Harbor Convertible Securities Fund

Manager Commentary
As of 06/30/2019

Subadviser: Shenkman Capital Management, Inc. *(Since 05/01/2011)*
Portfolio Managers: Mark R. Shenkman, Justin W. Slatky, Raymond F. Condon, Jordan N. Barrow, CFA, Thomas Whitley, CFA

2nd Quarter, 2019

"Similar to the first quarter, the continued strength in new-issue activity provided opportunity to further diversify the Harbor Convertible Securities Fund."

Shenkman Capital Management, Inc.

Market in Review

Performance during the first half of 2019 surprised and delighted most investors. Last December, the general consensus was for higher interest rates, rising inflation, and an impending recession, which rattled the markets. However, most forecasts have been upended as the markets staged a dramatic rebound, with the three major U.S. equity indices hitting record highs and the 10-year U.S. Treasury yield hovering around 2%. Meanwhile, the markets have had to contend with an inverted yield curve, an unresolved trade dispute with China, low inflation, slower earnings momentum, a robust job market, and a more dovish U.S. Federal Reserve policy. Amid the longest period of economic growth since 1854, the greatest danger to the markets, in our view, may be the unpredictability of economic and market forecasts in an era of dislocations due to technology, demographic shifts, and social change.

Portfolio Performance

In the second quarter of 2019, the Harbor Convertible Securities Fund (Institutional Class) returned 3.28%, underperforming its benchmark, the ICE BofAML US Convertible Excluding Mandatory Index, which returned 3.92%.

During an otherwise mixed second quarter, with June's gains retracing May's losses, the Fund trailed the benchmark. The disparity with the benchmark can be more than accounted for by the Fund's underweighting in the most equity-like benchmark constituents (those with a 100% investment premium or more), which contributed 143 basis points (36.5%) of the benchmark's second-quarter return. As a matter of style, we tend to underweight or avoid convertible securities of this type, as they have little to no bond characteristics and are closely correlated to equity risk/ volatility. It should also be noted that the greater portion of the Fund's performance can be primarily attributed to security selection in the more credit sensitive securities with an investment premium of less than 40%, which stylistically is a primary area of focus.

Portfolio Positioning

The Fund's largest industry exposures as of June 30 were software, semiconductors and semiconductor equipment, health care equipment and supplies, Internet and direct marketing retail, and media. At the end of the quarter, the Fund had an average credit quality of BB, equal to that of the benchmark index. The Fund's effective duration was shorter than the benchmark's, 2.07 versus 2.78, respectively. The average weighted investment premium of the Fund was calculated at 26.77% on June 30, 2019, versus 28.32% on March 31, 2019. During the same time, the average weighted underlying equity premium expanded from 38.81% to 41.01%.

Contributors and Detractors

The five largest contributors to the Fund's absolute performance during the quarter were Exact Sciences, DISH Network, Dexcom, Meritor, and Insulet. Exact Sciences, a life science equipment company, has developed a non-invasive screening test for the early detection of colorectal cancer. DISH Network, a provider of satellite-based pay-TV services, has recently benefited from speculation about its potential purchase of Sprint/T-Mobile-divested assets. Dexcom, a medical device company focused on the development of continuous glucose monitoring systems for diabetes, has continued to benefit from sustained revenue growth in an underpenetrated market. Meritor, a manufacturer of components used in trucks and trailers, has benefited from an extended heavy-truck backlog amid improving margins, while Insulet, a medical device company that manufactures an insulin-infusion system, recently raised earnings guidance based on strong patient growth.

The five largest detractors from absolute performance were Tesla, Chesapeake Energy, Intel, Pure Storage, and Palo Alto Networks. Tesla has been the subject of speculation surrounding its ability to maintain production schedules. Chesapeake Energy has seen concerns surrounding its ability to reduce its leverage profile amid recent commodity price volatility. We will continue to monitor closely. Intel has seen a semiconductor inventory buildup amid trade war uncertainty and a competitive landscape. Pure Storage, a provider of enterprise storage solutions, posted disappointing first-quarter earnings; however, we believe the company's fundamentals are still intact. Palo Alto Networks, a leading provider of network security systems, recently missed earnings-per-share consensus estimates, citing the integration of recent acquisitions.

Buys and Sells

During the quarter, we purchased shares of Altair Engineering, a global technology company providing software and cloud solutions in the areas of product design and development, high performance cloud computing, and data intelligence. Altair serves more than 5,000 customers in the automotive, aerospace, heavy equipment, and consumer product industries, among others. We believe Altair's 0.25% convertible notes are attractive for the several reasons. The company's addressable market is growing at a healthy rate (high single digits), and we expect Altair to outpace market growth as it gains share in the solver segment. The core mesh product's open architecture has been a key differentiator in the market, and its ability to integrate with other software systems has helped establish strong relationships with customers. A unique pricing strategy has provided efficient upsell opportunities and expansion; the average customer uses 15 products. Finally, the credit is supported by strong free cash flow generation and a meaningful equity cushion.

Similar to the first quarter, the continued strength in new-issue activity provided opportunity to further diversify the Fund through other selective purchases, including Guess, a licensor of casual apparel and related consumer products; Liberty Latin America, a provider of a variety of telecommunication and entertainment services in the Caribbean and Latin America; Vonage, a provider of high-speed Internet communication services; and Zynga, a leading social gaming company. In addition, for the purpose of rebalancing in a strong equity environment, we added new issues from currently or previously held deeper-in-the-money tranches from IAC/ Interactive, a provider of Internet search applications, among them Match.com and Home Advisor; Interdigital, a designer and developer of advanced digital wireless applications; and the aforementioned Dexcom.

On the sell side, we exited our position in HubSpot, a cloud-based marketing and sales software platform, after many reductions in weight over the last year, due to high equity sensitivity and valuation. We redeployed the proceeds into other names in software with a more balanced profile.

Outlook

Looking forward, similar to 2018, we believe the following prospects for convertible securities appear positive and could remain so for the indefinite future, lacking any material macro developments: a growth-oriented equity environment, positive overall credit conditions, historical non-correlation to U.S. Treasury rates, and increased new-issue activity. As we have experienced a period of interest rate and economic uncertainty, with associated intermittent periods of volatility, we believe the market is likely to favor more balanced convertible securities with a positive credit profile, placing a premium on reward versus risk.

Harbor Funds

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ECONOMIC SECTORS

	% of Net Assets
Information Technology	30.01
Communication Services	16.49
Health Care	15.16
Consumer Discretionary	12.67
Industrials	8.40
Financials	6.01
Energy	3.98
Real Estate	3.93
Utilities	1.33
Consumer Staples	0.57

TOP TEN HOLDINGS

Company Name	% of Net Assets
1. Live Nation Entertainment Inc.	2.22
2. Blackstone Mortgage Trust Inc.	1.96
3. Meritor Inc.	1.94
4. BioMarin Pharmaceutical Inc.	1.84
5. Akamai Technologies Inc.	1.83
6. Dish Network Corp.	1.83
7. Liberty Latin America Ltd.	1.79
8. Liberty Expedia Holdings Inc.	1.67
9. Marriott Vacations Worldwide Corp.	1.65
10. Microchip Technology Inc.	1.57

ADDITIONAL HOLDINGS

Company Name	% of Net Assets
Palo Alto Networks Inc.	1.49
Dexcom Inc.	1.45
Exact Sciences Corp.	1.23
Tesla	1.09
Insulet Corp.	1.07
Zynga Inc.	0.91
Intel Corp.	0.88
Chesapeake Energy Corp.	0.74
IAC Financeco 2 Inc.	0.69
Pure Storage Inc.	0.61
Guess? Inc.	0.49
InterDigital Inc.	0.45
Altair Engineering Inc.	0.41
Vonage Holdings Corp.	0.25
HubSpot Inc.	0.00

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*	3.28%	7.02%	4.45%	N/A	5.48%	0.78%	0.83%
ICE BofAML US Convertible Ex Mandatory Index	3.92%	8.00%	7.60%	N/A	9.08%		

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.

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 through 02/29/2020.

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 06/30/2019 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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