Market Commentary
Fourth Quarter 2016

HARBOUR ADVISORS

Harbour Fund
Harbour Global Equity Corporate Class

The fourth quarter marked the end of a transition year at Harbour. Over the last eight months we have rebuilt the team by adding three new analysts, reorganizing duties and streamlining workflow. We have sought to create an open environment where ideas and debate flow freely across our group. The most recent hire, Bunty Mahairhu, joined in October and comes to us from British Columbia Investment Management Company, one of the largest pension plans in the country.

I am thrilled to be working alongside Roger Mortimer, who has already led a successful turnaround of the Harbour balanced funds. The entire team at Harbour, which now totals 12, has a deep appreciation for the mission of improving investment results and restoring the Harbour brand in the eyes of our clients. Critical to our performance is the need to align fund strategies with client expectations so that the funds deliver equity exposure through a conservative value approach. I am happy to report that much of the heavy lifting is complete.

We have significantly enhanced the process around security selection and risk control. The transitions of the portfolios themselves took some time but now reflect these new enhancements. Among other things, our process emphasizes owning good businesses with solid balance sheets, led by shareholder-friendly management teams. Our value tilt demands that we clearly identify why these good businesses are mispriced. It is this last point that requires patience, since great businesses do not often go on sale.

The types of businesses that qualify as core Harbour investments are ones that many agree are great businesses but have experienced some sort of stumble or headwind. A great example of such an investment is Twentieth Century Fox, which we bought in September 2016 when the "for sale" sign was flashing. The key headwind here is cord-cutting, or viewers cancelling their traditional cable services, which indeed could impact Fox's numbers in the short term. After extensive due diligence we came to the conclusion that the risks were manageable and a company with such a vast content library was well positioned to navigate the changing dynamics of media consumption in the coming years.

The above example highlights the key advantage that Harbour still possesses in today's highly efficient markets – time arbitrage. We are simply willing to invest with a somewhat longer-term view relative to the market and this allows us to exploit pricing inefficiencies. We are not reinventing the wheel here. This tried-and-true method of conservative value investing has proved successful through many different markets over many different cycles throughout the years.

As of mid-fall, the portfolios broadly reflected our new process and controls. Key changes to the portfolios are as follows:

- Approximately half of the inherited names were sold across the funds over the last eight months. In Harbour Fund, new positions bought (and currently held) include Fox, Bank of Nova Scotia, Foot Locker, General Electric, Kion Group, Mattel, Mobileye, Northland Power, PNC Financial, SunTrust, Symantec, Bank of America, and SNC Lavalin. In Harbour Global Equity Corporate Class, new names include Symantec, Allergan, Bank of America, Colony Starwood Homes, Foot Locker, Kion Group, Mattel, Northland Power, Parker-Hannifin, Mobileye, PNC Financial, SunTrust, and TransCanada.

- For Harbour Fund, a new strategy was developed to invest in natural resources in such a way that best conforms to Harbour's core philosophy. Here we use a more diversified approach compared to other sectors. Even compared to our generally rigorous standards, we have stressed the importance of asset base, management quality and balance sheet. In order to capture these attributes, we have been willing to pay a little more relative to other sectors. We attempt to structure our resource holdings around a base-case commodity call but are mindful of where we might be wrong and therefore hedge our bets where possible.

Overall, the portfolios are relatively concentrated with Harbour Fund holding 46 companies and Harbour Global Equity Corporate Class holding 34 at the time of writing. The higher name count in Harbour Fund can be traced back to the aforementioned approach taken with natural resources.

Cash currently sits at approximately 14% in the Harbour Fund and 20% in Harbour Global Equity Corporate Class. Our U.S. dollar exposure is hedged 50% in the Canadian fund and 35% in the global fund.

On another note, regarding recent market action, if nothing else, the violent moves following the U.S. election showed how unprepared market participants were for the result. Stocks posted strong gains, bonds sold off, inflation expectations spiked and certain commodities soared. Furthermore, a massive shift of capital flows clearly indicated which sectors the market deemed winners and losers under the new regime. The S&P 500 U.S. bank and industrials sub-indexes were, for example, up about 23% and 7% respectively between the November election result and the end of the year. Meanwhile, the utility and technology sub-indexes were down 1% and up 1%, respectively.

We have embraced elements of the shifting landscape but have done so with caution. Our post-election portfolio activity did not dramatically change our portfolio structure, but rather tilted it in the direction of a pro-cyclical, higher rate environment. The equity portfolios are still defensively

positioned with plenty of cash and large weights in companies with fundamentals that are not affected one way or another by the U.S. election.

We expect performance in the equity funds to improve going forward and hopefully match the successful turnaround that the Harbour balanced funds have experienced in recent years under Roger's leadership. On that note, for anyone looking for balanced exposure through a conservative value strategy, we encourage you to revisit the Harbour balanced funds and consider them as a core element of client portfolios.

Thank you for your continued support.

Ryan Fitzgerald, CFA
Senior Portfolio Manager