



Harbor Small Cap Value Opportunities Fund



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3rd Quarter, 2018 Commentary

"We have focused our attention on identifying quality companies at somewhat reasonable valuations and self-help stories we believe can sustain in likely more volatile markets." -Sapience Investments, LLC

U.S. equity indexes hit all-time highs during the third quarter

During the third quarter of 2018, most major U.S. stock indexes closed the period at or near all-time highs. The majority of the positive returns occurred in July and August. The leadership of value stocks from the second quarter and into July reversed in August, in favor of the large growth companies that have been dominant in recent years. Smaller cap stocks generally kept pace until September, when they declined. Overall, the market environment was more favorable for growth stocks during the quarter.

The Harbor Small Cap Value Opportunities Fund advanced in the third quarter of 2018. The Fund posted a total return of 2.28%, outperforming the Fund's benchmark, the Russell 2000® Value Index, which returned 1.60%. From a relative performance perspective, stock selection was the primary contributor to relative results. More specifically, security selection in Financials, Real Estate and Consumer Discretionary benefited relative performance. Conversely, security selection in Information Technology detracted from relative results.

Sapience Investments' 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

The Aging Economic Expansion

As we assess the outlook, the most important fundamental economic news to watch so far this year has been the remarkably strong U.S. economy. Corporate tax cuts, broad-based deregulation and accommodative monetary policy have extended the aging economic expansion. The underlying fundamentals driving the expansion remain intact, in our view, as the second round effects of the fiscal stimulus kick in, credit growth to both households and businesses continues unabated, and pent-up demand remains unsatiated, specifically for fixed capital and consumer durable goods.

Risks to Our Sanguine View Are Mounting

While our baseline scenario shares the optimism of conventional wisdom, risks to this sanguine view are mounting. First, financial conditions are tightening. Short-term interest rate hikes by the Federal Reserve have translated into higher bond yields, raising the cost of capital. Real yields (i.e., net of inflation) across the U.S. Treasury yield curve are positive for the first time in this economic expansion. High relative returns have attracted global capital flows, boosting U.S. assets and the U.S. Dollar. However, we believe more restrictive financial conditions represent a headwind to U.S. corporate profitability, as borrowing costs increase and the strong U.S. Dollar weighs on foreign earnings. Equities are a long duration asset, so valuations are acutely affected by a higher cost of capital. Second, we believe market participants are too complacent about building inflationary pressures. According to the Organization for Economic Co-operation and Development, the U.S. output gap—the difference between actual and potential Gross Domestic Product—has moved into positive territory for the first time in this expansion. Historically, this has eventually been associated with accelerating inflationary outcomes. Third, the rest of the world remains a source of concern. In 2018 overall, Europe and Japan appear set to grow above trend, supported by loose fiscal and monetary policies. However, positive economic momentum outside the U.S. has faltered in recent months due to heightened political uncertainty in Europe,



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trade friction between the U.S. and Asia and the negative impact of select emerging markets. In our view, the global recovery has become increasingly tilted toward and dependent upon the U.S.

The Liquidity Tide Is Flowing Out

U.S. equity investors have climbed the proverbial “wall of worry” so far this year. Shifting metaphors, we believe the liquidity tide is flowing out. In our view, assets that have benefited from ample liquidity and cheap capital will inevitably reverse and de-rate. Mindful of this, we have focused our attention on identifying quality companies at somewhat reasonable valuations and self-help stories we believe can sustain in likely more volatile markets. In equities, growth and momentum strategies have vastly outperformed value strategies in recent years. In early October, a sudden increase in interest rates is bringing the duration and convexity into play within the equity markets and leading to a reversal in the growth versus value outperformance. We have been patiently waiting for this normalization to occur, and we believe this shift could be the beginning of this unwind.

Total Returns

As of 09/30/2018

| | Three Months | One Year | Three Years | Five Years | Since Inception (08/01/2017) | Expense Ratios Net | Expense Ratios Gross |
|---|--------------|----------|-------------|------------|---------------------------------|-----------------------|-------------------------|
| Harbor Small Cap Value Opportunities Fund - INST | 2.28% | 9.06% | N/A | N/A | 10.75% | 0.88% | 1.24% |
| Russell 2000® Value Index | 1.60% | 9.33% | N/A | N/A | 12.04% | | |

Sectors: As of 09/30/2018, the Harbor Small Cap Value Opportunities Fund had invested the following percentages of its assets in the sectors listed: Financials, 24.10%; Industrials, 18.72%; Consumer Discretionary, 14.04%; Energy, 9.61%; Real Estate, 6.92%; Information Technology, 6.08%; Health Care, 4.93%; Consumer Staples, 4.22%; Materials, 3.06%; Utilities, 1.49%;

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 02/28/2019.

The Russell 2000® Value Index is an unmanaged index representing the smallest 2000 stocks with the lowest 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® Value 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 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.

The views expressed herein are those of the subadviser, Sapience Investments, LLC, 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 or by calling 800-422-1050. Read it carefully before investing.

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