



# Harbor International Small Cap Fund



Nicholas M. Williams



Colin C. Riddles



Rosemary C. Simmonds, CFA

## 2nd Quarter, 2017 Commentary

*"International smaller companies generally performed strongly, reflecting increased confidence in the global economic outlook." -Baring International Investment Limited (Barings)*

### **Economic growth indicators are generally improving**

During the second quarter of 2017, forecasts for global economic growth continued to receive slight upgrades from many economists, reflecting improved business confidence. This was helped, in part, by the French presidential elections and the subsequent resounding victory of the "En Marche" representatives to the French Senate, leaving President Macron with an apparent mandate to attempt labor and fiscal reforms in France. Business confidence in France and in Europe was boosted by this outcome. The U.K. economy faced more serious challenges from the Pound's recent falls and, ultimately, from the fallout of Brexit. Renewed weakness in the price of oil, despite worsening relations between Qatar and Saudi Arabia, was less supportive of the outlook for economic growth.

The Harbor International Small Cap Fund advanced for the quarter and outperformed its benchmark, posting a return of 10.69%. Against this backdrop, the Fund's benchmark, the MSCI EAFE Small Cap (ND) Index, returned 8.10% for the second quarter. Relative outperformance was due mostly to strong stock selection in Industrials and Information Technology. Negative stock selection in Consumer Staples detracted from relative results. Among countries, stock selection drove a contribution from Japan, but stock selection in the Netherlands had a negative effect.

Baring International Investment's comments were made in a July, 2017 report. Highlights adapted from the report appear below. All comments relate to the quarter ended June 30, 2017, unless otherwise indicated. All references to the year-to-date are for the period January 1 through June 30, 2017.

## **HIGHLIGHTS**

### **Currencies Mixed Relative to the Dollar**

The major currencies of countries in the International Smaller Companies Index were mixed relative to the U.S. Dollar during the period, and our view on the likely trends for their future developments relative to the U.S. Dollar is little changed. In the short-term, the Euro may well lose some of its recent gains relative to the U.S. Dollar, although its relative strength was justified by the improved economic outlook for the eurozone. Our cautious outlook for the U.K. domestic economy is reflected in our overall view on the Pound's prospects, although, as the Pound has already weakened sharply since the Brexit referendum in 2016, the short-term outlook is more sanguine. The Japanese Yen is not anticipated to make significant short-term moves relative to the U.S. Dollar, although the currency can be volatile and, over the very long-term, could weaken.

### **Possible Increased Volatility on the Horizon**

Following continued gains in International equity share prices, the valuations of smaller companies were at a premium compared to their long-term averages, even if, relative to other asset classes, international smaller companies remained attractively valued. In this context, it seems plausible to anticipate that volatility might rise in coming weeks. Furthermore, while the French and U.K. elections did not upset sentiment, uncertainties might intensify over the outcome of the Italian and German elections and the potential disruptions that could be caused by the U.K.'s Brexit negotiations. In Asia, geopolitical tensions between Japan and North Korea began escalating again, and uncertainty continued to surround prospects for Chinese economic growth, despite encouraging economic data in the year so far.

Over the coming weeks, international smaller companies will begin announcing their results for the first half of the year, and update forecasts for the full year. We will meet with the management teams of the companies in our focus to review developments and strategy.



# Harbor International Small Cap Fund

Potential risks to companies' profit forecasts as the year progresses include rising wage costs, currency volatility, and recoveries in raw material prices in certain commodities.

## Short-Term Outlook Remains Steady and Positive

Our short-term outlook for international smaller companies has not been significantly impacted by the macro-level events of the quarter. Our outlook for international smaller companies remains positive with regard to the long-term potential for the asset class, and more importantly, the stock selection opportunities within this diverse group of companies. Our more circumspect short-term outlook for international smaller companies at the end of last quarter proved overly cautious, as economic data remained broadly supportive of world trade growth forecasts, and political events in Europe and the U.K. failed to cause any significant increase in volatility. Furthermore, despite sometimes contradictory statements from central bankers, there was very little substantive indication that interest rates would imminently rise in Europe, the U.K., or Japan.

## Total Returns

As of 06/30/2017

	Three Months	One Year	Three Years	Five Years	Since Inception (02/01/2016)	Expense Ratios Net	Expense Ratios Gross
<b>Harbor International Small Cap Fund - INST</b>	10.69%	24.08%	N/A	N/A	18.99%	0.95%	2.56%
MSCI EAFE Small Cap (ND) Index	8.10%	23.18%	N/A	N/A	20.07%		

**Sectors:** As of 06/30/2017, the Harbor International Small Cap Fund had invested the following percentages of its assets in the sectors listed: Industrials, 27.13%; Consumer Discretionary, 16.69%; Financials, 12.73%; Information Technology, 10.08%; Materials, 8.03%; Consumer Staples, 7.30%; Health Care, 7.25%; Real Estate, 2.40%; Energy, 1.21%; Utilities, 1.00%; Telecommunication Services, 0.52%;

**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.

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 contractually capped, excluding interest expense (if any), through 02/28/2018.

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 [www.harborfunds.com](http://www.harborfunds.com) or by calling 800-422-1050. Read it carefully before investing.**

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