



# Harbor Small Cap Growth Fund



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## 3rd Quarter, 2018 Commentary

*"We are taking the opportunity on any pullback to add to our highest quality companies." - Westfield Capital Management Company, L.P.*

### **The U.S. equity market rose in the third quarter despite global trade tensions**

Equity markets continued their advance in the third quarter, rising in the face of increasingly loud political rhetoric concerning matters of trade between the U.S. and its biggest trading partners. Aside from select industries, the domestic economy at large and broad U.S. equity indices digested the rising tensions with relative ease as the fundamental underpinnings of both economic and market activity remained resilient. However, the current U.S. economic growth trajectory is not without risk as rising interest rates and inflationary pressures mount within the economy, but evidence of stress in the system remained largely absent during the quarter.

The Harbor Small Cap Growth Fund returned 7.46% during the third quarter of 2018, outperforming its benchmark, the Russell 2000® Growth Index, which returned 5.52%. Stock selection in Industrials, Consumer Discretionary and Energy contributed to relative performance. In contrast, security selection in Health Care detracted from relative results.

Westfield Capital Management Company'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**

### **Stock Selection Drove Outperformance Despite Style Headwinds**

Similar to the market conditions in the second quarter of 2018 and year-to-date, fundamental leadership for the third quarter was driven by companies that we consider to be relatively expensive and lower quality. We are typically underweight these "expensive" and "low-quality" groups. Additionally, momentum has been the top-performing factor year-to-date, which is also a headwind to our growth at a reasonable price (GARP) style. These factor headwinds were most pronounced in August, when the Fund was unable to keep up with the benchmark despite delivering a positive absolute return. Nevertheless, positive stock selection drove the Fund's relative outperformance during the quarter. Importantly, the majority of the Fund's relative outperformance was in September when the market corrected.

### **We Remain Focused on High-Quality Domestic Companies**

We continue to believe the U.S. is the best place to invest, and domestic economic data remains encouraging. Given this view, we believe that U.S. companies with a greater domestic orientation and less debt are, on the margin, more attractive. Within the small cap universe, we continue to look for companies with the best earnings growth rates, improving operating margins and misunderstood franchises where we project meaningful improvement in free cash flow growth. We are taking the opportunity on any pullback to add to our highest quality companies.

### **We Are Closely Monitoring Global Risks**

We are closely monitoring a China slowdown as it relates to global automobile weakness, trade, cybersecurity and a potential military threat. We continue to see signs of global growth slowing and are carefully watching a potential emerging market contagion given a strong dollar, rising interest rates and oil prices.

### **Strong U.S. Economy Balances Market Uncertainty**

Risks currently appear balanced, with strong domestic economic activity offsetting policy uncertainty, mid-term elections and fears about slowing global growth. U.S. consumers remain on solid footing, supported by a robust employment picture and slowly rising wages. Corporations also look healthy as profit margins and corporate earnings growth exceed



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expectations. We believe interest rates will continue to grind higher and that inflation will likely rise faster than market participants currently project. Despite these risks, we maintain conviction in our ability to add value in this type of market environment.

## Total Returns

As of 09/30/2018

	Three Months	One Year	Three Years	Five Years	Ten Years	Expense Ratios Net	Gross
<b>Harbor Small Cap Growth Fund - INST</b>	7.46%	24.12%	17.20%	12.78%	12.98%	0.87%	0.87%
Russell 2000® Growth Index	5.52%	21.06%	17.98%	12.14%	12.65%		

**Sectors:** As of 09/30/2018, the Harbor Small Cap Growth Fund had invested the following percentages of its assets in the sectors listed: Health Care, 26.27%; Information Technology, 17.37%; Consumer Discretionary, 15.65%; Industrials, 15.50%; Financials, 8.39%; Materials, 6.75%; Energy, 5.49%; Real Estate, 1.68%; Consumer Staples, 0.52%;

**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](http://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 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.

The views expressed herein are those of the subadviser, Westfield Capital Management Company, L.P., 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.

**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](http://harborfunds.com) or by calling 800-422-1050. Read it carefully before investing.**

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