Harbor Convertible Securities Fund

Manager Commentary
As of 06/30/2020

Subadviser: Shenkman Capital Management, Inc. *(Since 05/11/2011)*
Portfolio Managers: Mark R. Shenkman, Justin W. Slatky, Raymond F. Condon, Jordan N. Barrow, CFA, Thomas Whitley, CFA

2nd Quarter, 2020

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Shenkman Capital Management, Inc.

Market in Review

Spurred by optimism for the gradual reopening of the U.S. economy and buoyed by continued Federal Reserve (the Fed) monetary intervention and U.S. government fiscal stimulus, the S&P 500 Index continued to rally off the March lows to finish June at 3100.29 points, returning 20.54% for the quarter. The S&P 500 return now stands at -3.08% year-to-date.

We saw a marked reduction in volatility during the quarter. The CBOE (Chicago Board Options Exchange) Volatility Index closed June at 30.53 points, after setting a twelve-month high of 82.69 points in March, and consequently, related equity markets rallied. As a result of these events, the underlying convertible values of the Harbor Convertible Securities Fund (the "Fund") now reflect a more balanced profile in contrast to the more defensive posture seen at the end of March. The average-weighted, estimated investment premium of the Fund was calculated at 33.77% at the end of June, versus 20.65% at month's end in March. The average-weighted, underlying equity premium of the Fund contracted from 61.03% to 33.97% over the same period. Despite the shift in underlying valuations between debt and equity throughout the quarter, we anticipate that given the COVID-19-related uncertainties facing domestic and world economies, there will be a continued emphasis on the importance of selectivity, based on credit analysis, in determining appropriately valued convertibles.

Portfolio Performance

In the second quarter of 2020, the Harbor Convertible Securities Fund (Institutional Class) returned 23.06%, underperforming its benchmark, the ICE BofAML US Convertible Ex Mandatory Index, which returned 25.92%.

All industries within the Fund, except energy, exhibited strong performance and posted positive returns.

The principal differential between the Fund and the Index was an underweight exposure in the most equity-like section of the marketplace, in other words, those convertibles trading with an investment premium of 100% or more. Stylistically, we tend to lighten or sell these securities due to their extreme equity sensitivity and lack of downside protection. During the quarter, the Fund's average weighting in the 100% investment premium bucket was 3.7%, returning 31.69% with a contribution of 165 basis points (bps). The Index's average weighting of 20.80% returned 52.02% with a contribution of 945 bps.

The most significant detractor from relative performance was underweight positioning in automobiles, namely Tesla, the sole industry constituent. The Fund sold its remaining "stub" of 0.23 bps in the company during the quarter. Software, the largest industry in the Fund, detracted from relative performance due to underweights in Coupa and Service Now. Semiconductors also detracted from relative performance due to underweight exposure in the industry's top performer, Microchip.

The best performing industries in the Fund were banks, hotels and leisure, internet marketing, equity REITs, and health-care technology. In banks, the Fund had no exposure to the perpetual preferred securities of Bank of America and Wells Fargo. In hotels and leisure, the Fund benefited from opportunistic purchases of new issues from Carnival Corporation, Penn National Gaming, and Norwegian Cruise Line, each looking to shore up their balance sheets. In internet marketing, the Fund benefited from an overweight allocation to Etsy and an out-of-index position in MercadoLibre, with both being beneficiaries of the "stay/work-at-home" phenomenon.

Portfolio Positioning

As a matter of style, we do not position the Fund relative to the unconstrained benchmark.

The sudden resurgence of the convertible new issue calendar with 92 deals in the quarter, raising $53.2 billion compared to $44.0 billion of average annual new issuance over each of the preceding four years, combined with the sustained rally in underlying equities, provided numerous opportunities to continue to sell Fund names with declining or diminishing optionality and lighten or sell positions that had materially appreciated. Additionally, it allowed for further diversification of the Fund by adding selective creditworthy names with balanced convertible profiles.

Contributors and Detractors

The two largest detractors from absolute Fund performance during the quarter were Oil States International and J2 Global. Together they detracted 31 bps from overall returns. Oil States, a provider of products and services for offshore oil and gas production, has experienced a deterioration of revenue. Consequently, we have exited the position. J2 Global, a provider of cloud-based, e-mail and fax services, noted recent weakness in its online advertising business.

The two largest contributors to absolute Fund performance during the quarter were Wayfair and Etsy. Wayfair delivered a total return of 147.79% and contributed 124 bps, while Etsy returned 77.52% and contributed 119 bps. Both companies are e-commerce specialty retailers that benefited from the "stay/work-at-home" phenomenon.

Buys and Sells

On May 26, the Fund purchased first-time issuer Datadog, and in just over a month, the position returned 18.41% and contributed 16 bps to performance. Datadog is a cloud-based, monitoring and analytics platform for developers and IT operations teams. We believe the company's technology is aligned with the growing secular trend toward improved visibility within IT apps and infrastructure.

During the quarter, we sold several "out of the money" positions due to declining or insufficient optionality in a rising market. These positions included Tutor Perini, Oil States International, VALEO, Verint Systems, OSI Systems, and Chart Industries.

Outlook

Given recent market upheaval and uncertainty combined with still elevated volatility, we believe that long term prospects remain constructive for convertible securities. These include a balanced posture of the current convertible market with an emphasis on credit, core-issuer base with long term growth characteristics, new issue conduit for backed-up high yield and/or equity issuers, potential upside combination of underlying equity improvement, and credit spread tightening.

As we experience an unprecedented period of economic uncertainty, with associated periods of heightened volatility, we anticipate that the market is likely to favor more balanced convertible securities with positive credit profiles and place a premium on reward versus risk.

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ECONOMIC SECTORS

	% of Net Assets
Information Technology	41.12
Health Care	16.30
Communication Services	15.55
Consumer Discretionary	11.51
Industrials	5.28
Financials	3.59
Energy	1.77
Real Estate	0.87
Consumer Staples	0.54
Utilities	0.11

TOP TEN HOLDINGS

Company Name	% of Net Assets
1. BioMarin Pharmaceutical Inc.	2.07
2. Microchip Technology Inc.	1.98
3. Dish Network Corp.	1.90
4. Palo Alto Networks Inc.	1.81
5. Etsy Inc.	1.57
6. ON Semiconductor Corp.	1.55
7. Zillow Group Inc.	1.51
8. Blackstone Mortgage Trust Inc.	1.47
9. Bilibili Inc.	1.43
10. Booking Holdings Inc.	1.41

TOTAL RETURNS

	Three Months	1 Yr.	5 Yr.	10 Yr.	Since Incp. (05/01/2011)	Expense Ratios Net	Expense Ratios Gross
Harbor Convertible Securities Fund - *INST*	23.06%	11.83%	6.62%	N/A	6.16%	0.77%	0.82%
ICE BofAML US Convertible Ex Mandatory Index	25.92%	17.79%	10.45%	N/A	10.00%		

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 countries mentioned may change at any time and may not represent current or future investments.

The Fund charges a redemption fee of 1.00% on redemption of shares that are held for less than 90 days.

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 ICE BofAML US Convertible Excluding Mandatory Index is broadly representative of the U.S. convertible securities market, consisting of publicly traded issues, denominated in U.S. dollars, of all credit qualities, and excluding mandatory (equity-linked) convertibles. This unmanaged index does not reflect fees and expenses and is not available for direct investment.

Convertible securities generally tend to be of lower credit quality and the value of a convertible security generally increases and decreases with the value of the underlying common stock, but may also be sensitive to changes in interest rates. As interest rates rise, the values of convertible securities held by the Fund are likely to decrease and reduce the value of the Fund's portfolio. Credit risk is higher for the Fund because it invests primarily in convertible securities of companies with debt rated below investment grade. High yield investing poses additional credit risk related to lower-rated bonds.

Views expressed herein are drawn from commentary provided to Harbor by the subadviser, Shenkman Capital Management, Inc., 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.

Credit quality breakdown is based on ratings from Standard and Poor's. Ratings are measured on a scale that generally ranges from AAA (highest) to D (lowest). A bond rated AAA is the most creditworthy, while a bond rated BB or below is much riskier. Any security that has not been given a credit rating by Standard & Poor's is listed as "not rated". The credit quality of securities in the Fund's portfolio does not apply to the stability or safety of the Fund. The Fund itself has not been rated by an independent rating agency. The ratings breakdown noted are as of 12/31/2019 and may not represent current or future holdings.

Investors should carefully consider the investment objectives, risks, charges and expenses of a Harbor fund before investing. A summary prospectus or prospectus for this and other information is available at harborfunds.com or by calling 800-422-1050. Read it carefully before investing.

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