Harbor Small Cap Growth Opportunities Fund

Manager Commentary
As of 12/31/2018

Subadviser: Elk Creek Partners, LLC *(Since 02/01/2014)*
Portfolio Managers: Cam Philpott, CFA, David Hand, CFA, Hiren Patel, Ph.D., Sean McGinnis, CFA

4th Quarter, 2018

"We believe that our portfolio holdings have better growth prospects than are currently reflected in their prices, and the combination of business fundamentals and valuations makes us optimistic about the year ahead."

Elk Creek Partners, LLC

Economic Overview

U.S. equities posted significantly negative returns during the fourth quarter, erasing their year-to-date gains through the first nine months of 2018. The decline took place in stages, starting with what seemed to be profit-taking over pressures to the U.S. economy, including rising interest rates and trade issues. Although markets settled somewhat during November and corporate earnings were consistent with expectations, the sell-off was tied more to forward-looking economic concerns than company-specific concerns. December was the worst month of the quarter, as market participants sold aggressively. Fears of a global recession were sparked by slowing Chinese economic data, rising concerns surrounding trade negotiations with China, and increasing conviction that the U.S. Federal Reserve would continue to hike short-term rates in a weakening global economy, potentially contributing to the recessionary conditions. As measured by Russell indexes, large-cap stocks broadly outpaced mid- and small-caps, and value outpaced growth.

Portfolio Review

In the fourth quarter of 2018, the Harbor Small Cap Growth Opportunities Fund (Institutional Class) returned -24.06%, underperforming its benchmark, the Russell 2000® Growth Index, which returned -21.65%.

Relative weakness in Industrials, Consumer Discretionary, Energy, and Information Technology outweighed relative strength in Health Care and Utilities. On a sector basis, the Fund’s holdings underperformed their benchmark counterparts in six of the nine sectors in which the Fund was invested, resulting in negative stock selection overall. Conversely, sector allocation effects aided relative performance, driven in part by an overweight position in Information Technology. Lack of exposure to Materials and a position in cash also bolstered relative results. The Fund’s sector weightings are purely a residual outcome of the bottom-up stock selection process.

The largest overall individual detractor from relative returns during the quarter was Invacare, a manufacturer and distributor of medical equipment. In our view, the company continues to make progress on its manufacturing margin recovery, yet the speed of the recovery clearly disappointed some investors. We believe the stock was punished quite severely in a difficult market environment, and we incrementally added to our position on the sell-off.

Shares of Maxar Technologies, a diversified satellite space company, declined sharply and weighed on relative returns. The company announced that its large satellite manufacturing facility is under strategic review, but in our view, that division's struggles are masking positive performance elsewhere in the company. We believe its government exposure—during the quarter, Maxar extended its imagery contract with the U.S. government through 2023—makes its higher leverage tolerable. Within Industrials, NN, a specialty manufacturer for aerospace, life sciences and auto emissions, was a notable detractor. Shares declined sharply as the company's revenues underperformed relative to expectations, driven in part by a sales slowdown in China. Investor were disappointed with the company's execution, and while we understand that frustration, we believe that the investor reaction was disproportionate. In our view, growth, particularly in the life science segment, combined with the stock's current valuation could drive price appreciation for patient investors.

In contrast, stock selection in the Health Care sector was a key contributor to relative performance. Shares of Tesaro, a biopharmaceutical company focused on oncology, was the top overall contributor. The company's lead drug, Zejula, performed slightly better than expectations, and we believe that it can continue to take market share in treating ovarian cancer. Near the end of the quarter, the company agreed to merge with GlaxoSmithKline, and we significantly reduced our position.

Nutrisystem, a leading weight management company, bolstered relative returns. Earlier in the year, shares struggled as the company mis-executed their marketing program, which negatively impacted sales. At the time, we believed the company's operational execution would return in the quarters that followed, and it did, evidenced most recently by strong third-quarter revenues. The company agreed to merge with Tivity Health in December, and we sold this position entirely on that news.

We added another top contributor, Yeti Holdings—the outdoor and recreation products maker—late in the quarter, after shares pulled back on concerns regarding Yeti's cooler business. We view Yeti as a premium brand poised for innovative new product introductions, as well as the expansion and enhancement of its existing categories. Shares advanced sharply after the sell-off, and the company recently pre-released a solid quarter and raised its earnings estimates for 2018.

Outlook

Investors were quite fearful at the end of 2018. While early 2019 news, such as a strong payroll report and initial signs of a strong holiday season, took some of the fear out of the market, investors remained concerned that headwinds exist. Those perceptions were not eased when Apple negatively warned about sales trends, especially from China. From our perspective, equity valuations compressed meaningfully during the fourth quarter. It may be, as some market pundits have said, that investors are having a challenging time differentiating slowing economic growth from a recession. There are areas of the market, such as the transportation industry, that are trading at 15-year-plus low valuations.

Our longstanding investment process seeks to identify companies that we believe have sustainable growth prospects and are trading at reasonable valuations. We believe that our portfolio holdings have better growth prospects than are currently reflected in their prices, and the combination of business fundamentals and valuations makes us optimistic about the year ahead. The day-to-day fluctuations in the market will largely be driven by the headlines in the morning news and their impact on investor sentiment, positive or negative. Over time, we believe that the performance of the underlying businesses, combined with the valuations of those businesses, will drive returns, and we remain focused on the individual businesses themselves.

Harbor Funds

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ECONOMIC SECTORS

	% of Net Assets
Health Care	27.38
Information Technology	22.33
Industrials	16.89
Consumer Discretionary	14.48
Financials	7.41
Communication Services	3.88
Consumer Staples	2.43
Energy	2.18
Utilities	1.19

TOP TEN HOLDINGS

Company Name	% of Net Assets
1. Interxion Holding NV	2.88
2. Quotient Technology Inc.	2.88
3. Evolent Health Inc.	2.83
4. Maxlinear Inc.	2.54
5. Cerus Corp.	2.38
6. Inphi Corp.	1.89
7. Pacira Pharmaceuticals Inc.	1.86
8. Iridium Communications Inc.	1.74
9. Intercept Pharmaceuticals Inc.	1.69
10. Electronics For Imaging Inc.	1.66

ADDITIONAL HOLDINGS

Company Name	% of Net Assets
Maxar Technologies Ltd.	1.11
Invacare Corp.	1.09
NN, Inc.	0.90
Tesaro Inc.	0.85
Tivity Health Inc.	0.64
Yeti Holdings Inc.	0.43
Apple Inc.	0.00
GlaxoSmithKline plc	0.00
Nutrisystem	0.00

TOTAL RETURNS

	Three Months	1 Yr.	5 Yr.	10 Yr.	Since Incp. (02/01/2014)	Expense Ratios Net	Expense Ratios Gross
Harbor Small Cap Growth Opportunities Fund - *INST*	-24.06%	-6.86%	N/A	N/A	4.75%	0.89%	0.89%
Russell 2000® Growth Index	-21.65%	-9.31%	N/A	N/A	5.60%		

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 Russell 2000® Growth Index is an unmanaged index representing the smallest 2000 stocks with the highest price-to-book ratio and future earnings. This unmanaged index does not reflect fees and expenses and is not available for direct investment. The Russell 2000® Growth Index and Russell® are trademarks of Frank Russell Company.

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

At times, a growth investing style may be out of favor with investors which could cause growth securities to underperform value 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, Elk Creek Partners, 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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