Harbor Large Cap Value Fund

Manager Commentary
As of 06/30/2020

Subadviser: Aristotle Capital Management, LLC *(Since 05/25/2012)*
Portfolio Managers: Howard Gleicher, CFA, Gregory D. Padilla, CFA

2nd Quarter, 2020

"As always, we believe a long term focus is paramount for equity investing."

Aristotle Capital Management, LLC

Market in Review

After suffering its worst quarter in over a decade, the U.S. stock market rebounded with its best quarter since 1998, as the S&P 500 Index rallied 20.54% in the second quarter of 2020. In terms of style, the Russell 3000® Growth Index outperformed its Value counterpart by 13.44% during the period. On a sector basis, all eleven sectors of the S&P 500 and Russell 1000® Value indexes finished higher for the quarter, and all but two sectors posted double-digit gains. Within the Russell 1000® Value Index, Energy, Consumer Discretionary, and Materials were the biggest winners, while Utilities, Consumer Staples, and Financials increased the least.

The devastating global impacts of COVID-19 persisted throughout the quarter, with total cases eclipsing 10 million and more than 500,000 related deaths. Economic data for April revealed an unemployment rate of 14.7%, the highest rate in the history of the data, as well as a double-digit decline in consumer spending. Despite the dismal economic data, equity markets rallied as many states initiated early phases of the reopening process. Moreover, the unemployment rate improved to 13.3%, and consumer spending rebounded by 8.2% in May. Additionally, a continued accommodative monetary policy from the Federal Reserve and the potential for incremental fiscal stimulus contributed to the market's optimism. Against this backdrop, the Fund posted its strongest quarterly return since its inception. While we are pleased to report a strong rebound in returns, we would caution that the short term nature of these outsized returns may not persist. As always, we believe a long term focus is paramount for equity investing.

Portfolio Performance

In the second quarter of 2020, the Harbor Large Cap Value Fund ("the Fund" Institutional Class) returned 20.89%, outperforming both its benchmark, the Russell 1000® Value Index, which returned 14.29%, and the S&P 500 Index, which returned 20.54%.

The Fund's relative outperformance this quarter can be attributed to both security selection and allocation effects. Security selection was positive in all but four sectors, with Information Technology and Financials being the top contributors. Additionally, an underweight position in Utilities positively added to relative returns. In contrast, security selection in Materials, Energy, and Consumer Staples detracted from overall results. (Relative weights are the result of bottom-up security selection.)

Contributors and Detractors

PayPal, the online and mobile e-commerce payments company, was the top contributor to relative performance during the second quarter. Shares of the company increased sharply, as recent lockdown measures have accelerated the ongoing transition from physical to e-commerce activity. During the quarter, PayPal announced a record-breaking, 7.4 million net new accounts in April, bringing the total number of active accounts to over 330 million, another record. Furthermore, the company experienced record levels of customer engagement, as the daily number of transactions increased by 25.0%, including the largest single-day of transactions in the company's history on May 1st. While we are encouraged by the elevated level of new users and customer engagement, we do not get overly excited by these short term data points. Instead, we will continue to focus on the long-term benefits the current environment may have on PayPal's business. Studies show that the increase in U.S. e-commerce penetration over the past few months rivals the gains made over the last decade. This accelerated transition could mark an inflection point in the secular shift toward e-commerce.

Xylem, a water equipment and services supplier, detracted from relative returns during the quarter. Shares declined as first quarter earnings were impacted by shutdowns of factories, supply chains, and customer operations around the world. Management pulled 2020 guidance and noted an expectation for organic revenue and margins to be further negatively impacted as its customers reassess future expenses. In response, Xylem announced restructuring initiatives, such as accelerating the reduction of overhead costs and reprioritizing investments to customers' post-COVID-19 needs. While customers and Xylem's business may continue to be pressured in the near term, we believe the company's financial strength will allow it to weather the short term storm and unlock value through operational improvements and technological investments as conditions normalize.

Buys and Sells

We acquired the California-based, telecommunications equipment company Qualcomm during the quarter. The group develops and licenses wireless technology and designs chips for smartphones. Its key patents revolve around CDMA and OFDMA technologies, which are the channel access methods for wireless communications devices, including 3G and 4G networks. Qualcomm charges a royalty fee on every device sold that uses its technologies, including smartphones. The company benefits from an asset-lite production model, which has allowed it to achieve attractive returns over time. Qualcomm's product offering is among the broadest in handset supply; it spans baseband, transceiver, radiofrequency, front end, and antennas. Catalysts we expect to see over our investment horizon include Qualcomm's continued ability to monetize its vast library of telecommunications-intellectual property, benefits from a large adoption of low-latency 5G technologies—a game changer in our opinion—the resolution of remaining legal issues about intellectual property royalties, most of which have been resolved or are on their way to resolution, and free cash flow deployment in shareholder-friendly manners.

Our holding in Home Depot was liquidated during the quarter. We first invested in the company in 2007, and our investment decision at the time was driven by what we saw as a high quality business undergoing a major transformation led, at the time, by new CEO Frank Blake. That transformation continued years later after his retirement in 2014, under the leadership of Craig Menear. During our holding period, Home Depot sold non-core businesses, improved the customer experience, deployed and implemented technology, and redesigned its supply chain—for example, by building distribution centers across the nation. In more recent years, the firm also improved the interconnectivity of its stores, invested in its online platform, and gained a share of the professional “pro” customers. While we continue to admire this business, we decided to sell to make room for a new investment opportunity.

Outlook

Although the current trajectory of the market may seem to indicate that the worst is behind us, we believe a great deal of uncertainty remains. With a myriad of economic, social, and political issues still at hand, volatility may persist. Furthermore, questions surrounding the COVID-19 pandemic’s long term impact on new and existing trends have yet to be answered. A few examples are the further rise of e-commerce, the digital transformation, the continued slippage of physical retailers, and increasing total debt loads for most countries around the world. Nevertheless, we will not invest based solely upon these trends. Our knowledge of them is driven primarily by our studies of individual companies. We seek out companies that are largely in control of their own destinies, not those dependent on “trends” or “markets.” This studious approach, we can assure you, will not change.

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ECONOMIC SECTORS

	% of Net Assets
Information Technology	22.33
Health Care	16.72
Financials	16.58
Industrials	12.71
Materials	6.77
Consumer Discretionary	5.40
Consumer Staples	5.33
Energy	4.99
Real Estate	2.37
Communication Services	1.67

TOP TEN HOLDINGS

Company Name	% of Net Assets
1. Microsoft Corp.	4.56
2. Danaher Corp.	4.51
3. Adobe Inc.	4.47
4. ANSYS Inc.	3.98
5. PayPal Holdings Inc.	3.92
6. Amgen Inc.	3.27
7. Microchip Technology Inc.	3.00
8. Sony Corp. ADR	2.85
9. Medtronic plc	2.63
10. Lennar Corp. Class A	2.52

TOTAL RETURNS

	Three Months	1 Yr.	5 Yr.	10 Yr.	Since Incp. (12/29/1987)	Expense Ratios Net	Expense Ratios Gross
Harbor Large Cap Value Fund - *INST*	20.89%	2.57%	9.20%	13.08%	9.81%	0.69%	0.73%
Russell 1000® Value Index	14.29%	-8.84%	4.64%	10.41%	9.88%		

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® Value Index is an unmanaged index generally representative of the U.S. market for larger capitalization value stocks. This unmanaged index does not reflect fees and expenses and is not available for direct investment. The Russell 1000® Value Index and Russell® are trademarks of Frank Russell Company.

Since the Fund typically invests in a limited number of companies, an adverse event affecting a particular company may hurt the Fund's performance more than if it had invested in a larger number of companies. 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 value investing style may be out of favor with investors which could cause value securities to underperform growth 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, Aristotle Capital Management, 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.

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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