



# Harbor Mid Cap Value Fund



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## 4th Quarter, 2011 Commentary

*"While valuations moved up as a result of the strong performance in the quarter, the Fund's valuation metrics remain very attractive from a historical perspective." - Bhaskaran Swaminathan, Director of Research*

### Value names led mid cap rally in Q4

Mid cap stocks staged a strong recovery in the fourth quarter of 2011, led by the value-oriented segment of the market. The Russell Midcap® Value Index posted a return of 13.37%, while the Russell Midcap® Growth Index rose 11.24%.

The Harbor Mid Cap Value Fund outpaced its Russell Midcap® Value benchmark in the quarter with a return of 15.91%. Sector and stock selection both boosted Fund performance relative to the index, says Bhaskaran Swaminathan, Director of Research for LSV Asset Management, subadvisor for the Harbor Mid Cap Value Fund. Stock selection was particularly strong in the Financial, Health Care, and Technology sectors, he reports, offset in part by unfavorable selection in Consumer Discretionary stocks.

Despite the fourth quarter run-up, value-oriented stocks still traded at attractive valuations entering the new year, Swaminathan says. He notes that value names have lagged the growth-stock segment for the past several years but now could be positioned to continue their outperformance of the overall market in the months ahead.

Bhaskaran Swaminathan's comments were made in a January 12, 2011, interview. Highlights adapted from the interview appear below. All comments relate to the quarter ended December 31, 2011, unless otherwise indicated. All references to year-to-date are for the period January 1 through December 31, 2011.

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## INTERVIEW HIGHLIGHTS

### Hope for sustained recovery

The economically-sensitive stocks are still attractive, in our view. They became a little bit more expensive after the gains in the fourth quarter but relatively speaking we think they're still very attractive. Given the long underperformance of value, we are hopeful that the recovery in the fourth quarter will continue this year and that we'll see a good run for the next two to three years.

### Value segment led in Q4

After lagging most of the year, value stocks led the recovery in the fourth quarter. Within the Russell Midcap® Value Index, economically-sensitive sectors such as Materials, Industrials, Consumer Discretionary, and Energy, which had trailed much of the year, led the market. Energy and Materials stocks were up over 20%.

### Favorable valuations

The Fund is trading at 9.5x forward earnings compared to 13.7x for the value benchmark, 1.1x book value compared to 1.4x for the benchmark, and 5.5x cash flow versus 8.1x for the index. While valuations moved up as a result of the strong performance in the quarter, the Fund's valuation metrics remain very attractive from a historical perspective.

### Cautiously optimistic

Given three years of poor performance, reversion to the mean certainly would be favorable to value stocks going forward. From a valuation perspective, the value segment definitely looks cheaper than it has been historically compared to growth. We think the stocks we are holding are good brick-and-mortar companies, well-managed companies with good balance sheets and good earnings quality. We are cautiously optimistic that this value run will continue.



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## Takeover targets

We don't have an M&A prediction factor explicitly built into our model. But the kinds of companies we like—attractive valuations, good momentum, good earnings quality, improving margins—are also the kinds of companies that tend to become takeover targets. As economic activity picks up and these stocks begin to recover, I would expect some of them to be potential takeover targets, particularly in the small cap and mid cap segments.

## Total Returns

As of 12/31/2011

	Three Months	One Year	Three Years	Five Years	Since Inception (03/01/2002)	Expense Ratios Net	Gross
Harbor Mid Cap Value Fund - INST	15.91%	-3.76%	17.56%	-0.89%	4.16%	0.95%	1.03%
Russell Midcap® Value Index	13.37%	-1.38%	18.19%	0.04%	7.51%		

As of 12/31/2011, the Harbor Mid Cap Value Fund had invested the following percentages of its assets in the sectors listed: Financials, 27.20%; Consumer Discretionary, 12.79%; Information Technology, 11.20%; Utilities, 10.14%; Industrials, 9.68%; Energy, 7.33%; Health Care, 7.30%; Materials, 7.05%; Consumer Staples, 5.78%;

**Performance data shown represents past performance, which is no guarantee of future results. Current performance may be higher or lower than the past performance data shown. Investment returns and the value of an investment will fluctuate, and an investor's shares, when sold, may be worth more or less than their original cost. You can obtain performance data current to the most recent month-end (available within seven business days after the most recent month-end) by calling 800-422-1050 or visiting [www.harborfunds.com](http://www.harborfunds.com).**

**Investors should carefully consider the Fund's investment objectives, risks, charges and expenses before investing. To obtain a summary prospectus or prospectus for this and other information about the Fund, visit [harborfunds.com](http://harborfunds.com) or call 800-422-1050. Read it carefully before investing.**

The Harbor Funds performance shown assumes the reinvestment of dividend and capital gain distributions and is net of management fees and expenses. Returns for periods less than one year are not annualized. From time to time, certain fees and/or expenses have been voluntarily waived, which has resulted in higher returns. Without these waivers, the returns would have been lower. Voluntary waivers may be applied or discontinued at any time without notice. The Harbor Funds are no-load; other fees and expenses do apply to a continued investment in the Funds and are described in each Fund's current prospectus.

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

Over time, a value oriented investing style may go in and out of favor, which may cause the Fund to sometimes underperform other equity funds that use different investing styles.

Equity securities, such as common stocks, are affected by company specific events and by movements in the overall stock markets in which those securities principally trade. An adverse company specific event, or downturn in those stock markets, can depress the value of a particular company's equity securities.

Forwards Earnings (Price to Earnings) is the industry analysts' consensus earnings forecast for the coming year divided by current price. Cash Flow (Price to Cash Flow) is defined as net income plus depreciation and amortization divided by current price. Book Value is company's total assets minus intangible assets and liabilities, such as debt.

About Expense Ratios: All mutual funds have expense ratios which represent what shareholders pay for operating expenses and management fees. Expense ratios are expressed as an annualized percentage of a fund's average net assets paid out in expenses. Net expense ratios reflect adjustments due to voluntary or contractual fee waivers or expense reimbursements. Expense ratio information is as of the Fund's current prospectus, as revised and supplemented from time to time. The net expense ratio reflected is contractual until 02/29/2012.

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 and the holdings or sectors mentioned may change at any time and may not represent current or future investments.

The Russell Midcap® Value Index is an unmanaged index generally representative of the U.S. market for medium capitalization value stocks. This unmanaged index does not reflect fees and expenses and is not available for direct investment. The Russell Midcap® Value Index and Russell® are trademarks of Russell Investments.

The views expressed herein are those of the portfolio managers at the time of the interview and may not be reflective of their current opinions or future actions. These views are not necessarily those of the fund company and should not be construed as such.

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