Harbour Global Equity Corporate Class
Second-quarter 2019 Commentary

Market Overview

- Global markets continued their upward march in the second quarter, although not at the furious pace that characterized the start of the year. Both bond and stock markets rejoiced as expectations of multiple interest rate cuts by the U.S. Federal Reserve solidified as well as further easing by other central banks around the world. The upward move in the market has been entirely driven by valuation as earnings projections have continued to deteriorate throughout 2019 and the hoped-for stabilization in global demand is, so far, nowhere in sight.

- It could easily be argued that last December's sell-off was overdone and resulting valuations at the market lows of December 24, 2018, were reflecting too dire an outcome for the global economy. Perhaps this was a symptom of the deep scars still visible on investors who lived through the Financial Crisis and the European Sovereign Debt Crisis. It seems that market participants are conditioned for the dramatic as an entire generation of investors has never seen a "garden variety" recession. However, even if valuations overshot to the downside last year, it is still difficult to fathom the strength of the recovery this year in the face of worsening economic data. Without question, developed market valuations appear to be stretched to the upside.

- One defining characteristic of the current market environment is the outperformance of structural growth stories that have business models insensitive to GDP. True, the market rally has dragged almost all sectors back to their mid-2018 all-time highs. However, it is the high-quality growth subset that has been the star of the show. The information technology sector has a plethora of these stories of course, with darlings such as Microsoft Corp., Visa Inc., and Adobe Inc. cruising uninterrupted to new highs. This dynamic is prevalent elsewhere in the market as well. For example, while the consumer discretionary sector lacks the panache of technology, companies such as Lululemon Athletica Inc. that have excellent growth prospects, continue to surprise value investors with their ever-fancier sky-high valuations. Lululemon is of course unique in that it continues to reap the benefits of the mass affluent's proclivity to purchase expensive yoga attire and then wear it in every given social situation.

- Even in GDP-sensitive sectors, such as industrials, where growth is far harder to come by, capital has flown like water into, at least, the best relative growth stories. Thus, current holding, Honeywell International Inc., which is a high-quality, but nonetheless, only a midsingle-digit earnings grower, now has a forward price earnings approaching 20x. Here, market participants, many of whom believe they need at least one or two industrial names, have favoured the best grower of a slow-growing lot. As an aside, we have been trimming Honeywell in recent months as the stock has moved past our original target price.

- We have seen this market environment several times in the last 10 years. There were several periods post-financial crisis, when market participants concluded that the slow-growth environment was a long-term structural issue. Possibly, very long term. Here, value investors who were taught over the decades to think in terms of mean reversion were continually frustrated. The old strategy of allocating capital to out-of-favour cyclicals and commodity stocks simply did not work, and as of yet, have not "mean reverted." As we stand today, the heightened growth expectations that accompanied U.S. President Donald Trump's election in 2016 are a distant memory and investors once again have a strong aversion to cheap value stocks. This also means that there is a massive crowding effect into high-quality, economically insensitive growth stocks. This has resulted in the aforementioned high valuations of such situations.

Performance Summary

- Over the second quarter of 2019, Class F of Harbour Global Equity Corporate Class (the "Fund") returned 0.9% while the Fund's benchmark, the MSCI World Total Return Index, was up 1.7% over the same period. The Fund lagged its benchmark during the quarter mostly due to the elevated cash position and defensive posture of the Fund.

Portfolio Activity

- We have trimmed, or outright sold, some outstanding winners in recent months. Some names included Microsoft Corp., S&P Global Inc., and London Stock Exchange Group PLC. These names were initiated at substantially lower valuations, back when the stocks would have been considered GARP (growth at a reasonable price) names. Today, it is probably a stretch to apply the GARP term to these companies as a degree of momentum has clearly taken hold. This means that it is time for us to move on and hope that a new crowd of growth investors does well with the stocks in the future.

- Top contributors to the Fund included Microsoft and London Stock Exchange while detractors included Constellation Brands Inc. as well as Japanese appliance maker Daifuku Co. Ltd.

- We initiated, or added to four names, which meant that our already elevated cash position of almost 20% did not change much. These included Booking.com Ltd., Lowe’s Companies Inc., Humana Inc., and Constellation Brands. All four of these names share common characteristics in that they are high-quality businesses with decent growth prospects but are currently experiencing short-term disruption. We feel that the issues facing these companies are transient and that they therefore represent compelling buying opportunities for patient long-term investors.

Outlook

- What is an investor to do with a market such as this? Especially investors such as ourselves at Harbour, who place great importance on quality but also have a value tilt to our disposition? There are no easy answers. The typical “Harbour stock,” a high moat business that generates high returns on capital, is now selling at valuations that have passed our comfort zone. While prospects have not changed much with these businesses over the last year, we must now consider that owning such companies entails substantial valuation risk.

- On the other hand, we do not disagree with others’ assessment that growth will continue to be sluggish well into the future and that this will make for a challenging environment for many old-world-type sectors and businesses. Valuations here appear to be closer to planet earth than those of the high growers, however, we would hesitate before declaring that they are at rock-bottom prices.

- What accounts for these high valuations? Suspect number one lurks in the shadows of global finance as we once again have central banks hard at work trying to make sure that stock markets never go down by much. The promises made this year by central bankers for ever-looser monetary policy surely has something to do with the discussed overvaluation that we are witnessing in financial markets.

- The collapse in bond yields around the world has investors in a tough spot if they are in search of a reasonable return in the fixed-income world. Note for example, German 10-year bonds which are priced to yield -0.45%! Even the relatively high yielding 10-year U.S. treasury bond yields less than 2%. In such a world, it is not surprising that capital has poured into higher risk assets such as real estate and the stock market. Microsoft’s steady double-digit earnings growth sounds pretty good compared to, in some cases, literally less than nothing in the bond market. One must wonder however, how long this can continue? Unfortunately, the answer to this question is unknown. Could we be sitting here a year from now discussing how central

banks have not only cut rates but are again embarked on another quantitative easing program? In such a case, one could imagine that today's high valuations are even higher. We do not feel that an investor should base an investment strategy around such an assumption. Quite the opposite, we feel that a high degree of caution is warranted in today's market.

Class F returns (in %) as at June 30, 2019	Year-to-date	1 year	3 year	5 year	10 year
Harbour Global Equity Corporate Class	6.3	1.6	6.1	3.2	9.1

Sources: Bloomberg Finance L.P., Harbour Advisors, as at June 30, 2019.

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