it is good for oil producers in Western Canada, it more probably reflects how unknowable are the long-term consequences of the changes underway in that part of the world. In a

similar manner, there is confusion with regard to the effects of the Japanese tsunami. Contradictory opinions abound about the effect on the global economy. Some pundits pronounce that when Japan rebuilds, it will act as a catalyst for stronger global economic performance, while others feel quite the opposite, that the long-term consequences of nuclear radiation may tip Japan over the edge of an economic abyss.

We are watching the developments in the Middle East and Japan closely. But for now, we have no definitive opinion as to how they will ultimately be resolved. The essence of investment success in the long-term is building portfolios that can cope with uncertainty, and that reflect the economic and corporate developments that we can properly interpret. On these traditional investment and economic considerations, the quarter contained a lot of mixed news.

Of most importance to our investment thesis is growing evidence that the U.S. consumer is continuing to make a gradual recovery. While the effect of a spike in gasoline prices is worrisome in the short run (due to its effect on consumer spending), nothing drives consumer activity more than being employed. And on that point, there has been continued improvement in labour markets in North America. After peaking at a rate of 10.2%, U.S. unemployment has now fallen to 8.8%. Likewise the weekly jobless claims statistics, which peaked at 650,000 claimants in the depths of the recession, have fallen back below 400,000 a – level they have not seen since the summer of 2008. There is also evidence that U.S. consumers are getting a better handle on their finances. Total household debt (which includes mortgages and credit card balances) has now fallen for two years in a row and, when expressed as a ratio to income, is now at 116% – a six year low.¹ Some of this improvement has been the result of defaults and foreclosures, but a large part has been an increase in the savings rate to 6% and the effect of rebounding share prices on net worth. If consumer finances have largely stabilized, the prospect that spending will grow at the same rate as incomes will be very positive for economic growth in the period ahead.

While the condition of the U.S. consumer has improved, so too has the state of business confidence. One of the most heartening pieces of data this quarter was the ramping-up of hiring intentions by small business.² During the depths of the recession, because the availability of credit was so restricted, small businesses felt the pinch more than large businesses did. However, in the last few months, credit has become more available and a recent survey of small-business sentiment conducted by the National Federation of Independent Business rose to its highest level since December 2007, with a notably improved attitude regarding the necessity and the intention of hiring more employees.

Consistent with our viewpoint of a slow recovery, there remain a number of economic indicators that continue to be worrisome. One of the most troubling is continued softness in the U.S. housing market. After having stabilized for a period of time, home prices as measured by the Case-Shiller home price index have once again begun to slide. In addition, surveys of new home starts and home-builder sentiment are at extraordinarily low levels. More than 11 million Americans – 23% of all mortgage borrowers – have no equity in their homes and mortgage delinquencies continue to rise.³ Prodded by the regulators and some government funding, for some borrowers who cannot make their payments, banks have begun to consider loan modifications, such as interest rate or principal reductions. However, there is little reason to believe that the programs, as they are contemplated currently, will do much to restore a semblance of stability to the housing market. What will eventually stabilize the housing market and solidify economic recovery is an improvement in affordability. Thankfully, on that basis, the decline in prices, combined with still very low mortgage rates, has made home-buying in the U.S. as affordable as anytime since 1971.⁴ There may be light at the end of the tunnel yet.

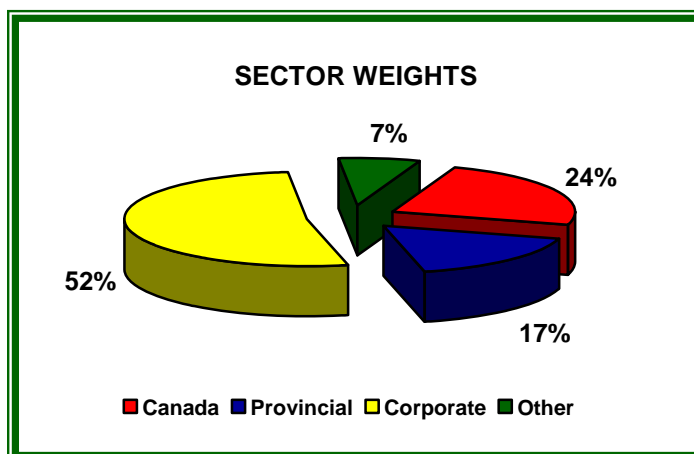
Another issue we are watching is the continued saga of sovereign debt problems in Europe. Surprisingly, considering its potential for disruption to global capital markets, this issue recently has receded from the market's attention. If we learned anything from the credit crisis, it is that debts matter and that the financial community is more interconnected than people ever imagine. For now, the European Union, financed largely by the Germans and French, seems willing to shore up countries such as Greece and Ireland. No doubt a key motivation is the exposure of the German and French banking systems to these weak sovereign credits. Yet there are signs that support, particularly in Germany, is waning for these rescue efforts. To make matters worse, the populations of countries most in crisis have already tired of the austerity that has been imposed. In short, this issue could flare up at any time to worry the markets.

The quarterly return of the Fund was 1.5%⁵ – the result of slightly better bond performance⁵ than the index and a strong positive contribution from the allocation to 'other income-oriented securities'. The fund is higher by 7.7% in the last 12 months. The DEX Universe Bond Index (DUBI) declined 0.3% over the quarter and increased 5.1% in the last 12 months.

Asset Mix

We are at our maximum allocation to 'other income-oriented securities', and in fact had to trim a few positions in order not to exceed our 20% limit. Reflecting our cautious opinion on returns from the bond market, we reduced the bond allocation to 70% of the portfolio and cash has been increased to 10%.

Fixed Income (70% of Assets)



For all the startling economic and geopolitical developments of the past three months, the bond market was relatively undisturbed. Short-term interest rates actually declined slightly and long-term rates increased slightly. In a bond trader's parlance, "the curve steepened". To nobody's surprise, the Bank of Canada has left the Bank Rate unchanged at 1%. But, in a number of different speeches over the quarter, officials from the Bank of Canada have broadly hinted that Canadians should prepare for higher interest rates. We agree, and have the portfolio positioned with an average maturity that is quite short compared

to the index we are measured against. As well, we have built up our cash reserves to be deployed once interest rates rise to more attractive levels.

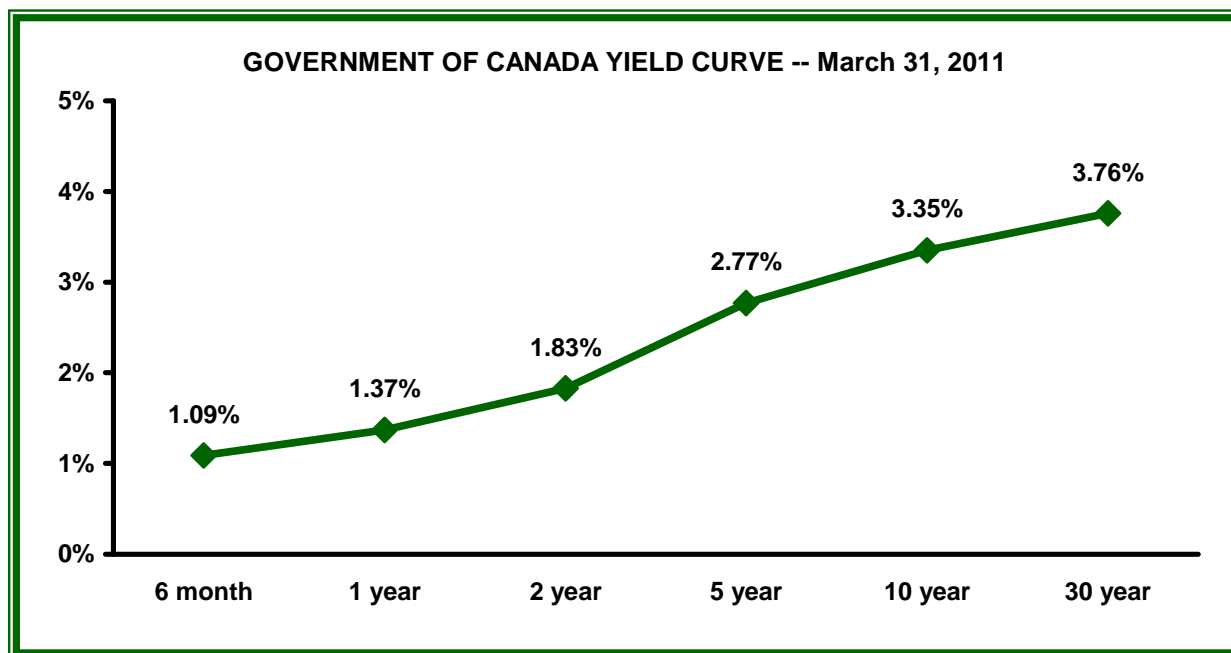
Monetary and fiscal stimulus in the United States continue at extreme levels. While it remains very much up in the air whether Democrats and Republicans can craft some coherent compromise for reigning in spending, we believe that on the monetary front, like the Bank of Canada, Governor Bernanke and his colleagues on the U.S. Federal Reserve are preparing for the day when interest rates will be higher.

On March 25th, in a speech simply entitled “Exit”, Governor Plosser from the Philadelphia Fed mapped out a plan for normalizing monetary policy – not just raising rates but also selling down the nearly \$2.4 trillion of assets (government bonds and mortgage securities) that have been held since the start of the crisis on the books of the Federal Reserve. While his speech was provocative, Plosser is well known as a policy hawk, so it was perhaps more notable that Governor Kocherlakota from the Minneapolis Fed, and a noted dove, said in an interview that if the economic recovery unfolds as he is expecting, interest rates will need to rise. With both ten year U.S treasuries and Canada bonds yielding less than 3.5%, the time for investing in longer-dated bonds is over.

In an effort to squeeze as much return from the portfolio as possible, we continue to overweight better quality corporate bonds. The Fund’s fixed income returns this past quarter of 2010 were -0.2%, marginally better than the DEX Universe Bond Index (DUBI) return of -0.3% for the same period. Over the course of the past year, our fixed income return of +5.2% slightly beat the DUBI, which was up 5.1%.

Other Income-Oriented Securities (20% of Assets)

While bond market returns were negative this past quarter, returns in this component of the Fund were +7.4% and returned 21.2% over the course of the last 12 months. The allocation to this asset class is at its limit of 20%. We own 12 different securities spread across 6 industrial sectors and continue to believe that an allocation to these securities will enhance long-term returns to unitholders.



¹ “Families Slice Debt to Lowest in 6 Years”, *Wall Street Journal*, March 11, 2011.

² “Small Business Hiring Gains Momentum, Data Show”, *Bloomberg*, March 24, 2011.

³ “Mortgage Servicers Resist But Cut Loans”, *Wall Street Journal*, March 28, 2011.

⁴ National Association of Realtors Affordability Index, as cited by BMO Nesbitt Burns, March 22, 2011.

⁵ Fund returns are shown before the deduction of management fees but after the deduction of direct expenses.