CNBC

One ETF that focuses on employee happiness is outperforming the market this year

By Alex Harring
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The team behind a group of exchange-traded funds focused on employee happiness doesn't want you to get the wrong idea.

Yes, it's an investing thesis investors can feel good about: a screen for companies that treat their workers well. But the managers emphasize that there doesn't need to be a hit to returns to invest in a socially responsible way. In fact, the team has found the opposite to be true.

The Harbor Human Capital Factor U.S. Large Cap ETF — which fittingly trades under the HAPI ticker — has climbed nearly 25% this year as megacap technology stocks rallied. Meanwhile, the benchmark S&P 500 index has added less than 20% in the same period.

"It's a conceptual bridge that people need to get over," said Kristof Gleich, chief investment officer of Harbor Capital Advisors.

But once they do, it's not a hard sell: "This appeals to my mom – my dear old mom – as much as it does a sophisticated institutional pension plan because it's relatable," Gleich said. "People understand: OK, if companies are doing a good job at engaging and motivating … that's obviously going to result in better outcomes for the company, for the shareholders and for all the stakeholders."

Morningstar has a bronze rating and put the ETF's year-to-date performance in the top 6th percentile of nearly 1,400 large blend funds. HAPI has a fee of 0.36%.

A strong year

That marks a strong start for the fund, which launched in late 2022. The investing strategy behind it, meanwhile, has a longer history.

Through working with data partners, Irrational Capital has surveyed more than 15 million employees across around 4,500 companies. In some instances, the firm has been gathering data about companies' treatment of workers for more than a decade.

A survey will ask workers about topics ranging from their level of pride in their work, if their ideas are valued and for their view of both direct and senior management. There's typically interest from companies in participating because the data can be used by management for feedback without being publicly shared, according to Irrational founder David van Adelsberg.

Executives don't need to worry about Irrational misrepresenting their company, and participation can open them up to potential inclusion in products such as an ETF, van Adelsberg said. While he said data from internal human resource teams can be self-referential, this type of survey is viewed as more beneficial when trying to predict future equity performance.

Survey results are then melded with publicly available data about companies to create a "score" around their human capital. This has been codified into a new investment factor that is considered uncorrelated to others, such as value or growth, van Adelsberg noted.

From there, the Harbor ETF is built from companies that perform well in the human capital assessment. It is sector weighted to the S&P 500, with an individual limit of either five times the exposure in the broad index or 5% in net assets.

Mega-cap stocks make up a sizable portion of the biggest holdings, which helps explain the outperformance this year thanks to the "Magnificent 7" rally. In fact, Microsoft, Apple, Nvidia, Alphabet (both A and C shares) and Meta together make up more than a quarter of individual stock holdings, according to Morningstar data as of Nov. 29.

Outside of technology, health care stocks Eli Lilly and Johnson & Johnson and financial names Mastercard and Berkshire Hathaway are also among the largest holdings. J&J is the only one of the top 10 on track to end 2023 with losses.

In total, the ETF recently held nearly 150 equities and is benchmarked to the CIBC Human Capital Index.

Harbor runs a similar ETF, under the ticker HAPS, focused on small cap stocks that similarly builds on Irrational research. That fund includes stocks such as buy-now-pay-later fintech provider Affirm, human resources solutions company Insperity and investment firm Evercore.

While small-cap securities have underperformed this year, Gleich said there could be an opportunity for investors to get in the fund before a rebound. The small-cap ETF has a fee of 0.64%.

Many investors are "waiting on the sideline, and have been waiting on the sidelines to allocate more to small caps," Gleich said. "Next year could be a year where small caps surprise to the upside more broadly, and obviously HAPS, then, would do very well in that environment."

'Novel approaches'

The team sees a moat around their data that allows investors to gauge human capital in a way no one else can. Gleich said Irrational's data has "cracked the code" for investors looking to understand an intangible factor that has largely been overlooked.

"It's measuring an asset in a way that others can't measure," the former JPMorgan Chase managing director said. "We're all about looking for novel approaches to investing that are measuring value in unique ways. And if you can do that, and if you can do it in a disciplined way, we think we can generate strong returns for our clients."

Still, the team noted some challenges in building broader awareness of what human capital is or why it matters. But they've said awareness begets interest in the product.

Improved understanding can also come from the Securities and Exchange Commission's draft recommendations on human capital disclosure requirements, van Adelsberg said. More human capital-focused products could be on the way as the investing framework gains favor, the pair said.

And the Irrational Capital founder said there could also be a positive byproduct from their work as these efforts become more widely known.

If executives see there’s a connection between strong equity performance and positive treatment of workers, he said they will act accordingly. In other words: the firm has found the business case for treating workers well.

“In this market, what we’re seeing is that those companies who have strong human capital ratings are outperforming,” van Adelsberg said. “The role that human capital plays in driving future equity performance isn’t going down. It’s going up.”

HAPI: Average Annual Returns as of 12/31/23

	3 month	YTD	1 Yr.	Since Inception (10/12/22)
Harbor Human Capital Factor U.S. Lage Cap ETF (HAPI) – NAV	10.85%	30.30%	30.30%	33.39%
Harbor Human Capital Factor U.S. Lage Cap ETF (HAPI) – Market	10.85%	30.30%	30.30%	33.39%
CIBC Human Capital Index	11.05%	30.65%	30.65%	33.79%
S&P 500 Index	11.69%	26.29%	26.29%	28.68%

The Harbor Human Capital Factor U.S. Large Cap ETF (HAPI) gross expense ratio is 0.36%

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 harborcapital.com or by calling 800-422-1050.

For an updated list of HAPI's holdings and weights, please access HAPI.
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Important Information

Investors should carefully consider the investment objectives, risks, charges and expenses of a Harbor fund before investing. To obtain a summary prospectus or prospectus for this and other information, visit harborcapital.com or call 800-422-1050. Read it carefully before investing.

Risks
Investing involves risk, principal loss is possible. Unlike mutual funds, ETFs may trade at a premium or discount to their net asset value. Harbor ETFs are new and have limited operating history to judge.

Shares are bought and sold at market price not net asset value (NAV). Market price returns are based upon the closing composite market price and do not represent the returns you would receive if you traded shares at other times.

HAPI: There is no guarantee that the investment objective of the Fund will be achieved. Stock markets are volatile and equity values can decline significantly in response to adverse issuer, political, regulatory,market, and economic conditions. The Fund may not exactly track the performance of the Index with perfect accuracy at all times. Tracking error may occur because of pricing differences, timing and costs incurred by the fund or during times of heightened market volatility. The Fund relies on the Index provider's methodology in assessing whether a company may be considered a corporate culture leader. There is no guarantee that the construction methodology will accurately assess a company to include or exclude it from the index which could have an adverse effect on the Fund's returns. The Fund's assets may be concentrated in a particular sector or industries to the extent the Index is concentrated and is subject to the risk that economic, political, or other market conditions that have a negative effect on that sector or industry will negatively impact the value of the Fund. Companies in the information technology sector can be significantly affected by short product cycles, obsolescence of existing technology, impairment or loss of intellectual property rights, falling prices and profits, competition from new market entrants, government regulation and other factors.

The Fund’s returns achieved during certain periods shown were unusual and an investor should not expect such performance to be sustained.

This information should not be considered as a recommendation to purchase or sell a particular security. The holdings mentioned may change at any time and may not represent current or future investments.

The views expressed herein are those of named investment professionals at the time the comments were made. These views are subject to change at any time based upon market or other conditions, and the author/s disclaims any responsibility to update such views. These views may not be relied upon as investment advice and, because investment decisions are based on many factors, may not be relied upon as an indication of trading intent. The discussion herein is general in nature and is provided for informational purposes only. There is no guarantee as to its accuracy or completeness. Past performance is no guarantee of future results.

Diversification does not assure a profit or protect against loss in a declining market.

Important Information

Benchmarks
The CIBC Human Capital Index consists of a modified market-weighted portfolio of the equity securities of U.S. companies identified by Irrational Capital LLC ("Irrational Capital") as those it believes to possess strong corporate culture based on its proprietary scoring methodology. Constituents eligible are chosen from Solactive GBS United States 500 Index (the "index universe") at the time of Index reconstitution. The Solactive GBS United States 500 Index intends to track the performance of the largest 500 companies from the US stock market. The index listed is unmanaged and does not reflect fees and expenses and is not available for direct investment.

The S&P 500 Index is an unmanaged index generally representative of the U.S. market for large capitalization equities. This unmanaged index does not reflect fees and expenses and is not available for direct investment.

The Morningstar Medalist RatingTM is the summary expression of Morningstar's forward-looking analysis of investment strategies as offered via specific vehicles using a rating scale of Gold, Silver, Bronze, Neutral, and Negative. The Medalist Ratings indicate which investments Morningstar believes are likely to outperform a relevant index or peer group average on a risk-adjusted basis over time. Investment products are evaluated on three key pillars (People, Parent, and Process) which, when coupled with a fee assessment, forms the basis for Morningstar's conviction in those products' investment merits and determines the Medalist Rating they're assigned. Pillar ratings take the form of Low, Below Average, Average, Above Average, and High. Pillars may be evaluated via an analyst's qualitative assessment (either directly to a vehicle the analyst covers or indirectly when the pillar ratings of a covered vehicle are mapped to a related uncovered vehicle) or using algorithmic techniques. Vehicles are sorted by their expected performance into rating groups defined by their Morningstar Category and their active or passive status. When analysts directly cover a vehicle, they assign the three pillar ratings based on their qualitative assessment, subject to the oversight of the Analyst Rating Committee, and monitor and reevaluate them at least every 14 months. When the vehicles are covered either indirectly by analysts or by algorithm, the ratings are assigned monthly.

For more detailed information about these ratings, including their methodology, please go to **global.morningstar.com/managerdisclosures/.**

The Morningstar Medalist Ratings are not statements of fact, nor are they credit or risk ratings. The Morningstar Medalist Rating (i) should not be used as the sole basis in evaluating an investment product, (ii) involves unknown risks and uncertainties which may cause expectations not to occur or to differ significantly from what was expected, (iii) are not guaranteed to be based on complete or accurate assumptions or models when determined algorithmically, (iv) involve the risk that the return target will not be met due to such things as unforeseen changes in management, technology, economic development, interest rate development, operating and/or material costs, competitive pressure, supervisory law, exchange rate, tax rates, exchange rate changes, and/or changes in political and social conditions, and (v) should not be considered an offer or solicitation to buy or sell the investment product. A change in the fundamental factors underlying the Morningstar Medalist Rating can mean that the rating is subsequently no longer accurate.

2023 Analyst-Driven 10% and Data Coverage 77%

Important Information

Past rankings are no guarantee of future rankings. Morningstar rankings are based on a fund's average annual total return relative to all funds in the same Morningstar category. Fund performance used within the rankings, reflects certain fee waivers, without which, returns and Morningstar rankings would have been lower. The highest (or most favorable) percentile rank is 1 and the lowest (or least favorable) percentile rank is 100.Morningstar Rankings are for the fund's respective category, quarterly, as of 12/31/2023. The Morningstar Rankings are based on total returns, with distributions reinvested and operating expenses deducted. Morningstar does not take into account sales charges. The Harbor Human Capital Factor US Large Cap ETF ranked as follows: Returns (inception to date – 10/12/22-12/31/23): 6th percentile ranking out of 597 funds based on total returns reported as of 12/31/2023. Returns (1YR ending 12/31/2023): 7th percentile ranking out of 609 funds based on total returns reported as of 12/31/2023. Information ratio (inception to date – 10/12/22-12/31/23): 1st percentile ranking out of 597 funds based on information ratio as of 12/31/2023. Information Ratio (1YR ending 12/31/2023): 3rd percentile ranking out of 609 funds based on information ratio as of 12/31/2023.

Expense ratio information is as of the Fund's current prospectus, as supplemented. Gross expenses are the Fund's total annual operating expense.

The information ratio (IR) is a measurement of portfolio returns beyond the returns of a benchmark, usually an index, compared to the volatility of those returns. The benchmark used is typically an index that represents the market or a particular sector or industry.

Alpha refers to excess returns earned on an investment

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CIBC is a third-party index provider to the Harbor Human Capital Factor US Large Cap ETF.

Foreside Fund Services, LLC is the Distributor of the Harbor ETFs.
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