Harbor Mid Cap Value Fund

Manager Commentary
As of 12/31/2018

Subadviser: LSV Asset Management *(Since 09/30/2004)*
Portfolio Managers: Josef Lakonishok, Ph.D., Menno Vermeulen, CFA, Puneet Mansharamani, CFA, Greg Sleight, Guy Lakonishok, CFA

4th Quarter, 2018

"While 2018 was a difficult year for value investors, we believe the companies we hold are generating strong cash flow and earnings. In general, we have seen little deterioration in company fundamentals."

LSV Asset Management

Economic Overview

U.S. equity markets reversed course in the fourth quarter of 2018 and declined sharply, particularly in December. Volatility returned to the market, driven by uncertainty surrounding fears of a global economic slowdown, the pace of central bank interest rate hikes and ongoing trade tensions with China. Rising interest rates seemed to start to weigh on markets, after the U.S. Federal Reserve raised rates four times in 2018. The impact of U.S./China trade restrictions began to emerge, as evidenced by an uptick in U.S. material and labor costs and a slowdown in China's economic activity, particularly softer retail sales, exports, and industrial activity. During the quarter, the S&P 500 returned -13.52%, finishing down for the calendar year. As measured by Russell indexes, large-cap stocks broadly outpaced both mid- and small-caps during the quarter and the calendar year. Value stocks held up better than growth stocks in the fourth quarter but lagged significantly for the year.

Portfolio Review

During the fourth quarter of 2018, the Harbor Mid Cap Value Fund (Institutional Class) returned -17.36%, underperforming its benchmark, the Russell Midcap® Value Index, which returned -14.95%.

Stock selection accounted for most of the underperformance during the quarter, most notably in the Materials, Financials and Real Estate sectors. Relative weakness there outweighed relative strength in Utilities, Consumer Discretionary, and Consumer Staples. Sector allocation effects also detracted from relative returns, driven by the Fund's underweight positions in defensive sectors such as Utilities and Real Estate, which had relatively modest quarterly declines and were the strongest performers in the benchmark. Conversely, the Fund's underweight to Energy stocks, particularly oil and gas exploration and production companies that declined sharply in the index, contributed to relative returns.

Although value stocks outperformed during the quarter, stocks that we find expensive held up better than the deeper value names we favor. Cheaper stocks, in our view, based on key indicators such as cash flow and earnings, lagged throughout the year, and the Fund's emphasis on those negatively impacted results. Trade tensions and fears of an economic slowdown seemed to have a negative impact on some of our holdings in more cyclical areas of the market, including the Industrials and Materials sectors. In addition, the fourth-quarter flight to more defensive stocks late in the year had a negative impact. Based on our measures, the spread between the cheapest stocks and the most expensive are at one of the highest levels we have seen since the technology bubble of the late 1990s.

Ameriprise Financial, a long-term holding in the Fund, was the largest individual detractor from relative performance. Shares declined nearly 30% during the quarter as publicly traded asset managers had a difficult time. Regions Financial Corporation also weighed substantially on relative performance. Fund holdings in the Energy sector declined as oil prices plummeted during the period. Refiners such as Valero Energy weighed on relative performance, along with holdings in the oil and gas exploration and production industry, including Carrizo Oil & Gas. Over the last year, we initiated several positions in the exploration and production industry. As oil prices stabilized in the $65-$75 range in 2018, we viewed some of those stocks as more attractive after several years of weak cash flow and earnings. However, with the reversal of oil prices in late 2018, several holdings suffered. The Fund has been underweight to this industry relative to the benchmark, and remained so at period end.

Conversely, several Utilities holdings were among the top overall relative contributors, as the defensive sector held up well in a difficult equity environment. SCANA shares advanced sharply on news that it would be acquired by Dominion Energy, a merger that was completed shortly after the quarter ended. A position in Entergy was also a notable contributor. Not owning PG&E, whose shares plummeted due to liability costs stemming from California wildfires, also bolstered relative returns.

While Real Estate was an overall detractor, overweight positions in Medical Properties Trust, and Omega Healthcare Investor, added value. The hospital REITs (Real Estate Investment Trusts) posted gains of nearly 10% during the period.

Throughout the year, we sold or trimmed positions in Health Care stocks that performed well. Early in the fourth quarter, we sold Davita, from the health care services industry, prior to a share-price drop later in the period. Davita shares had advanced, and the stock become relatively expensive, in our view. While the company continued to generate good cash flow, it became less attractive on other valuation measures, including earnings and book value. In addition, DaVita did not pay a dividend.

Outlook

While we do not develop an outlook or use any macroeconomic forecasts in our investment process, we can comment on the relative attractiveness of the portfolio. The Fund continues to trade at attractive valuations on multiple measures relative to benchmark averages. The Fund traded at 8.8 times forward earnings, compared to 13.1 times for the Russell Midcap® Value Index, as well as 5.9 times cash flow, compared to 8.9 times for the index.

While 2018 was a difficult year for value investors, we believe the companies we hold are generating strong cash flow and earnings. In general, we have seen little deterioration in company fundamentals, such as revenues, earnings and net income. Value stocks are trading at significant discounts to their growth counterparts, and we believe the Fund is well positioned given current valuations.

Harbor Funds

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ECONOMIC SECTORS

	% of Net Assets
Financials	22.21
Consumer Discretionary	13.61
Industrials	12.65
Real Estate	11.29
Information Technology	11.20
Utilities	6.95
Materials	6.33
Consumer Staples	5.61
Energy	4.24
Health Care	2.90
Communication Services	1.61

TOP TEN HOLDINGS

Company Name	% of Net Assets
1. Entergy Corp.	2.20
2. FirstEnergy Corp.	1.99
3. Kroger Co.	1.37
4. Eastman Chemical Co.	1.34
5. Juniper Networks Inc.	1.33
6. Cummins Inc.	1.31
7. LAM Research Corp.	1.27
8. United Continental Holdings Inc.	1.27
9. Regions Financial Corp.	1.21
10. SunTrust Banks Inc.	1.20

ADDITIONAL HOLDINGS

Company Name	% of Net Assets
Ameriprise Financial Inc.	1.17
OMEGA Healthcare Investors Inc.	1.08
Medical Properties Trust Inc.	1.05
Valero Energy Corp.	0.99
Scana Corp.	0.80
Carrizo Oil & Gas Inc.	0.33
DaVita Inc.	0.00
Dominion Energy Gas Holdings LLC	0.00
Pacific Gas and Electric Company	0.00

TOTAL RETURNS

	Three Months	1 Yr.	5 Yr.	10 Yr.	Since Incp. (03/01/2002)	Expense Ratios Net	Expense Ratios Gross
Harbor Mid Cap Value Fund - *INST*	-17.36%	-17.68%	3.39%	12.67%	6.80%	0.84%	0.87%
Russell Midcap® Value Index	-14.95%	-12.29%	5.44%	13.03%	8.90%		

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.

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 02/28/2019.

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

Stocks of mid cap companies pose special risks, including possible illiquidity and greater price volatility than stocks of larger, more established companies.

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, LSV Asset Management, 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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