# Harbor Focused International Fund

**Manager Commentary**
*As of 12/31/2019*

**Subadviser:** Comgest Asset Management International Limited *( Since 06/01/2019)*
**Portfolio Managers:** Laure Négiar, CFA, Zak Smerczak, CFA, Alexandre Narboni, Richard Mercado, CFA

4th Quarter, 2019

**"The dovish pivot in monetary policy and signs of protectionist barriers potentially unwinding have fueled multiple expansion across all sectors and styles of equities, while sending bond yields to historic lows."**

Comgest Asset Management International Limited

## Market in Review

Political uncertainty in the U.K. has been removed by the election, with a consequent reduction of risk in Europe, while growth in China has exceeded expectations. Optimism over a reported trade-war resolution led the International Monetary Fund (IMF) to raise its 2020 Gross Domestic Product (GDP) growth forecast for China from 5.8% to 6%, while the global economy is now expected to grow 3.2%, higher than in 2019 despite a sequential slowdown in the U.S.

The 2019 market environment, globally, absorbed many questions around geopolitical instability and finished with strong performance in the fourth quarter of the year. Fundamentals matter, and, fundamentally, the global economy remained clear of recession, with the lowest level of unemployment seen across most major economies in years. The year was capped off by a fourth-quarter market rally fueled by risk-on sentiment from improved U.S. and Eurozone manufacturing surveys, robust employment (albeit mainly in the U.S.), and healthy service sector indicators. Not to mention the avoidance of two political risks – continued Brexit uncertainty, thanks to a landslide Conservative win, and another round of U.S. tariffs, thanks to a 'phase one' deal with China.

As bottom-up stock pickers, macro level events have no impact on our Fund-level decision making. However, the year did see multiple expansion across stocks in various sectors and regions. We continue to closely watch the valuation of all stocks in our universe relative to the strength of their fundamentals.

## Portfolio Performance

In the fourth quarter of 2019, the Harbor Focused International Fund (Institutional Class) returned 6.02%, underperforming its benchmark, the MSCI All Country World Ex. US (ND) Index, which returned 8.92%.

The Fund performed well in absolute terms during the fourth quarter but failed to keep pace with the stronger return of the Index. Befitting of our quality growth approach, the Fund did not receive the same boost from the beta rally in the fourth quarter as the market. While nothing was wrong fundamentally with our Fund positioning, some of our more quality-tilted positions, the likes of Kose (Japanese personal care company), Unilever (global consumer goods), and Heineken (global beer brand) produced an average return of closer to 4%, lagging the Index's return of over 8% and creating a relative performance headwind. We remain confident in the long-term compound ability of these companies and continue to view them as attractive investments for the Fund.

**Contributors and Detractors**

Top contributors for the quarter included Hoya and Hikari Tsushin. Hoya is a leading Japanese company focused on the manufacturing of optical lenses and products. The company has a multi-decade history of focusing on global core strengths where it is the only or a duopoly player, for example, extreme ultraviolet lithography (EUV) blanks, glasses, and substrates. The company continued to execute on its full year and long-term plan into the fourth quarter, leading to strong contribution to Fund performance.

Hikari Tsushin is a Japanese corporate solutions provider, selling WiFi routers, mobile data packages, and office equipment (copiers, water servers, etc.) - focused on the small- and medium-sized enterprises (SME) space in Japan. Essentially, a one-stop shop, with unmatched distribution strength across Japan. Hikari Tsushin's organic operating profit growth was in high 20 percent – as its range of services for small Japanese companies continues to win popularity – which helped boost the stock's performance.

Kose was a significant detractor during the quarter. Kose is one of Japan's leading cosmetics companies, competing with Shiseido and Kao. Its Kose brand and individual brands allow it to capture both the high-end/prestige market and the discount toiletries market. The company faced some operating margin pressure, as it needs to invest more in SG&A (selling, general, and administrative expenses) to protect its brand placement. Slowing inbound tourism also had a negative impact. We are closely monitoring the stock for signs of improvement.

Another detractor from Fund performance was Unilever, the global consumer goods company with hundreds of brands covering personal care and home care, including Dove, Axe, Magnum, Lipton, Ben & Jerrys, and more. With 14 brands drawing more than $1 billion in revenues each, the company is well diversified, with strong cash flow. Nothing fundamental drove the weaker contribution to performance; the stock was just out of favor during the fourth quarter beta rally.

**Buys and Sells**

We bought Alibaba during the quarter. Alibaba is the most integrated operator and market leader along the e-commerce value chain in China. We believe the company could grow its earnings per share at a rate of 30%-plus. As of December 31, the stock was trading below a mid-20s multiple, which put it below its longer term average valuation. We believe in Alibaba as a long-term, secular growth opportunity, given the company's dominant market share in China's growing e-commerce channel. We capitalized on the attractive valuation to begin a position.

We sold Makita during the quarter. Makita, a leading Japanese power tool manufacturer that competes with the likes of Stanley Black & Decker, continued to report dampened earnings growth potential due to trade-induced pressures as a result of roughly 60% of its manufacturing being based in China. With too much uncertainty around when its earnings growth could resume given a number of variables, we felt the visibility we require was lacking and therefore exited the position.

**Country Allocation**

The Fund's country allocations did not change materially during the quarter. Please note that country allocations, both absolute and relative, are the result of our stock picking approach and fundamental analysis. For instance, the purchase of Alibaba and Tencent, absent a corresponding sale, impacted our aggregate China weighting.

**Outlook**

The dovish pivot in monetary policy and signs of protectionist barriers potentially unwinding have fueled multiple expansion across all sectors and styles of equities, while sending bond yields to historic lows. We believe that 2020 is unlikely to be so indiscriminate, and we anticipate that 2019-level returns might be harder to find. It is difficult for us to imagine equity performance being driven by anything other than underlying earnings growth, given that valuations are starting from a higher point. For instance, if the European market valuation rises by a similar amount in 2020, the NTM (next 12 months) price/earnings ratio would reach 19 times, a level last seen during the dot-com mania of the 1990s. Moreover, we see less room for global monetary stimulus; fiscal tax overhauls are a thing of the past; phase one of the U.S.-China trade deal looks promising, but may not deliver; and rates of any consequence are near zero. While it seems unlikely that the U.S. or global economy will slip into a recession over the near-term, risks do remain, which, together with the current market backdrop, may create further volatility.

While the individual variables always change, nothing in the potential outlook materially alters our view, as we remain resolute in our focus on underlying business models and the ability of specific companies to continuously compound their earnings. We are disciplined quality growth investors, which means the Fund today is invested in long-term, structurally sustainable and secular growers, while maintaining what we believe to be an attractive Fund valuation. To quote one of our Comgest founders over an informal catchup when asked for some advice: "Simply do your job and do it well." We shall endeavor to keep doing so.

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## ECONOMIC SECTORS

| | % of Net Assets |
|---|---|
| Consumer Staples | 23.92 |
| Information Technology | 18.38 |
| Consumer Discretionary | 15.77 |
| Health Care | 12.38 |
| Financials | 9.14 |
| Industrials | 8.33 |
| Communication Services | 4.78 |
| Materials | 3.03 |

## TOP TEN HOLDINGS

| Company Name | % of Net Assets |
|---|---|
| 1. Ping An Insurance Group Co. of China | 6.04 |
| 2. Hikari Tsushin Inc. | 5.16 |
| 3. Hoya Corp. | 4.69 |
| 4. Inner Mongolia Yili Industrial Group | 4.57 |
| 5. L'Oreal SA | 4.57 |
| 6. Heineken NV | 4.46 |
| 7. Roche Holding AG | 4.06 |
| 8. SAP SE | 3.99 |
| 9. Hangzhou Hikvision Digital Technology | 3.92 |
| 10. Fomento Economico Mexicano SAB de CV | 3.77 |

## ADDITIONAL HOLDINGS

| Company Name | % of Net Assets |
|---|---|
| Unilever plc | 3.36 |
| Tencent Holdings Ltd. | 2.11 |
| Alibaba Group Holding Ltd. ADR | 1.56 |
| Kose Corp. | 1.52 |
| Kao Corp. | 0.00 |
| Makita Corp. | 0.00 |
| Shiseido Company, Limited | 0.00 |
| Stanley Black & Decker, Inc. | 0.00 |

## TOTAL RETURNS

| | Three Months | 1 Yr. | 5 Yr. | 10 Yr. | Since Incp. (06/01/2019) | Expense Ratios Net | Expense Ratios Gross |
|---|---|---|---|---|---|---|---|
| **Harbor Focused International Fund** - *INST* | 6.02% | N/A | N/A | N/A | 11.64% | 0.85% | 2.35% |
| MSCI All Country World Ex. US (ND) Index | 8.92% | N/A | N/A | N/A | 13.41% | | |

## TOP TEN COUNTRIES

| Country | % of Net Assets |
|---|---|
| Japan | 30.69 |
| China | 22.55 |
| France | 7.54 |
| United Kingdom | 6.54 |
| Switzerland | 6.33 |
| Netherlands | 4.46 |
| Germany | 3.99 |
| Mexico | 3.77 |
| Hong Kong | 3.10 |
| Spain | 2.98 |

***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.*

*Expense ratio information is as of the Fund's current prospectus, as supplemented. Gross expenses are the Fund's total annual operating expenses. The net expense ratios for this fund are subject to an expense limitation agreement, excluding interest expense, if any, through 05/31/2020.*

*The MSCI All Country World Ex. US (ND) Index is a free float-adjusted market capitalization weighted index that is designed to measure equity market performance in the global developed and emerging markets, excluding the United States. This unmanaged index does not reflect fees and expenses and is not available for direct investment.*

*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. Investing in foreign and emerging markets poses special risks, including potentially greater price volatility due to regulatory, social, political and economic factors, as well as currency exchange rate fluctuations. These risks are more severe for securities of issuers in emerging markets.*

*The Fund may invest in a limited number of companies and from time to time, the Fund may be more heavily invested in particular countries, geographic regions or sectors. As a result, the Fund's performance may be more volatile, and you may experience greater losses.*

*Views expressed herein are drawn from commentary provided to Harbor by the subadviser, Comgest Asset Management International Limited, 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.*

***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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