Harbor Capital Appreciation Fund

Manager Commentary
As of 06/30/2020

Subadviser: Jennison Associates LLC *(Since 05/01/1990)*
Portfolio Managers: Spiros "Sig" Segalas, Kathleen A. McCarragher, Blair A. Boyer, Natasha Kuhlkin, CFA

2nd Quarter, 2020

"The market's bifurcation between winners and losers in a COVID/post-COVID environment has lifted advantaged companies to records, while beleaguered businesses with bleak prospects for recovery have seen equity values atrophy."

Jennison Associates LLC

Market in Review

Equities markets rebounded in the second quarter, but the COVID-19 pandemic's economic damage continued to accumulate. U.S. first-quarter gross domestic product (GDP) provided a preliminary gauge of the toll, contracting by 5.0%. The spread of the virus led to stay-at-home orders, bringing economic activity dependent on face-to-face interaction to a virtual standstill and leading to employment losses not seen since the Great Depression.

Authorities acted to contain the economic distress. The Federal Reserve (the Fed) provided liquidity across asset classes and credit intermediaries, alleviating solvency issues and ensuring access to capital. Congress passed the largest fiscal stimulus legislation in U.S. history, providing direct payments to individual households, as well as funds to enable small businesses and service industries to maintain their payrolls, hire back laid-off employees, and cover overhead.

Awash in liquidity, markets began rebounding dramatically in late March, just as health-care-system utilization and fatality rates across the hardest hit regions of the pandemic's first wave reached their peaks. Although economically debilitating, social distancing and work-from-home initiatives helped to flatten inflection curves and relieve health-care systems pushed to the brink of collapse. Corporations able to do so capitalized on easing financial conditions, issuing record amounts of public debt at low nominal interest rates. Less well-positioned businesses were left to access loans from the government on less favorable terms. Energy prices rebounded, as major producers agreed to cut production.

The patchwork of regional responses to the virus underscored the absence of a coherent national strategy to combat the pandemic and reflected increasing politicization of the crisis. As conditions improved in the Northeast and Midwest, many states in the South and West, which had had few restrictions on crowding and no social-distancing or mask-wearing recommendations, experienced alarming rates of infection as the quarter drew to a close. The late June surge in cases in these regions prompted some authorities to rescind moves to reopen.

Portfolio Performance

In the second quarter of 2020, the Harbor Capital Appreciation Fund (Institutional Class) returned 34.29%, outperforming its benchmark, the Russell 1000® Growth Index, which returned 27.84%.

For the year-to-date through June 30th, the growth benchmark rose 9.81% and the S&P 500 fell -3.08%. During the quarter, every sector in both indexes advanced. In the growth benchmark, only three sectors—Information Technology, Consumer Discretionary, and Energy (with a near-negligible weighting)—outperformed the overall index.

Fund holdings in virtually every sector contributed positively to absolute and relative return in the quarter, with stock selection and sector weights both broadly beneficial to the Fund's performance. As in the first quarter, positions in the Fund's largest areas—Information Technology and Consumer Discretionary—were especially strong performers.

The impressive performance of many Fund holdings in the quarter reflected indications that the digital transformation of the global economy is accelerating meaningfully. Social-distancing and shelter-in-place directives, necessitated by the pandemic, have underscored the value, utility, and resilience of e-commerce, digitally enabled payment, cloud computing, and streaming business models.

Contributors and Detractors

Amazon and Tesla were among the Fund's top contributors during the second quarter. Amazon continues to benefit from economies of scale and its platform-based business model. Through reinvestment in its business, it continues to strengthen its competitive edge. The AWS web services business is an additional driver of revenue and profit. The company's secular growth profile looks even stronger in the current environment. Amazon's first-quarter revenue, reported in April, exceeded consensus forecasts.

Tesla has surged on a host of impressive financial metrics made possible by solid production, increased capacity, and strong execution. The stock's strong advance reflected indications that, despite the shutdown of its primary factory for half of the second quarter, production rates may have actually accelerated quarter over quarter.

Marriott International was the only security held in the Fund to decline in the quarter. Its "asset-light" model of managing properties, rather than owning capital assets, enhances return-on-invested capital (ROIC) and free cash flow. We trimmed, then eliminated the position on recent lackluster revenue per available room and exposure to the coronavirus's impact on global travel and tourism.

Buys and Sells

We added Spotify and CrowdStrike to the Fund in the second quarter. Spotify is the world's largest pure-play, music-streaming service. It is both driving and benefiting from the ongoing consumer shift from buying music files to accessing music through audio streaming. We believe Spotify's aggressive move into podcasts and launch of a marketplace business have propelled the stock and company to an inflection point and fundamentally changed the competitive dynamics of the industry. The perceived threat from big tech players and the relative power of the music labels have been reduced, as Spotify has used its scale to improve its business model and strengthen its pricing power.

CrowdStrike provides a consolidated, endpoint security platform that protects customers from cyberattacks. It has entered a variety of related markets, including endpoint protection, endpoint search, threat intelligence, endpoint management, cloud workload security, and mobile security. We like the company's rapid growth, large and expanding market, competitive differentiation, significant market share gains, vulnerable competition, and major customer and partner relationships.

We sold positions in Boston Scientific and FleetCor during the quarter. Boston Scientific makes medical supplies and devices used to diagnose and treat various medical conditions. We eliminated the position in May on concerns that elective device procedures could be postponed or cancelled because of the COVID-19 outbreak.

FleetCor provides specific-purpose charge cards (used to purchase fuel and lodging) and payment-processing services for commercial and government trucking fleets. It also has a rapidly growing mobile payments business in Brazil. The stock's recent weakness reflects the filing of a lawsuit by the Federal Trade Commission over the company's marketing and fee practices. Although the dispute will likely be settled, we believe the uncertainty of the outcome presents an overhang that could last several months. We began reducing the position to mitigate the attendant risk and, later in the quarter, because of the company's exposure to oil prices. We eliminated the Fund's holding in June.

Outlook

A new surge in infection rates has led to second thoughts about phased-in reopenings in the U.S., Europe, and most of Asia even though these countries have been more successful in containing the spread of the virus, while conditions in much of Africa and South America remain acute. While strategies for controlling the spread are well-documented, they require will, determination, and a sense of social responsibility. We believe progress in developing a vaccine has been made, but it will be some time before one is approved and widely available. Ramped-up testing and compliance with social-distancing guidelines seem to be prerequisites for broad economic reopening.

Given the uncertainty, companies are taking a cautious approach to near term business planning, and many are suspending financial guidance. Investors and policymakers are wrestling with numerous questions: What are the limits to fiscal stimulus and the Fed balance-sheet expansion? How quickly can unemployed workers be reabsorbed into a reopening economy? Who will win the upcoming U.S. elections, and what are the policy implications?

With the crisis several months old now, its effects on economic activity and behavior have become clearer. Consumers have altered their approach to daily life as work from home leads to greater e-commerce engagement, increased demand for food and grocery delivery, and rising spending and investment in dwellings. In addition, faster adoption of streaming services has resulted in attendant needs for robust internet infrastructure. The transformation of work is equally notable and starts with the same necessity for robust connectivity. Face-to-face meetings, business travel, and office needs are being re-imagined, giving rise to Zoom (and other virtual meeting applications), cloud-based telephony, and remote working.

The second-quarter recovery in equity prices was as swift and dramatic as was their decline in February and March. Perhaps even more remarkable was the number of stocks that closed at record highs as of June 30. The market's bifurcation between winners and losers in a COVID/post-COVID environment has lifted advantaged companies to records, while beleaguered businesses with bleak prospects for recovery have seen equity values atrophy.

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ECONOMIC SECTORS

	% of Net Assets
Information Technology	43.03
Consumer Discretionary	21.55
Communication Services	15.41
Health Care	9.98
Industrials	3.04
Consumer Staples	2.96
Financials	2.56
Real Estate	0.74

TOP TEN HOLDINGS

Company Name	% of Net Assets
1. Amazon.com Inc.	7.57
2. Microsoft Corp.	6.10
3. Apple Inc.	5.79
4. NetFlix Inc.	4.08
5. Tesla Inc.	3.95
6. Facebook Inc.	3.56
7. MasterCard Inc.	3.27
8. Adobe Inc.	3.19
9. NVIDIA Corp.	3.01
10. Salesforce.com Inc.	2.99

TOTAL RETURNS

	Three Months	1 Yr.	5 Yr.	10 Yr.	Since Incp. (12/29/1987)	Expense Ratios Net	Expense Ratios Gross
Harbor Capital Appreciation Fund - *INST*	34.29%	30.30%	16.62%	17.82%	12.34%	0.67%	0.72%
Russell 1000® Growth Index	27.84%	23.28%	15.89%	17.23%	10.91%		
S&P 500 Index	20.54%	7.51%	10.73%	13.99%	10.50%		

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.

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.

The net expense ratios for this fund are subject to a contractual management fee waiver and/or expense limitation agreement, excluding interest expense and acquired fund fees and expenses (if any), through 02/28/2021.

The Russell 1000® Growth Index is an unmanaged index generally representative of the U.S. market for larger capitalization growth stocks. The Standard & Poor's 500 Index is an unmanaged index generally representative of the U.S. stock market. These unmanaged indices do not reflect fees and expenses and are not available for direct investment. The Russell 1000® Growth Index and Russell® are trademarks of Frank Russell Company.

Since the Fund may hold foreign securities, it may be subject to greater risks than funds invested only in the U.S. These risks are more severe for securities of issuers in emerging market regions. At times, a growth investing style may be out of favor with investors which could cause growth securities to underperform value or other equity securities.

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

Views expressed herein are drawn from commentary provided to Harbor by the subadviser, Jennison Associates LLC, and may not be reflective of their current opinions or future actions, are subject to change without prior notice, and should not be considered investment advice.

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