



Harbor Real Return Fund



Mihir P. Worah, Ph.D.



Jeremie Banet

3rd Quarter, 2018 Commentary

"We anticipate that three more increases in the federal funds rate could happen by the end of 2019." –Pacific Investment Management Company LLC

Risk assets perform well despite geopolitical tensions and increased volatility

Geopolitical developments – including escalating U.S.–China trade tensions, NAFTA negotiations, Brexit developments, Italian budget concerns, and turmoil in certain emerging market countries such as Turkey and Argentina – dominated news headlines and contributed to bouts of volatility in the third quarter of 2018. At the same time, several developed market central banks shifted toward reduced monetary accommodation. Nevertheless, risk assets performed well in the quarter. In particular, U.S. equities experienced gains as strong growth momentum helped to fuel positive investor sentiment.

The Harbor Real Return Fund posted a return of -0.78% in the third quarter, outperforming the -0.82% return of its benchmark, the Bloomberg Barclays U.S. TIPS Index. The TIPS index underperformed the Bloomberg Barclays U.S. Aggregate Bond Index, a diversified benchmark of investment-grade bonds, which had a return of 0.02%. The Fund invests primarily in inflation-linked bonds issued by the U.S. and other governments. The Fund's overall underweight duration position, primarily focused on developed market countries with rich valuations, such as the U.K. and Japan, contributed to relative performance as interest rates in developed markets generally moved higher in the third quarter, fueled by a continued move towards policy normalization by major central banks. The Fund's long position in the U.S. versus the U.K. and the eurozone detracted from performance as U.S. breakeven inflation remained restrained amid oil price volatility and mixed inflation data, while U.K. inflation came in higher than expected.

PIMCO's comments were made in an October, 2018 report. Highlights adapted from the report appear below. All comments relate to the quarter ended September 30, 2018, unless otherwise indicated. All references to the year-to-date are for the period January 1 through September 30, 2018.

HIGHLIGHTS

Higher Interest Rates Shape Our Strategy

We moved to a modestly overweight position in U.S. nominal rates, reflecting our view that the Federal Reserve (Fed) may be further along in unwinding its stimulative monetary policy compared to central banks in other developed markets, particularly Japan, the eurozone and the U.K. We also increased the portfolio's position in short U.K. real yields.

We Anticipate a Synchronized Deceleration of Growth

We believe world economic growth could slow somewhat in 2019 but remain above-trend at 2.75% to 3.25%. With tighter global financial conditions, increased political and economic uncertainties, and U.S. fiscal stimulus starting to fade in 2019, we believe the economic divergence of 2018 – with the U.S. accelerating and other regions slowing – could give way to a more synchronized deceleration, with the U.S., eurozone and China all seeing lower growth next year compared to 2018. In the U.S., following an expansion of about 3% in 2018, we believe growth could slow to a below-consensus 2.0% to 2.5% range in 2019. This anticipated drop reflects our view that we will likely see less support from fiscal stimulus, the ongoing removal of monetary accommodation, a stronger U.S. Dollar and a less favorable trade and external environment. With economic growth still above potential, however, we believe the U.S. unemployment rate could decline further. We believe inflation could peak at around 2.5% in response to tariff increases before moderating somewhat. We anticipate that three more increases in the federal funds rate could happen by the end of 2019.



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International Outlook

For the eurozone, we believe growth could decline to a range of 1.5% to 2.0% over the next year, down significantly from 2.5% in 2017 but still above potential. In our view, the European Central Bank could end its net asset purchases by the end of 2018, with a first interest rate increase more likely to happen than not in the second half of 2019. In the U.K., we believe real growth could accelerate to an above-consensus range of 1.5% to 2.0% in the next year based on our belief that Brexit negotiations could progress, avoiding a hard Brexit. This could help domestic demand in 2019. In our view, Japan's Gross Domestic Product is likely to remain steady at 1.0% to 1.5% in 2019, supported by a tight labor market and accommodative fiscal stance. While we don't believe the Bank of Japan will raise interest rates, we anticipate further tapering of bond purchases and further steepening of the yield curve. In China, we believe 2019 growth will land roughly in the middle of a 5.5% to 6.5% range, reflecting large uncertainties caused by trade tensions with the U.S. and an economic policy with partially conflicting targets.

Total Returns

As of 09/30/2018

	Three Months	One Year	Three Years	Five Years	Ten Years	Expense Ratios Net	Expense Ratios Gross
Harbor Real Return Fund - INST	-0.78%	0.30%	2.35%	1.11%	3.38%	0.52%	1.03%
Bloomberg Barclays U.S. TIPS Index	-0.82%	0.41%	2.04%	1.37%	3.32%		

Sectors: As of 09/30/2018, the Harbor Real Return Fund had invested the following percentages of its assets in the sectors listed: U.S. Government Obligations, 108.78%; Mortgage Pass-Through, 17.45%; Foreign Government Obligations, 6.61%; Corporate Bonds & Notes, 5.79%; Asset-Backed Securities, 4.33%; Collateralized Mortgage Obligations, 1.65%;

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.

Performance figures discussed in any of the Manager Commentaries reflect that of the Institutional Class shares.

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 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.

The views expressed herein are those of the subadviser, Pacific Investment Management Company, LLC (PIMCO), and may not be reflective of their current opinions or future actions. These views are not necessarily those of Harbor Funds and should not be construed as such.

Duration is a commonly used measure of the sensitivity of the price of a debt security, or the aggregate market value of a portfolio of debt securities, to a change in interest rates. Securities with a longer duration are more sensitive to changes in interest rates and generally have more volatile prices than securities of comparable quality with a shorter duration.

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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