



# Harbor Convertible Securities Fund



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## 1st Quarter, 2017 Commentary

*"The changes that we began to implement in the fourth quarter of 2016 continue to be a work in progress." -Shenkman Capital Management, Inc.*

### **In 2017's first quarter, the U.S. convertible securities market had a positive return**

The macroeconomic changes that we saw developing in the fourth quarter of 2016 continued to play out during the first quarter of 2017. The unexpected result of the U.S. presidential election signaled an anticipation of a more business friendly environment for U.S. companies, with a consequent boost in the economy. The Federal Reserve's decision to reinstate a gradual rise in interest rates signaled a shift from a multi-year dependence on monetary stimulus to a greater focus on the outlook for growth through fiscal policy. The continued stabilization of Energy prices, buoyed by major oil producers' agreement to limit production, removed a substantial sector from market uncertainty, at least for the time being. In this environment, the benchmark, the BofA Merrill Lynch All US Convertibles Ex Mandatory Index, returned 5.62% for the quarter. The broad stock market, as measured by the S&P 500 Index, returned 6.07%. Investment-grade bonds, as represented by the Bloomberg Barclays U.S. Aggregate Bond Index, posted a return of 0.82%.

The Harbor Convertible Securities Fund generated a return of 3.40%, underperforming its benchmark. The Fund invests primarily in convertible bonds, which can be converted into common stock at a predetermined price.

Shenkman Capital Management's comments were made in an April, 2017 report. Highlights adapted from the report appear below. All comments relate to the quarter ended March 31, 2017, unless otherwise indicated. All references to the year-to-date are for the period January 1 through March 31, 2017.

## **HIGHLIGHTS**

### **We Are Continuing to Gradually Increase Our Exposure to the Energy Sector**

The changes that we began to implement in the fourth quarter of 2016 continue to be a work in progress. We are looking to extend optionality, as appropriate, through the use of swaps and the selective purchase of new issues. We are continuing to gradually increase our exposure to the Energy sector, with an emphasis on improved balance sheets. We will look to enhance the current yield of the Fund as we move toward a higher yield environment.

### **We Continued to Diversify Through Selective Purchases**

During the first quarter, a significant pickup in new issue activity gave us ample opportunity to further diversify the Fund's portfolio through selective purchases. In addition, the secondary market was fluid enough for us to also further diversify by initiating several positions.

### **The First Quarter Saw a Reversal of Much of the Rotation Effect of Late 2016**

After seeing signs of stabilization in December 2016, the rotation effect in the underlying equities of the convertible securities market's two largest sectors, Health Care and Information Technology, largely reversed. After declining in the fourth quarter of 2016, the Health Care sector rose significantly in the first quarter of 2017, while the Information Technology sector continued its overall positive momentum. During the period, convertible securities with investment premiums were a significant factor in the Fund's underperformance relative to its benchmark. As a matter of style, we tend to underweight or avoid convertible securities of this type, as they have little to no bond characteristics and are closely correlated with equity risk and volatility.

### **We Expect Increased New Issue Activity Going Forward**

Convertible securities have a historical non-correlation to rising Treasury rates, and we believe there could be increased new issue activity going forward. As we enter a period of higher interest rates, with associated intermittent periods of volatility, we believe the market is likely



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to favor more balanced convertible securities, with positive credit profiles, which would place a premium on risk versus reward.

## Looking Forward, We Believe Prospects for Convertible Securities Appear Positive

We believe the market's transition from monetary to fiscal stimulus should enhance opportunities for convertible securities. Looking forward, we believe prospects for convertible securities appear positive. The equity market is likely to face a growth oriented environment, in our view, with positive overall credit conditions.

## Total Returns

As of 03/31/2017

	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>	3.40%	10.10%	2.58%	5.26%	4.68%	0.73%	0.78%
BofA Merrill Lynch All US Convertibles Ex Mandatory Index	5.62%	21.08%	6.32%	10.31%	8.41%		

**Sectors:** As of 03/31/2017, the Harbor Convertible Securities Fund had invested the following percentages of its assets in the sectors listed: Information Technology, 40.81%; Health Care, 15.90%; Consumer Discretionary, 12.39%; Industrials, 9.15%; Real Estate, 6.03%; Financials, 5.23%; Energy, 4.38%; Materials, 2.26%; Utilities, 1.55%; Telecommunication Services, 1.19%;

**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 [www.harborfunds.com](http://www.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 reflect a contractual management fee waiver through 02/28/2018.

The BofA Merrill Lynch All US Convertibles Ex 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 [www.harborfunds.com](http://www.harborfunds.com) or by calling 800-422-1050. Read it carefully before investing.**

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