



# Harbor Convertible Securities Fund



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## 3rd Quarter, 2018 Commentary

*"Performance for the Fund and the market continued to be led by the two largest sectors, Information Technology and Healthcare." -Shenkman Capital Management, Inc.*

### U.S. equity markets hit record highs in the third quarter

The markets proved resilient in the third quarter of 2018. U.S. equity markets roared to record levels as investors shrugged off a growing trade rift, hostile political discourse, escalating oil prices and rising interest rates. Investor appetite for risk assets continued to drive the markets.

In this environment, the Harbor Convertible Securities Fund generated a return of 2.24% for the third quarter of 2018, underperforming its benchmark, the ICE BofAML US Convertible Excluding Mandatory Index, which returned 4.02%. The convertible securities market's most equity-like constituents contributed a significant portion of the market's performance. As a matter of style, Shenkman tends to underweight or avoid this type of convertible security, as they generally have little to no bond characteristics and are closely correlated to equity risk and volatility. The broad stock market, as measured by the S&P 500 Index, returned 7.71%. Investment-grade bonds, as represented by the Bloomberg Barclays U.S. Aggregate Bond Index, posted a return of 0.02%. The Fund invests primarily in convertible bonds, which can be converted into common stock at a predetermined price.

Shenkman Capital's comments were made in an October, 2018 report. Highlights adapted from the report appear below. All comments relate to the quarter ended September 30, 2018, unless otherwise indicated. All references to the year-to-date are for the period January 1 through September 30, 2018.

### HIGHLIGHTS

#### Information Technology and Health Care Drove Performance

Buoyed by continuing strength in underlying equities after another strong earnings season, the convertible securities market posted positive results during the quarter. Performance continued to be led by the market's two largest sectors, Information Technology and Health Care. In Information Technology, it should be noted that weakness in semiconductors due to trade war fears was more than offset by strength in the fast-growing software sub-sector. Health Care, with an average market weight in the Fund of 15.64% had a total return of 15.71% and contributed 150 basis points to performance. Also, the benchmark's average market weight during the quarter was 17.03% with a total return of 9.59% and a contribution of 159 basis points. Strength in the sector was led by biotechnology, equipment and life sciences.

#### Uncertainty and Periodic Volatility Tend to Favor Our Strategy

Similar to most of the first half of 2018, the continued strength in new issue activity provided us the opportunity to further diversify the portfolio through selective purchases. In addition, new issuance from a number of existing holdings enabled us to maintain a more balanced risk-reward profile. We are looking to extend optionality, as appropriate, through the use of swaps (i.e., selling out of one tranche and buying into another tranche of the same issuer) and the selective purchase of new issues. We will look to enhance the current yield of the portfolio as the markets move toward a higher yield environment. There was no change to our outlook based on macroeconomic events during the quarter. We believe uncertainty and periodic volatility in a growth environment tend to favor our strategy by providing numerous opportunities to rebalance the portfolio.

#### Convertible New Issue Activity Has Been Encouraging

With equities trading near record highs at quarter end, the convertible new issue market, despite the recent seasonal slowdown, has been encouraging thus far in 2018, on pace to have the most new issuance since 2007. We believe convertible new issue activity could pick up at any sign of



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a prolonged backup in the corporate/high yield issuance calendars, as convertible issuers look to take advantage of the opportunity to sell into an apparent supply and demand imbalance. We believe additional catalysts for convertible new issue activity are continued improvement in underlying equity prices and the potential for higher interest rates.

## Overall Prospects Remain Positive

We believe the overall prospects for the convertible securities market remain positive, including a growth-oriented equity environment, positive overall credit conditions and increased new issue activity, combined with a historical non-correlation to rising Treasury rates. We believe historical convertible securities market performance has been consistent with a negative correlation to U.S. Treasuries. Going forward, we believe Federal Reserve (Fed) activity and associated intermittent periods of volatility are likely to favor more balance convertible securities with a positive credit profile, which is endemic of our investment style. Given that we are in the early stages of Fed activity to normalize monetary policy, we currently have no specific interest rate level that would change our outlook.

## Total Returns

As of 09/30/2018

	Three Months	One Year	Three Years	Five Years	Since Inception (05/01/2011)	Expense Ratios Net	Expense Ratios Gross
<b>Harbor Convertible Securities Fund - INST</b>	2.24%	8.69%	7.15%	5.47%	5.40%	0.75%	0.80%
ICE BofAML US Convertible Ex Mandatory Index	4.02%	12.92%	13.14%	10.08%	9.49%		

**Sectors:** As of 09/30/2018, the Harbor Convertible Securities Fund had invested the following percentages of its assets in the sectors listed: Information Technology, 35.32%; Health Care, 15.68%; Consumer Discretionary, 15.66%; Industrials, 8.63%; Financials, 5.08%; Energy, 4.90%; Real Estate, 4.84%; Telecommunication Services, 2.94%; Utilities, 2.22%; Materials, 1.85%;

**Performance data shown represents past performance and is no guarantee of future results. Past performance is net of management fees and expenses and reflects reinvested dividends and distributions. Past performance reflects the beneficial effect of any expense waivers or reimbursements, without which returns would have been lower. Investment returns and principal value will fluctuate and when redeemed may be worth more or less than their original cost. Returns for periods less than one year are not annualized. Current performance may be higher or lower and is available through the most recent month end at harborfunds.com or by calling 800-422-1050.**

Performance figures discussed in any of the Manager Commentaries reflect that of the Institutional Class shares.

This information should not be considered as a recommendation to purchase or sell a particular security. The holdings or sectors mentioned may change at any time and may not represent current or future investments.

The Fund charges a redemption fee of 1.00% on redemption of shares that are held for less than 90 days.

Expense ratio information is as of the Fund's current prospectus, as supplemented. Gross expenses are the Fund's total annual operating expenses. The net expense ratios for this fund are subject to a contractual management fee waiver through 02/29/2020.

The ICE BofAML US Convertible Excluding Mandatory Index is broadly representative of the U.S. convertible securities market, consisting of publicly traded issues, denominated in U.S. dollars, of all credit qualities, and excluding mandatory (equity-linked) convertibles. This unmanaged index does not reflect fees and expenses and is not available for direct investment.

Convertible securities generally tend to be of lower credit quality and the value of a convertible security generally increases and decreases with the value of the underlying common stock, but may also be sensitive to changes in interest rates. As interest rates rise, the values of convertible securities held by the Fund are likely to decrease and reduce the value of the Fund's portfolio. Credit risk is higher for the Fund because it invests primarily in convertible securities of companies with debt rated below investment grade. High yield investing poses additional credit risk related to lower-rated bonds.

The views expressed herein are those of the subadviser, Shenkman Capital Management, Inc., and may not be reflective of their current opinions or future actions. These views are not necessarily those of Harbor Funds and should not be construed as such.

**Investors should carefully consider the investment objectives, risks, charges and expenses of a Harbor fund before investing. A summary prospectus or prospectus for this and other information is available at harborfunds.com or by calling 800-422-1050. Read it carefully before investing.**

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