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Third Quarter 2020 Executive Summary

Harbor Capital Appreciation Fund Update

"We feel cautiously optimistic about where we'll be in a year with the virus, with a vaccine, and with the economy."

Rick Mastain – Managing Director, Jennison Associates LLC

A Year Like No Other

Equity markets extended the strong, post-March rally in the third quarter, and new highs were recorded in those sectors and companies that appear best positioned to benefit from the new realities created by the pandemic—such as work from home and the digital transformation of the economy.

- Growth has continued to outperform value, despite a slight hiccup in September when growth companies surrendered a portion of their advances.
- The Harbor Capital Appreciation Fund began the year with top quartile performance, and for the entire year-to-date period, has sustained its presence in the top quartile.[1]

A Consistent Philosophy and Process

What types of companies does Jennison look for, and why do they add to such long-term outperformance?

- Jennison looks for companies with 1) the potential for consistent, absolute, and relative earnings growth and 2) the potential for sales growth, improving sales momentum, and high levels of unit growth.
- Jennison's fundamental, bottom-up approach designed to identify those companies that will continue to grow earnings, revenues, and free cash flow substantially faster than the investable universe over a sustained period—a three- to five-year period. In a nutshell—long-duration growth. Along with these criteria, the companies must also have great management teams, great balance sheets, and competitive advantages with deep moats, and be priced at reasonable valuation levels.
- The consistency of Jennison's investment philosophy over three decades—through many market environment including presidential impeachments, recessions, wars, and oil embargoes—has helped performance because they purchase companies that have long-duration growth.

[1]Source: Morningstar as of 9/30/20

A Three-Growth-Bucket Process

Jennison divides the portfolio into three growth buckets. Using a rolling three-year time period, portfolio holdings are separated into 1) growth above 20%; 2) growth between 15% and 20%; and 3) growth below 15%. When the portfolio is broken out in this way, Jennison creates an extremely well diversified portfolio.

- There may be more volatility in the faster growing companies, and companies may shift over time from one bucket to another, but overall, each bucket has delivered very well. A company like an Apple or a Microsoft can do very well, even though it's growing more slowly than a company like Netflix, for example.

Preserving Capital During Market Drawdowns

Growth has outperformed, but what happens if another downturn occurs? Historically, the Capital Appreciation Fund has been able to preserve capital and outperform the Russell 1000® Growth Index in periods of significant market turmoil— for example, the Tech Bubble, the Global Financial Crisis, the early COVID-19 period last spring, and the full spectrum of the COVID-19 pandemic, year-to-date.[1]

Harbor Capital Appreciation Fund Performance

The Fund's performance over three decades, and year-to-date, validates Jennison's investment philosophy and process.

- For the third quarter of 2020, the Fund returned 15.83%, and for the trailing one-year period ending September 30, the Fund returned 54% versus the Russell 1000® Growth Index at 39%.

Contributor

Sector allocation and stock selection drove performance during the quarter.

- Consumer Discretionary was the strongest performing sector, with an overweight compared to the Index. Information Technology was also a strong contributor. Health Care and Communication Services lagged the benchmark. However, the Fund is benchmark agnostic. Jennison is not comparing sector weights; just looking for great companies that have the characteristics mentioned.
- Amazon was the largest weight in Consumer Discretionary and a strong performer for the quarter and the full year. Tesla is in the same category, as a top five contributor that Jennison has owned since 2013. The company has executed its business plan extremely well, and the stock has performed strongly for more than a year. In addition, the outlook for Tesla, and for the electric vehicle market overall, is positive.

Detractor

One stock that did not perform well was Illumina, and Jennison trimmed the position in the early part of the crisis. Illumina focuses on DNA sequencing.

[1]Source: Morningstar as of 9/30/20

- During the COVID-19 crisis, companies focusing on vaccine development were in the spotlight. Jennison knew Q2 and Q3 revenues would decline at Illumina, and in addition, the company made an $8 billion acquisition of GRAIL, which raised some questions about management's focus, and so, Jennison exited the position.

Top Holdings

The top ten holdings account for roughly 47% of the Fund.

- The Top 10 holdings represent a concentrated, conviction-weighted approach. They are comprised of Amazon, Tesla, Apple, Microsoft, NVIDIA, Facebook, Netflix, Adobe, VISA, and Salesforce. In most cases, the Fund has held these stocks for a long time, and they have done well.

Valuation Is a Hot Topic

Are valuations stretched for our Top 10?

- Jennison does not think so. Valuations are very important to them. A better question might be—is the valuation of a company in sync with its earnings growth? Looking at Amazon, you can make the case that it probably sells at 90 times earnings this year. But they think that its use of capital is such that they're very happy to have them spend on growing their grocery business, their cloud business, their presence in India, and their retail business. Jennison believes Amazon is a very good allocator of capital.
- Jennison's point is: They look at each individual company on its merits. They don't have metrics to say a company can only have a multiple of X times the Russell 1000® Growth Index. In the case of Tesla, which is probably the highest valuation in the portfolio, does that valuation make sense—over what they think is their holding period?
- If Jennison looks out into 2024, they think that multiples on Tesla are probably in the 30-40 range, which they think is still very attractive for a company with the growth potential that it has.

Jennison's Outlook

Jennison is a bottom-up manager, focusing on fundamental research, and benchmark agnostic. Therefore, they do not let macro events influence individual stock selections.

- Jennison's biggest concern, as year-end approaches, is the extent and magnitude of the recent surge in COVID-19.
- Greater clarity about the economic recovery path is ultimately dependent upon progress in developing and ultimately, distributing an effective vaccine.
- Jennison's second biggest concern is about the timing and scope of additional fiscal and monetary stimulus measures necessary to keep the economy moving forward.
- Jennison doesn't expect economic recovery to be uniform, and unemployment will likely remain higher than normal for some time.

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Total Returns	3 Months	1 Year	3 Years	5 Years	10 Years	Since Inception (12/29/1987)
Harbor Capital Appreciation Fund ***Institutional Class***	**15.83%**	**54.19%**	**24.71%**	**21.45%**	**18.21%**	**12.75%**
Russell 1000® Growth Index	*13.22%*	*37.53%*	*21.67%*	*20.10%*	*17.25%*	*11.25%*
Standard & Poor's 500 Index	*8.93%*	*15.15%*	*12.28%*	*14.15%*	*13.74%*	*10.71%*

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

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Jennison Associates LLC is an independent subadviser to the Harbor Capital Appreciation Fund.

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As of 9/30/2020, the Fund's top ten holdings were: Amazon.com Inc. (8.0%), Tesla Inc. (6.9%), Apple Inc. (6.5%), Microsoft Corp. (5.1%), NVIDIA Corp. (4.2%), Facebook Inc. (4.2%), NetFlix Inc. (3.2%), Adobe Inc. (3.2%), VISA Inc. (3.1%), Salesforce.com Inc. (3.0%).

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