Harbor Real Return Fund

Manager Commentary
As of 12/31/2018

Subadviser: Pacific Investment Management Company LLC *(Since 12/01/2005)*
Portfolio Managers: Mihir P. Worah, Ph.D., Steve A. Rodosky

4th Quarter, 2018

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Pacific Investment Management Company LLC

Economic Overview

The coordinated efforts of global central banks to normalize monetary policy continued to be a focus for fixed income markets in 2018. Overall, markets were more challenged in light of continued reduction in global central bank accommodation and myriad geopolitical events, with volatility rising well above recent averages. In the U.S., expectations for higher inflation, increased Treasury debt supply, and more Federal Reserve (Fed) interest rate hikes all contributed to higher interest rates.

In the fourth quarter of 2018, most risk assets experienced challenging performance as volatility rose. Concerns about slowing economic growth, along with several other sources of uncertainty, contributed to a sell-off in global equity markets while credit spreads widened and developed market yields fell. Meanwhile, central banks remained on course for diminished monetary support as the fundamental backdrop remained positive. The Fed raised interest rates again, although it lowered its expectations for further rate increases in 2019, while the European Central Bank (ECB) reiterated its intention to end its quantitative easing program.

Portfolio Review

In the fourth quarter of 2018, the Harbor Real Return Fund (Institutional Class) returned -1.04%, underperforming its benchmark, the Bloomberg Barclays U.S. TIPS Index, which returned -0.42%.

The Fund’s performance in the fourth quarter was negatively impacted by our overall underweight duration position in interest rates, which was primarily held in developed market countries with rich valuations, such as the U.K. and Japan. While the Fund benefited from its overweight to U.S. nominal rates – which rallied during the quarter – this was more than offset by short rate exposure in Japan and the U.K. as rates in both regions fell during the quarter.

Conversely, Fund performance benefited from our long position in U.S. real rates versus the U.K. and eurozone. We maintain a preference for U.S. real rate exposure versus other developed markets given what we believe are still attractive valuations in the U.S. and rich valuations in U.K. and European markets. This benefit was partially offset by our U.S. breakeven inflation positioning.

The Fund received a positive contribution from our position in U.S. agency and non-agency mortgage-backed securities. Relative performance also benefited from our exposure to select Latin American currencies, including the Argentine Peso. We remain tactical in foreign exchange, with an emphasis on select emerging markets currencies that offer attractive valuations and diversifying risk exposures.

As regards portfolio positioning, in the fourth quarter we increased our overall duration underweight position and increased our overweight position in real interest rates.

Outlook

In our view, world Gross Domestic Product (GDP) growth is likely to slow somewhat but remain above trend at 2.75% to 3.25% in 2019. With tighter global financial conditions, increased political and economic uncertainties, and U.S. fiscal stimulus starting to fade in 2019, we think the economic divergence of 2018 – the U.S. accelerating and other regions slowing – could give way to a more synchronized deceleration, with the U.S., the eurozone, and China all seeing lower growth. We believe global inflation could fall to a range of 1.75% to 2.25%, from about 2.3% in 2018, due to the recent plunge in oil prices and continued below-target inflation in the U.S., Europe, and Japan.

In the U.S., after an expansion of close to 3% in 2018, we look for growth to slow to a below-consensus 2.0% to 2.5% range in 2019. Our opinion reflects the recent tightening of financial conditions, fading fiscal stimulus, and slower growth in China and elsewhere. Growth momentum, we believe, is likely to moderate during the year, converging to trend growth of just below 2% in the second half. We anticipate that headline inflation could drop sharply over the next several months, reflecting base effects and the recent plunge in oil prices, with core inflation to hold steady at about 2%. In our view, one or two more increases in the federal funds rate by year end 2019 seems possible, with a high chance of the Fed pausing or even ending the rate-rising cycle in the first half of the year.

For the eurozone, we believe growth could slow to a below-consensus 1.0% to 1.5% in 2019 from close to 2% in 2018. With the ECB announcing the end of net asset purchases, we anticipate one rate increase in the second half of 2019. However, if the Fed pauses and the Euro appreciates versus the U.S. Dollar, we believe the ECB may leave rates unchanged until 2020.

In China, our view is that growth might slow in 2019 to the middle of a 5.5% to 6.5% range that reflects large uncertainties caused by trade tensions with the U.S., domestic pressure to deleverage, and an economic policy with partially conflicting targets (i.e., growth and unemployment versus financial stability).

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ECONOMIC SECTORS

	% of Net Assets
U.S. Government Obligations	114.47
Mortgage Pass-Through	17.20
Corporate Bonds & Notes	8.80
Foreign Government Obligations	6.88
Asset-Backed Securities	5.03
Collateralized Mortgage Obligations	1.84

TOP TEN HOLDINGS

Company Name	% of Net Assets
1. U.S. Treasury Inflation Indexed Bonds	32.07
2. U.S. Treasury Inflation Indexed Bonds	14.89
3. U.S. Treasury Inflation Indexed Bonds	11.48
4. Federal National Mortgage Association	9.06
5. U.S. Treasury Inflation Indexed Bonds	8.63
6. U.S. Treasury Inflation Indexed Bonds	8.11
7. Federal National Mortgage Association	7.83
8. U.S. Treasury Inflation Indexed Bonds	4.79
9. U.S. Treasury Inflation Indexed Bonds	4.22
10. U.S. Treasury Inflation Indexed Bond	3.85

ADDITIONAL HOLDINGS

Company Name	% of Net Assets

TOTAL RETURNS

	Three Months	1 Yr.	5 Yr.	10 Yr.	Since Incp. (12/01/2005)	Expense Ratios Net	Expense Ratios Gross
Harbor Real Return Fund - *INST*	-1.04%	-2.13%	1.33%	3.76%	3.43%	0.52%	1.03%
Bloomberg Barclays U.S. TIPS Index	-0.42%	-1.26%	1.69%	3.64%	3.58%		

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 an expense limitation agreement, excluding interest expense, if any, through 02/29/2020.

The Bloomberg Barclays U.S. TIPS Index is an unmanaged market index comprised of all U.S. Treasury Inflation Protected Securities rated investment grade (Baa3 or better), have at least one year to final maturity, and at least $250 million par amount outstanding. 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. 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.

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