Harbor Capital Appreciation Fund Update – Second Quarter 2020

"We're looking for companies that we believe will grow earnings, revenues, and free cash flow substantially faster than the investible universe. And we believe if we can find companies with these characteristics, we have the potential…for consistent, absolute, and relative earnings growth which leads to strong performance over long-term time periods."

Rick Mastain – Managing Director, Jennison Associates LLC

Overview

Following a tumultuous first quarter, global equity markets rebounded during the second quarter of 2020. The Harbor Capital Appreciation Fund ("the Fund") fully participated in the recovery. Growth significantly outperformed value and, in our view, still has more room to run.

- Earnings drive share prices over the long term. When comparing the rolling 10-year returns for the Russell 1000® Growth and Value indexes, growth stocks have had a tremendous run and have outperformed value stocks. We believe one reason for the large gap between growth and value could be earnings.
- The long-term correlation of earnings to share price is evident when we look at the S&P 500 Index and see how it has risen over time as earnings have increased. This relationship between earnings and stock prices is especially important to point out because a core belief in Jennison's investment philosophy is to identify consistent and persistent earnings growth.

This Time May be Different

When we compare the S&P 500 technology sector today to where it was back in 2000, at the height of the tech bubble, we see that previously, stocks were driven entirely by multiple expansions, whereas today the technology stocks are driven by earnings and cash flow.

- Earnings and free cash flow multiples are roughly 50% lower than the 2000 levels, but the companies are significantly more profitable and have net margins that are nearly double where they were during the tech bubble.
- Furthermore, growth stocks have protected capital or outperformed value stocks during the most recent market dislocation.

Harbor
Trusted Partnerships › Trusted Solutions

Executive Summary

Active Management During Times of Market Stress

We have certainly experienced significant volatility during the last year. Although somewhat counterintuitive, many active managers have held their own during exceedingly difficult periods.

- We believe Jennison's investment process has allowed the Fund to participate broadly during market rebounds.

Investment Philosophy

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

- Jennison looks for companies that they believe will grow earnings, revenues, and free cash flow substantially faster than the investible universe. They also believe if they can find companies with these characteristics, there is the potential for consistent, absolute, and relative earnings growth, which leads to strong performance over long term periods.
- The result of this consistent investment process has historically been preservation of capital during challenging periods. But more importantly, for the long-term investor, it has resulted in strong excess returns, gross and net of fee, since inception, and that performance has been over a decades-long time period. For the long-term investor, this process has worked very well.

Harbor Capital Appreciation Fund Performance

The Fund posted an exceptionally strong quarter.

- The Fund outperformed both its benchmark, the Russell 1000® Growth Index, by nearly 700 basis points (bps) net of fees, and the S&P 500 Index by nearly 1400 bps over the same period.
- During this time of extreme volatility, Jennison remained true to their discipline, which includes never raising cash and never trying to time the market. The Fund was fully invested throughout this entire period, and that has resulted in robust outperformance.

Contributor

Amazon, as a good, work-from-home company, was extremely well-positioned to outperform during this quarter.

- Online sales have increased from 15% of total discretionary dollars spent near the beginning of the year, to about 25% today, and that is largely why Amazon has done so well.

Detractor

Hospitality company Marriott, which is no longer in the Fund, detracted from quarterly returns.

- Jennison believes it is an excellent company with a broad range of products, but during this period of lockdown and reduced travel, it's a name that they feel will take several years to come back to the prosperity it enjoyed in 2019.

Top Holdings

The top ten holdings account for roughly 45% of the Fund.

- Tesla is a name that Jennison has owned since 2013, but the company's price performance has been especially remarkable since the beginning of the fourth quarter of last year. It is a top ten name today based solely on price appreciation. Jennison believes the long-term growth outlook for this company justifies its position as a top 10 Fund name.
- Apple is a name that Jennison purchased in 2004. They have maintained the position for several reasons. One reason is because about 25% of the company's revenue comes from services, such as recurring monthly payments for apps, Apple iTunes, and telephone leases. These numbers are increasing dramatically and are a sustainable, recurring revenue model. Apple has done very well over the years and remains a top 10 position in the Fund.

Jennison's Outlook

The challenge for investors today is that the remainder of 2020 is extremely difficult to forecast. Jennison believes a recovery is occurring, but the magnitude is difficult to gauge, and it will likely be different by region, as well as by company.

- While Jennison is very aware of the macro environment, it does not drive decisions on buys and sells.
- The potential for a second wave of COVID-19 spikes means those companies, restaurants, etcetera, which are important to the employment base, may take longer to get people back to work. When companies talk about earnings, they may have a tough time being specific. Jennison anticipates earnings growth in the Fund in 2021.
- Jennison is most excited about how companies are using innovation and technology to adapt to the work-from-home and social distancing environment.
- Jenison thinks the Fund, by the nature of how they invest, is well-positioned to withstand difficult periods. The recent period of market volatility is, unfortunately, as good an example as we've had in many years of how the Fund can excel during a challenging period.

Harbor
Trusted Partnerships › Trusted Solutions

Legal Disclosures

The views expressed herein are those of Harbor Capital Advisors, Inc. and/or Jennison Associates LLC investment professionals at the time the comments were made. They may not be reflective of their current opinions, are subject to change without prior notice, and should not be considered investment advice. The information provided in this presentation is for informational purposes only.

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

The information provided in this presentation should not be considered as a recommendation to purchase or sell a particular security. The weightings, holdings, industries, sectors, and countries mentioned may change at any time and may not represent current or future investments.

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.

There is no guarantee that the investment objective of the Fund will be achieved. Stock markets are volatile and equity values can decline significantly in response to adverse issuer, political, regulatory, market and economic conditions. 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. 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.

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. market for large capitalization equities. 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.

As of 6/30/2020, the Fund’s top ten holdings were: Amazon.com Inc. (7.6%), Microsoft Corp. (6.1%), Apple Inc. (5.8%), NetFlix Inc. (4.1%), Tesla Inc. (4.0%), Facebook Inc. (3.6%), MasterCard Inc. (3.3%), Adobe Inc. (3.2%), NVIDIA Corp. (3.0%), Salesforce.com Inc. (3.0%).

Distributed by Harbor Funds Distributors, Inc.