



# Harbor Small Cap Value Fund



Paul Viera

## 4th Quarter, 2011 Commentary

*"We're focused on buying good companies and avoiding areas where we see peril." -Paul Viera*

### **Small caps closed 2011 with solid rally**

Small cap stock prices staged a strong recovery in the fourth quarter of 2011. Key factors in the rebound included signs of progress in addressing Europe's debt crisis as well as improving U.S. economic data, says Paul Viera, Portfolio Manager of the Harbor Small Cap Value Fund.

The U.S. small cap value universe, as measured by the Russell 2000® Value Index, registered a return of 15.97% for the quarter. All 10 economic sectors in the index had positive returns. The Harbor Small Cap Value Fund outpaced the index with a return of 17.63%. Stock selection in the Energy, Financials, and Health Care sectors made major contributions to the Fund's performance relative to the index, Viera reports.

For the full year, the Fund returned a positive 2.38% versus a negative return of -5.50% by the Russell 2000® Value benchmark. From a longer-term perspective the Fund also outperformed the index for the 5-year and 10-year periods ended December 31, 2011.

Paul Viera's comments were made in a January 12, 2012, 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**

### **Stock selection focus**

We're focused on buying good companies and avoiding areas where we see peril. We continue to see problems in the Financials sector. Nonetheless, the Financial stocks that we selected performed better than those in the benchmark.

### **Portfolio metrics**

The overall portfolio continues to have a lower P/E than the benchmark, lower debt-to-capitalization, a higher earnings-growth rate, and a higher return on equity. Those are elements that you've seen consistently with us over the years. We don't target them specifically, but as our process unfolds they tend to be pretty consistent characteristics of the portfolio.

### **Potential takeover targets**

We never buy a stock on the expectation that it will be taken out by acquisition. Our focus is on companies that have stable businesses, that do relatively better than their peers in all economic environments, and are profitable and producing meaningful cash flows. It turns out that those characteristics are also attractive to private equity buyers as well as corporate buyers. In 2011, which was volatile by any definition, four of our companies were taken out by acquisition.

### **Caution on Financials**

The biggest underweight in the portfolio is the Financials sector. We are still of the belief that the Financial stocks, and in particular the small cap stocks in that sector, are expensive relative to other things we could own.



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## Total Returns

As of 12/31/2011

	Three Months	One Year	Three Years	Five Years	Ten Years	Expense Ratios	
						Net	Gross
<b>Harbor Small Cap Value Fund - INST</b>	17.63%	2.38%	15.11%	0.18%	7.74%	0.86%	0.86%
Russell 2000® Value Index	15.97%	-5.50%	12.36%	-1.87%	6.40%		

As of 12/31/2011, the Harbor Small Cap Value Fund had invested the following percentages of its assets in the sectors listed: Financials, 21.79%; Industrials, 16.35%; Energy, 14.45%; Information Technology, 11.38%; Consumer Discretionary, 10.22%; Health Care, 8.54%; Utilities, 7.50%; Materials, 5.78%; Telecommunication Services, 1.66%;

**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 small 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.

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.

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 2000® Value Index is an unmanaged index representing the smallest 2000 stocks with the lowest price-to-book ratio and future earnings. This unmanaged index does not reflect fees and expenses and is not available for direct investment. The Russell 2000® 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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