



Harbor International Small Cap Fund



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3rd Quarter, 2018 Commentary

"We believe the international smaller companies asset class is one that offers many opportunities for bottom-up stock pickers over the longer term."

-Baring International Investment Limited (Barings)

U.S. Dollar strength constrained international equity market performance

During the third quarter of 2018, global equity markets benefited from the boost provided by a strong U.S. economy, although returns from international equity markets were constrained, in U.S. Dollar terms, by the U.S. Dollar's relative strength. Furthermore, while on a global basis changes in analysts' forecasts of corporate profit growth were slightly positive during the quarter, the upward revisions reflect increased profit forecasts for U.S. companies and slight downgrades to expectations of corporate profit growth in the rest of the world. In this context, international smaller companies fell slightly overall during the quarter, in U.S. Dollar terms. International companies with a high volume of sales in emerging economies were particularly weak performers, as they were negatively affected by political and economic developments in Russia, Argentina and Turkey, and by the U.S.-China trade disputes.

Against this backdrop, the Harbor International Small Cap Fund returned 0.58%, outperforming the Fund's benchmark, the MSCI EAFE Small Cap (ND) Index, which returned -0.88%. From a sector perspective, Consumer Discretionary contributed to relative performance, due to stock selection. Conversely, stock selection in Information Technology detracted from relative results. Among countries, the U.K. contributed to relative performance, due to stock selection. In contrast, security selection in France hindered relative performance.

Barings' 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

Our Focus Remains on Stock Selection

Central banks across developed markets continue to pursue accommodative monetary policies, and we believe equity markets remain reasonably attractively valued relative to other asset classes. Accordingly, our focus remains on stock selection and on identifying unrecognized growth opportunities among the diverse and wide investment universe available in international smaller companies. With a backdrop of continued, but slow, economic growth, one of our key concerns remains the developments around corporate profit margins. The management of salary costs represents a continued challenge, in our view, while low inflation highlights the risk to companies from higher input costs, although commodity price inflation has slowed in recent months.

Opportunities for Bottom-Up Stock Pickers Over the Longer Term

We believe the international smaller companies asset class is one that offers many opportunities for bottom-up stock pickers over the longer term. The asset class has not yet attracted greater sell side analyst coverage, so we believe considerable opportunities remain to add value through bottom-up research in what is a large, diverse and growing section of the market.

Shorter Term Outlook More Challenging to Forecast

We believe the shorter term outlook, though challenging to forecast, has probably improved slightly since the beginning of the third quarter. Although political and macro-level developments retain the capacity to upset global equity markets, recent policy actions generally appear to have calmed nerves. In this context, while the leaders of the governments of Germany, France, Japan, the U.K. and Australia are each experiencing weakening popular support, we believe there is little likelihood of a leadership change what would result in policy change sufficient to significantly disconcert equity markets.



Harbor International Small Cap Fund

Smaller Companies Remain Attractively Valued

We continue to see economic expansion in 2018, albeit more modest than in 2017. Further volatility due to geopolitical tensions in a number of regions remains a significant possibility, in our view. Nevertheless, we believe international smaller companies remain attractively valued, relative to other asset classes and relative to their historical valuation ranges, should earnings growth somewhere close to recent forecasts be achieved. A continuing area of focus, particularly for the companies represented in the portfolio, will be the resilience of their profit margins given the input cost pressure challenges posed by higher raw materials prices and the likelihood of rising labor costs. This assessment is consistent with our view at the start of 2018. Our focus will continue to be on identifying individual companies, assessing the outlook for their products and margins, the sustainability of their competitive advantages, the strength of their balance sheets and the skills of their management teams in deploying capital to create value for shareholders.

Total Returns

As of 09/30/2018

	Three Months	One Year	Three Years	Five Years	Since Inception (02/01/2016)	Expense Ratios Net	Expense Ratios Gross
Harbor International Small Cap Fund - INST	0.58%	3.27%	N/A	N/A	14.11%	0.95%	1.42%
MSCI EAFE Small Cap (ND) Index	-0.88%	3.73%	N/A	N/A	14.76%		

Sectors: As of 09/30/2018, the Harbor International Small Cap Fund had invested the following percentages of its assets in the sectors listed: Industrials, 31.22%; Consumer Discretionary, 16.00%; Financials, 13.81%; Consumer Staples, 8.70%; Health Care, 8.27%; Materials, 7.45%; Information Technology, 5.40%; Energy, 2.96%; Real Estate, 1.96%; Utilities, 1.41%; Telecommunication Services, 1.09%;

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.

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 an expense limitation agreement, excluding interest expense, if any, through 02/28/2019.

The MSCI EAFE Small Cap (ND) Index is an equity index which captures small cap representation across developed markets countries around the world, excluding the U.S. and Canada. This unmanaged index does not reflect fees and expenses and is not available for direct investment.

Investing in international and emerging markets poses special risks, including potentially greater price volatility due to social, political and economic factors, as well as currency exchange rate fluctuations. These risks are more severe for securities of issuers in emerging market regions.

Stocks of small cap companies pose special risks, including possible illiquidity and greater price volatility than stocks of larger, more established companies.

Stock markets are volatile and equity values can decline significantly in response to adverse issuer, political, regulatory, market and economic conditions.

The views expressed herein are those of the subadviser, Baring International Investment Limited, 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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