Harbor Bond Fund

Manager Commentary
As of 06/30/2019

Subadviser: Pacific Investment Management Company LLC *(Since 12/29/1987)*
Portfolio Managers: Scott A. Mather, Mark R. Kiesel, Mihir P. Worah, Ph.D.

2nd Quarter, 2019

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Pacific Investment Management Company LLC

Market in Review

Despite heightened global trade tensions for much of the quarter, both safe haven and risk assets broadly rallied as central bank rhetoric struck even more accommodative tones amid mounting economic uncertainties. The Federal Reserve appeared to signal an easing bias as it dropped the word “patient” from its policy statement and indicated that it would act as appropriate to sustain the expansion. Similarly, the European Central Bank suggested that it was primed for additional stimulus in the form of rate cuts or quantitative easing. While risk sentiment moved in tandem with the ebb and flow of global trade tensions throughout the quarter, the S&P 500 still set new highs and credit spreads broadly tightened. Meanwhile, 10-year government bond yields fell in the U.S. and Germany – with the latter setting a new record low – and the U.S. yield curve inverted again.

An unanticipated escalation in U.S.-China trade frictions during the quarter precipitated a sell-off in risk assets. Some reprieve occurred, however, when President Trump retraced tariff threats on Mexico and agreed to proceed with U.S.-China negotiations at the G20 summit. Global economic data were mixed as optimism from better-than-expected growth in China at the start of the quarter was offset by continued signs of decelerating growth in other regions. Purchasing managers indexes (PMI) in several developed markets fell into contractionary territory and the U.S. index declined to its lowest level in nearly a decade (though remaining in expansionary territory).

Portfolio Performance

In the second quarter of 2019, the Harbor Bond Fund (Institutional Class) returned 3.08%, matching the performance of its benchmark, the Bloomberg Barclays U.S. Aggregate Bond Index, which also returned 3.08%.

Performance was led by contributions from an overweight to U.S. duration as yields fell, an overweight to banking and financial sectors as spreads tightened, and an out-of-benchmark exposure to non-agency mortgage-backed securities (MBS) as the sector benefited from positive supply-and-demand dynamics. An overweight to agency MBS, with a preference for 3% to 4% Fannie Mae mortgages, and an out-of-benchmark exposure to U.S. Treasury Inflation-Protected Securities (TIPS), detracted from performance as agency MBS underperformed Treasuries and TIPS underperformed their nominal counterparts during the quarter.

Portfolio Positioning

The Harbor Bond Fund ("Fund") was underweight duration overall but favored an overweight to U.S. duration against rate exposure in other developed regions, including the U.K. and Japan. Although U.S. yields have fallen, we believe U.S. duration is still attractive given the potential for capital appreciation (i.e., U.S. rates have more room to fall) in adverse market environments versus other economies. Overall, our duration positioning was positive for performance. Within the investment grade credit sector, we believe current valuations warrant a more defensive stance and we therefore favor higher quality and shorter maturity names, which was positive for performance as spreads tightened during the quarter. Although it detracted from performance, the Fund continues to remain overweight – even after reducing some of its exposure during the quarter – to agency MBS, as it allows for excess yield from a source that should be more defensive than – and less correlated to – traditional corporate and other credit risk.

Out-of-benchmark allocations were a net positive during the quarter. Tactical high-yield credit and currency exposures, coupled with non-agency MBS exposure given their attractive loss-adjusted yields, were contributors during the quarter. An increase to our U.S. TIPS allocation given low breakeven rates detracted from performance.

Contributors and Detractors

During the second quarter, the Fund's overweight to U.S. duration was the largest contributor to performance as U.S. yields fell. We believe U.S. duration continues to be attractive given the potential for capital appreciation in adverse market environments. Although it was the largest detractor in the Fund, we remain overweight agency MBS, with a preference for 3% to 4% Fannie Mae mortgages.

Buys and Sells

During the quarter, we added U.S. duration exposure via Treasuries as we believe U.S. duration continues to be attractive given the potential for capital appreciation in adverse market environments.

The Fund reduced its agency MBS overweight exposure as we are cautious on the sector and prefer to proceed slowly given relatively unfavorable technical factors. Importantly, our overweight in this sector continues as it allows for excess yield from a source that should be more defensive than – and less correlated to – traditional corporate and other credit risk.

Outlook

In the U.S., we continue to anticipate growth to slow to 2% to 2.5% in 2019 from nearly 3% last year. Factors contributing to the deceleration include fading fiscal stimulus, the lagged effect of tighter monetary policy over the past few years, and headwinds from the China-global slowdown. Headline inflation is likely to remain in the 1.5% to 2% range this year, we believe, while core Consumer Price Index ("CPI") moves sideways. With growth likely to continue slowing through the year and inflation remaining below target, the Fed has adopted a more dovish stance and looks likely to cut rates by 50 basis points by year-end 2019, in our view. In response, U.S. duration exposure, both nominal and real, increased meaningfully during the quarter.

On the global front, we anticipate eurozone growth to slow to a trend-like pace of 0.75% to 1.25% in 2019 from close to 2% in 2018, as weak global trade exerts significant downward pressure on the economy and some countries experience a recession. In the U.K., we anticipate real growth in the range of 1% to 1.5% in 2019, modestly below trend, and we continue to believe that a chaotic no-deal Brexit is a lower-probability event. We believe Japan’s Gross Domestic Product ("GDP") growth to be modest at 0.5% to 1% in 2019, broadly unchanged from 0.7% in 2018. Lastly, we believe China’s growth may slow in 2019 to the middle of a 5.5% to 6.5% range from 6.6% in 2018, stabilizing somewhat in the second half of the year as fiscal and monetary stimulus find some traction.

Harbor Funds

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ECONOMIC SECTORS

	% of Net Assets
Mortgage Pass-Through	48.10
Corporate Bonds & Notes	46.85
U.S. Government Obligations	34.19
Foreign Government Obligations	13.14
Asset-Backed Securities	8.96
Collateralized Mortgage Obligations	5.76
Bank Loan Obligations	0.26
Municipal Bonds	0.26
Consumer Discretionary	0.00

TOP TEN HOLDINGS

Company Name	% of Net Assets
1. Federal National Mortgage Association	7.14
2. Government National Mortgage Associat	6.76
3. Federal National Mortgage Association	6.11
4. Federal National Mortgage Association	3.88
5. Federal National Mortgage Association	3.64
6. Federal National Mortgage Association	3.55
7. Japan Treasury Discount Bill	3.05
8. U.S. Treasury Bonds	2.99
9. U.S. Treasury Inflation Indexed Bonds	2.63
10. U.S. Treasury Notes	2.63

ADDITIONAL HOLDINGS

Company Name	% of Net Assets

TOTAL RETURNS

	Three Months	1 Yr.	5 Yr.	10 Yr.	Since Incp. (12/29/1987)	Expense Ratios Net	Expense Ratios Gross
Harbor Bond Fund - *INST*	3.08%	7.66%	3.09%	4.45%	6.90%	0.51%	0.91%
Bloomberg Barclays U.S. Aggregate Bond Index	3.08%	7.87%	2.95%	3.90%	6.25%		

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 a contractual management fee waiver and an expense limitation agreement, excluding interest expense, if any, through 02/29/2020.

The Bloomberg Barclays U.S. Aggregate Bond Index is an unmanaged index of investment-grade fixed-rate debt issues with maturities of at least one year. This unmanaged index does not reflect fees and expenses and is 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. The use of derivative instruments may add additional risk. There may be a greater risk that the Fund could lose money due to prepayment and extension risks because the Fund invests heavily at times in mortgage-related and/or asset backed securities. The Fund may engage in active and frequent trading to achieve its principal investment strategies. Investing in international and emerging markets poses special risks, including potentially greater price volatility due to social, political and economic factors, as well as currency exchange rate fluctuations. These risks are more severe for securities of issuers in emerging market regions.

Views expressed herein are drawn from commentary provided to Harbor by the subadviser, Pacific Investment Management Company 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.