Harbor High-Yield Bond Fund

Manager Commentary
As of 06/30/2020

Subadviser: Shenkman Capital Management, Inc. *(Since 12/01/2002)*
Portfolio Managers: Mark R. Shenkman, Justin W. Slatky, Eric S. Dobbin, Robert S. Kricheff, Neil Wechsler, CFA, Jordan N. Barrow, CFA

2nd Quarter, 2020

"As uncertainty continues to be the recurring theme, our team has an approach to be balanced and cautious, while looking to selectively take advantage of the likely periodic dislocations."

Shenkman Capital Management, Inc.

Market in Review

The rapid introduction of monetary and fiscal programs swiftly changed the environment for the capital markets, and, to a lesser extent, for the broad economy in the second quarter. This created an environment that reopened the access to finance for many companies. Record levels of new issuance were set in high yield bonds, and substantial volumes were seen in investment grade, convertibles, and the leveraged loan market.

Whether or not a company was in the direct target of the COVID-19-related shutdowns, the ability to access capital and improve balance-sheet strength rapidly became a major differentiator in security performance in the credit markets. Companies that accessed the markets primarily added cash to their balance sheets or refinanced upcoming debt maturities. The net effect was the strengthening of their balance sheets, though cash flows are generally going to be under pressure, in our view.

This increased the value of credit selection, and the outperformance of the Harbor High-Yield Bond Fund (the "Fund") relative to the ICE BofAML US Non-Distressed High Yield Index, the Fund's benchmark, was primarily driven by better selection and was most notable in the CCC-rated credit category. The Fund's CCC-rated issues posted a 14% return versus the 6.1% return for the benchmark.

Portfolio Performance

In the second quarter of 2020, the Harbor High-Yield Bond Fund (Institutional Class) returned 9.04%, outperforming its benchmark, the ICE BofAML US Non-Distressed High Yield Index (H0ND), which returned 7.98%. The Fund underperformed the broader market index, the ICE BofAML US High Yield Index (H0A0), which returned 9.61%.

On an industry basis, our selection in oil & gas (both exploration & production and storage & transport), along with an increased allocation to storage & transport, contributed to relative performance. Combined, these two oil & gas segments had a total effect of +103 basis points. Our underweight in automotive was a detractor to relative performance. However, our better selection helped to counterbalance the negative effect, and we increased our exposure to the sector during the quarter. Our selection in building products also detracted from relative performance. Together, these two sectors had a total effect of -21 basis points.

By credit quality, our selection in B-rated and CCC-rated and below credits (CCC and below) added +159 basis points on a relative basis. While only an average 7% weighting in the Fund, CCC and below-rated credits contributed 10% of the return. Our underweight and selection in BB-rated credits detracted -54 basis points from relative performance.

Out-of-benchmark positions included bank loans, BBB-rated crossover credits, and convertible bonds. All of these positions contributed to positive attribution versus the benchmark. As of the quarter end, these positions accounted for approximately 14% of the Fund. BBB-rated credits contributed +33 basis points to relative performance, with bank loans and convertible bonds contributing +3 basis points and +19 basis points, respectively.

Portfolio Positioning

The Fund's duration declined approximately 0.3 years and remains slightly shorter than the benchmark. We believe the Fund now has a slightly steeper curve than it did versus the benchmark, notably increasing exposure in the 6-to-8-year, option-adjusted duration (OAD) portion of the market, primarily in higher rated issuers. This segment of the market outperformed the broader index.

The Fund increased exposure to the automotive industry and the exploration & production segment of the oil & gas industry. It reduced exposure to the telecom services and building products industries. In media, the Fund is overweight in cable & satellites, which remains one of its largest active positions. The Fund continues to have no exposure to airlines.

We did not make major shifts by credit rating category during the quarter. We are underweighted in BB-rated issues, but we have about 6% of the Fund invested in BBB-rated issues and roughly the same amount in leveraged loans. Net, the allocation effect between these three positions was a positive for the Fund, with loans' and BBB-rated issues' positive impact counterbalancing the negative impact of the underweighted position in BB-rated issues.

From a currency perspective, we invest exclusively in U.S. Dollar-denominated, fixed income securities.

Country positioning was not a significant factor in overall performance during the quarter.

Contributors and Detractors

QEP Resources was one of the largest contributors in the second quarter. This was one of the exploration & production credits within oil & gas that we chose to hold through the first quarter's sharp drop in oil prices. We liked the company's relative balance-sheet profile and its asset holdings, and it benefited as oil prices rebounded. Murphy Oil was another credit with a similar return profile and rationale.

T-Mobile was also one of the largest contributors to performance. This long-held position outperformed, as the merger with Sprint closed, and investment grade-driven refinancing of much of the company's capital structure was undertaken.

Diamond Sports was one of the larger detractors to performance in the second quarter. Much of the programmer's revenue is related to broadcasts of professional basketball and baseball games and was affected by the lockdown and struggles in trying to restart both seasons. We do believe there is significant optionality in the company's franchises and its relationships with cable and satellite carriers.

Meredith was another negative contributor to performance. Its business mix includes magazines and related technology products, which have lagged many other media assets.

Buys and Sells

We purchased Occidental Petroleum in the second quarter. We became more constructive on the company's ability to manage its maturing debt with the bottoming of oil prices and, more importantly, the company's recent $2 billion unsecured bond issuance. In our view, the issuance proved Occidental's ability to access capital markets without priming existing debt, which had been a market concern. It also signified management's focus on maintaining a unified debt-priority structure.

The company still has $9 billion in debt maturing in 2021 and 2022. However, we feel the company has a number of levers for managing the debt coming due. This includes balance-sheet cash and free cash flow through 2021 (approximately $3 billion), asset sales (a $2 billion target for 2020), and a $5 billion undrawn revolving credit facility.

Caesars Entertainment was sold to take advantage of higher prices, as the new Eldorado Resorts capital raising (as part of its merger with Caesars) was announced. In the second quarter, casinos were beginning to reopen, and numbers were strong, but we anticipate that it will take time for business performance to recover. Caesars' exposure to Las Vegas will likely lead to a longer recovery time and more volatility compared to other operators, in our view. Also, with the recent debt raise, nearly $1 billion of additional secured debt will be ahead of the company's unsecured bonds.

Outlook

We believe the third quarter is likely to see more mixed performance than the first two quarters of the year. Worries over a surge of COVID-19 cases, company outlooks during earnings season, and the U.S. election in November are all likely to result in more mixed results for the third quarter, thus increasing the value of credit selection. As uncertainty continues to be the recurring theme, our team has an approach to be balanced and cautious, while looking to selectively take advantage of the likely periodic dislocations.

Our view is made in the context of several macro expectations, which include the yield on the U.S. 10-year Treasury staying range-bound on either side of 0.75%, low inflation, and a slightly weaker U.S. Dollar. Our view also takes into account expectations that payrolls do not begin to see consistent growth until the second quarter of 2021, and that Gross Domestic Product (GDP) increases in the third quarter but will be flat after that.

We believe the biggest factor to watch is employment within small-to-medium-sized businesses and the services sector. The biggest wildcard is the U.S. election. We expect equities to grind higher, but performance to be more stratified, with technology outperforming, while services lag. A surprise to the upside could be manufacturing, in our view.

Harbor™
Trusted Partnerships › Trusted Solutions

Harbor High-Yield Bond Fund

Manager Commentary
As of 06/30/2020

Subadviser: Shenkman Capital Management, Inc. *(Since 12/01/2002)*
Portfolio Managers: Mark R. Shenkman, Justin W. Slatky, Eric S. Dobbin, Robert S. Kricheff, Neil Wechsler, CFA, Jordan N. Barrow, CFA

ECONOMIC SECTORS

	% of Net Assets
Communication Services	17.58
Health Care	13.45
Industrials	13.42
Consumer Discretionary	12.82
Information Technology	10.45
Energy	10.11
Financials	6.37
Materials	4.54
Consumer Staples	3.05
Utilities	2.60
Real Estate	2.13

TOP TEN HOLDINGS

Company Name	% of Net Assets
1. CSC Holdings LLC	1.08
2. Dell International LLC / EMC Corp.	1.02
3. Bausch Health Cos Inc.	0.86
4. Sprint Capital Corp.	0.81
5. United Rentals North America Inc.	0.80
6. Hughes Satellite Systems Corp.	0.79
7. Centene Corp.	0.77
8. Vistra Operations Co. LLC	0.75
9. XPO Logistics Inc.	0.71
10. Iron Mountain Inc.	0.70

TOTAL RETURNS

	Three Months	1 Yr.	5 Yr.	10 Yr.	Since Incp. (12/01/2002)	Expense Ratios Net	Expense Ratios Gross
Harbor High-Yield Bond Fund - *INST*	9.04%	-0.22%	3.52%	5.33%	6.40%	0.65%	0.74%
ICE BofAML US Non-Distressed High Yield Index	7.98%	0.49%	4.90%	6.67%	7.14%		
ICE BofAML US High Yield Index (H0A0)	9.61%	-1.10%	4.58%	6.48%	7.97%		

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 Non-Distressed High Yield Index (H0ND) is a subset of the ICE BofAML US High Yield Index (H0A0) including all securities with an option-adjusted spread less than 1,000 basis points. The ICE BofAML US High Yield Index (H0A0) is an unmanaged index that tracks the performance of below investment grade U.S. Dollar-denominated corporate bonds publicly issued in the U.S. domestic market. All bonds are U.S. Dollar-denominated and rated Split BBB and below. These unmanaged indices do not reflect fees and expenses and are not available for direct investment.

Fixed income investments are affected by interest rate changes and the creditworthiness of the issues held by the Fund. As interest rates rise, the values of fixed income securities held by the Fund are likely to decrease and reduce the value of the Fund's portfolio. High yield investing poses additional credit risk related to lower-rated bonds.

Credit quality breakdown is based on ratings from Moody's, Standard and Poor's and Fitch. In cases where the security is rated by two or more of the rating agencies, an average is provided. In cases where only one rating agency has assigned a credit rating to a security, that rating is used. Ratings are measured on a scale that generally ranges from AAA (highest) to D (lowest). Securities that receive no rating from an independent agency have been categorized as 'not rated.' Certain unrated securities (such as derivatives) are not reflected in the data shown. U.S. Treasury and U.S. Agency securities appear under the category U.S. Government/Agency. 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 credit quality breakdown is based on market value, excluding cash and accrued interest, and portfolio characteristics and holdings are subject to change at any time. The ratings breakdown noted are as of 12/31/2019 and may not represent current or future holdings.

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.

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.

Harbor Funds is distributed by Harbor Funds Distributors, Inc.