Market Commentary
Fourth Quarter 2016

Harbour Growth & Income Fund
Harbour Global Growth & Income Corporate Class

The fourth quarter closed out 2016 every bit as turbulent as the periods that preceded it. The year was a tumultuous one, marked by significant political upheaval that is setting the stage for considerable uncertainty in the year ahead.

While the Brexit vote in June was a bombshell for financial markets, it paled in comparison to the election of Donald Trump as President of the United States. The unexpected choice of Trump amounted to the United States' own Arab Spring, effectively a revolution by the people against the political status quo. Trump is unlike any President the United States has ever seen, and his actions, and global reaction to them, will be the defining elements of the year ahead.

Financial markets were all over the place in the fourth quarter, initially fearing a Trump Presidency and then embracing it. Equity markets in the U.S. initially sold off 5% after the election but quickly rallied, and the Dow Jones Industrial Average closed the year 8% higher than it did on election day, led by financials and pro-cyclical sectors. The real action, however, was in the bond market – U.S. 10-year yields took off after the election, rising 40% from 185 basis points immediately before the election to a peak of 260 basis points in December as investors became increasingly convinced that Trump would "make America great again." We'll hold our thoughts for now on the likelihood of that eventuality.

The Harbour balanced funds were highly competitive in the fourth quarter, completing a very solid year for our clients. Both our equity and bond portfolios performed well. We took a defensive asset allocation stance into the U.S. election, believing that a Trump victory was more likely than was priced in by markets – and that it implied potential downside in the bond market versus a largely status quo outcome if Hillary Clinton won. As our clients value our ability to protect their capital more than our comparative skill at making money in rising markets, we felt that with little to play for in the most defensive part of our portfolios, we'd rather be out than gamble on the outcome. Simply put, if the bond sleeve is supposed to be the most defensive portion of our portfolio, we certainly should not put ourselves in a position where we risk losing capital there. A week before the election, we shortened duration dramatically in our bond portfolios – effectively making them more cash like – and as a result, avoided, and have continued to avoid, a nasty re-rating in the bond market. Led by the U.S. Treasury market, bonds in Canada and elsewhere saw yields spike post the election. Canadian 10-year yields rose 50% from 122 on November 7th to a post-election peak of

184. For now, we will satisfy ourselves with having avoided much of the cost of being associated with the bond market during this period, and will continue to consider at what point our stance will imply undue opportunity cost.

Our stock portfolios were also highly effective during this period. Immediately after the election, we deployed some excess cash in each fund, increasing our equity exposure and adding to our positions in financial services, including capital market-sensitive groups like Morgan Stanley and Goldman Sachs, and to broader U.S.-exposed financial services entities Bank of America, Citigroup and Royal Bank of Canada. Financial services firms benefit from rising interest rates, a steepening yield curve, a potentially better economic environment and from the Trump-suggested potential for lower corporate taxes and less regulatory burden, which would allow big banks to reduce cost structure and expand margins. Our positions in Morgan Stanley, Citigroup and Bank of America were among the biggest contributors to both funds during the quarter.

In the immediate aftermath of the election, the U.S. technology sector, which is home to a number of our largest positions (particularly in Harbour Global Growth & Income Corporate Class), sold off somewhat, as investors gravitated from companies seen as defensive (with strong balance sheets and often big cash balances) to sectors like banks where the immediate opportunity was perceived to be greater. We maintained our technology holdings, with Alphabet (Google) and Microsoft remaining large positions for us. In our minds, the existence of something more attractive doesn't reduce their appeal, and within a portfolio context, these highly cash generative businesses remain core holdings. Both stocks have recovered to pre-election levels.

During the quarter, our gold holdings and defensive names such as Fairfax Financial and Northland Power performed poorly and detracted from results. We consider each name held within the context of our overall portfolio objectives of providing stability and capital protection, and were very happy with the funds' overall performance during the quarter. We continue to maintain exposure to these more defensive securities, and expect that there will be times when they again make a positive contribution to the portfolio.

During the quarter, Bunty Mahairhu joined us from British Columbia Investment Management Corporation as an investment analyst covering global financial services – and the timing of his arrival was excellent in the context of subsequent political events. Bunty is the third analyst to join Harbour in 2016 and our group is proving to be highly effective and cohesive in assessing the changing environment.

Further thoughts on the year ahead are available on our blog at blogs.ci.com/harbour.

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Thank you for your continued confidence.

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