

Second Quarter 2017

Quarterly Commentary

Ticker	Inv Manager or Sub-Advisor	Benchmark	Morningstar Category	Investment Objective
PPSAX	Spectrum	BofA Merrill Lynch U.S. All Capital Securities Index	Preferred Stock	Income

Economic Overview

The world economy appears to be in the midst of a synchronized economic upturn. Central bankers are now talking in a synchronized fashion about reducing the massive monetary accommodation put in place since the financial crises. In June the European Central Bank (ECB) President Mario Draghi spoke positively about euro-area economic activity and the U.S. Federal Reserve hiked the Fed funds rate another 0.25% and unveiled a specific plan to shrink its huge portfolio of bonds. Capital spending has been picking up, loan growth has improved, financial conditions have been easing; job gains have been excellent, and unemployment has fallen.

In China, purchasing manager indices (PMIs) picked up in June and trade data has been excellent. Even in Japan, confidence is at or near the highs of the cycle. Industrial production and machine orders have rebounded, and retail sales have been strong. Profits have been picking up at a double-digit pace, and the labor market is the best in decades. Robust activity has failed to inspire pricing power, and core inflation is still running well below 1%. Sentiment in the Eurozone is the highest in decades. Soft data soared over the last few months. Investors, businesses, and consumers have cheered the fading political risk and better growth prospects. Some German measures are the best since reunification, but Italian and French sentiment has been robust too. Hard data has picked up also with German industrial production and factory orders rebounding from contractionary territory. Retail sales have grown at a healthy 2.5% pace across the entire Eurozone. Spain's unemployment rate dropped to 17.7% from a peak of 26.3%; Germany's unemployment rate is currently 5.7%. U.S. consumer and business sentiment has soared to the best levels of this cycle with hard data rebounding from the first-quarter slump. Core retail sales (the number included in GDP) soared over 5% on a three-month annualized pace in May. Industrial production expanded 3.8%. Both manufacturing and non-manufacturing PMIs from the Institute for Supply Management (ISM) surprised to the upside in June. Fed regional surveys were also solid. Consumer confidence has edged lower from recent highs, but remains well above 2016 levels. Housing starts have lost some momentum, since the multifamily real estate cycle peaked; but, single-family sales remain strong.

German and U.S. yields rose sharply during the last week of June. German 10-year yields more than doubled, reaching 0.56% on July 6th. Other sovereign yields pushed higher too; rates on 10-year British gilts surged to 1.31% at the end of June 30 from 1.0% or so earlier in the month. Even ten-year Japanese government bond yields jumped to 0.09% from 0.0% in April.

Fixed Income

The Treasury curve flattened during the quarter with short-term interest rates rising and long-term rates declining. The two-year U.S. Treasury rate rose 0.13% while the five-year U.S. Treasury rate fell 0.03%. The 10-year rate fell 0.08% and the 30-year rate fell 0.18%. The slope of the two to 10-year Treasury curve fell from 1.13% to 0.92%.¹

Spread sectors outperformed during the quarter, driven by strong technical factors. The Bloomberg Barclays U.S. Aggregate Index, a proxy for the overall fixed income market, had an excess return of 0.30% for the quarter when compared to similar duration U.S. Treasury securities. The best performing sectors were below investment-grade corporate bonds, investment-grade corporate bonds, and emerging market debt with excess returns of 1.46%, 1.12%, and 0.72%, respectively. Commercial mortgage-backed securities (CMBS) and asset-backed securities (ABS) also outperformed with excess returns of 0.34% and 0.32%, respectively. U.S. agencies outperformed similar duration U.S. Treasury securities but underperformed the Bloomberg Barclays U.S. Aggregate Index with an excess return of 0.24%. Mortgage-backed securities (MBS) underperformed.²

Performance Contributors

Positive Contributors

During last quarter:

The flattening yield curve contributed to performance of preferred securities overall. Rising rates in the front end benefitted the extended insurance and utility issues. Rising front end rates have also buoyed fixed to float \$1000 pars and longer duration bonds have benefitted as well. \$25 par securities have made a strong comeback after selling off in November during the spike in rates after the U.S. election. Allocation to contingent convertibles (CoCos) (company stock price at conversion must reach specific price in addition to bond strike price prior to converting) contributed. The general upward trajectory in European bank equity, given rising inflation and improved confidence in the Eurozone, has helped CoCos.

During last 12 months:

Although rates spiked post the U.S. election, this was followed by increased investor optimism given the prospect for growth due to tax reform, de-regulation, and infrastructure. Rising rates in the front end have benefitted the extended insurance and utility issues. Rising front end rates have also buoyed fixed to float \$1000 par securities. Allocation to CoCos continues to contribute. The general upward trajectory in European bank equity, given rising inflation and improved confidence in the Eurozone, has helped CoCos. CoCos were the strongest performing asset class over the last 12 months.

Negative Contributors

During last quarter:

The short call issues detracted from relative performance due to the environment where investors were rewarded for taking risk and going long duration. In the risk-on second quarter the lower coupon, lower duration, and higher quality CoCos underperformed relative to other CoCos. The corporate hybrids in the portfolio underperformed given their shorter duration profile.

During last 12 months:

Preferred securities and the \$25 par market in particular sold off in November post the result of the U.S. election, given the sharp spike up in rates. Higher coupon, short call, shorter duration bonds underperformed in a risk-on environment. Underweight to \$25 par securities detracted from relative performance as they have rebounded strongly in 2017 post their election jitters.

Changes to the investment option's structure or portfolio:

No material changes occurred in the portfolio structure.

Preferred Securities Fund (A)

Performance

Investment results shown represent historical performance and do not guarantee future results. Investment returns and principal values fluctuate with changes in interest rates and other market conditions so the value, when redeemed may be worth more or less than original costs. Current performance may be lower or higher than the performance data shown. The gross fund expense figure does not reflect any waivers or caps on the mutual fund. Performance shown reflects the application of net expenses of the fund. For more performance information, including most recent month-end performance, visit principalfunds.com, or contact your financial representative of The Principal.

In situations where the net and gross fund expense figures are different, the investment manager has contractually agreed to limit the investment option's expense. Differences may also be shown due to the investment manager choosing to pay certain expenses that would normally be payable by the fund. The gross fund expense figure does not reflect any waivers or caps on the mutual fund. Performance shown reflects the application of net expenses of the fund.

Average Annual Total Returns (%) as of 06/30/2017	QTR	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception	Inception Date	06/28/2005
Preferred Securities Fund (A) (excl. sales charge)	3.73	7.85	8.98	5.92	7.42	6.74	6.12	Ext. Perf. Inc. Date	05/01/2002
Preferred Securities Fund (A) (incl. sales charge)	-0.17	3.78	4.85	4.58	6.60	6.33	5.85	Total Inv. Exp Gross	1.08
BofA Merrill Lynch U.S. All Capital Securities Index	3.52	8.24	7.90	6.49	8.02	-	-	Total Inv Exp Net	1.08
Preferred Stock Category	3.20	7.15	9.12	5.61	7.08	6.14	-	Waiver Date	-
Morningstar Percentile Ranking	-	-	54	57	47	25	-	Contractual Cap Date	-
Total Funds in Category	57	55	55	41	33	17	-	Contingent Deferred Sales Charge	1.00
								Maximum Up-front Sales Charge	3.75

Past performance is no guarantee of future results. Market indices have been provided for comparison purposes only. They are unmanaged and do not reflect fees or expenses. Individuals cannot invest directly in an index.

These calculated returns reflect the historical performance of the oldest share class of the fund, adjusted to reflect a portion of the fees and expenses of this share class. For time periods prior to inception date of the fund, predecessor performance is reflected. Please see the fund's prospectus for more information on specific expenses, and the fund's most recent shareholder report for actual date of first sale. Expenses are deducted from income earned by the fund. As a result, dividends and investment results will differ for each share class.

Preferred Securities Fund (A)

Top Ten Holdings as of 05/31/2017

Security	Net Assets (%)
Jpmorgan Chase FRN	2.75
General Elec FRN	2.35
Centaur Fdg Pfd 144A	2.01
Wells Fargo Co New FRN	1.57
Nationwide Finl Svcs FRN	1.47
Rabobank Nederland 144A FRN	1.46
Citigroup FRN	1.45
Bk New York Mellon FRN	1.38
Credit Suisse Intl 144A Cv	1.38
Wells Fargo & Co, San Francisco Ca Pfd	1.35
Total % in Top 10	17.17

Statistics as of 05/31/2017	
Average Eff Duration (yrs)	4.84
Average Eff Maturity (yrs)	-
Average Weighted Price	\$115.77
30-Day SEC Yield - Subsidized (Net) as of 06/30/2017	3.81%
30-Day SEC Yield - Non-Subsidized (Gross) as of 06/30/2017	3.81%

Information is current as of the date noted. Keep in mind that all current and future portfolio holdings are subject to risk.

Preferred Securities Fund (A)

Manager(s)	Start Date	Degree	Alma Mater
L. Phillip Jacoby	05/01/2002	B.S.	Boston University
Mark A. Lieb	07/01/2009	B.A.	Central Connecticut State University
Fernando Diaz	12/31/2010	-	-
Roberto Giangregorio	12/31/2010	M.B.A.	Cornell University
Manu Krishnan	12/31/2010	M.B.A.	Cornell University

Fund Strategy

The investment seeks to provide current income. The fund invests at least 80% of its net assets, plus any borrowings for investment purposes, in preferred securities at the time of purchase. It concentrates its investments (invests more than 25% of its net assets) in securities in the U.S. and non-U.S. financial services (i.e., banking, insurance and commercial finance) industry. The fund also regularly invests in the real estate investment trust (REIT) and utility industries.

About Spectrum

Spectrum Asset Management (Spectrum) - an affiliate of Principal Global Investors - offers specialized expertise in the management of preferred securities. The firm was founded in 1987 and is based in Stamford, Connecticut. Spectrum's clients include insurance companies, corporations, pension funds, retirement plans, mutual funds, charitable trusts and financial institutions in the U.S. and abroad.

Important Notes

Investors should carefully consider a fund's investment objectives, risks, charges, and expenses prior to investing. A prospectus, or summary prospectus if available, containing this and other information can be obtained by contacting a financial professional, visiting principalfunds.com, or calling 800-222-5852. Read the prospectus carefully before investing.

The value of the investment options will fluctuate so that when redeemed, shares or units may be worth more or less than the original cost.

Returns shown for periods of less than one year are not annualized. All returns displayed here are after Total Investment Expense of the investment option. Any operating expenses of a mutual fund or underlying mutual fund that are part of net Total Investment Expense are obtained from the mutual fund's most recent prospectus. The operating expenses shown as part of the Total Investment Expense include voluntary expense limits and fee credit.

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These calculated returns reflect the historical performance of the oldest share class of the fund, adjusted to reflect a portion of the fees and expenses of this share class. For time periods prior to inception date of the fund, predecessor performance is reflected. Please see the fund's prospectus for more information on specific expenses, and the fund's most recent shareholder report for actual date of first sale. Expenses are deducted from income earned by the fund. As a result, dividends and investment results will differ for each share class.

Fixed-income and asset allocation investment options that invest in mortgage securities are subject to increased risk due to real estate exposure.

Fixed-income investment options are subject to interest rate risk, and their value will decline as interest rates rise. Neither the principal of bond investment options nor their yields are guaranteed by the U.S. government.

BofA Merrill Lynch U.S. All Capital Securities Index represents the all capital securities market.

Extended Performance Inception Date (Ext. Perf. Inc. Date) - Inception date of the oldest share class of the fund, or underlying fund of the Separate Account.

About Principal Financial Group



The Principal Financial Group® (The Principal®) is a leading global financial company offering businesses, individuals and institutional clients a wide range of financial products and services. Our range of products and services includes retirement solutions, life and health insurance, wellness programs, and investment and banking products through our diverse family of financial services companies and national network of financial professionals.

Important Notes

Statistics:

30-Day SEC Yield - Subsidized (Net) - This yield citation reflects the income that the investment option produced taking into consideration all expense waivers, caps, and breakpoints in place during the 30 day period. Without these waivers, the investment option's yield would be lower.

30-Day SEC Yield - Non-Subsidized (Gross) - This yield citation reflects the income that the investment option would produce if the investment option did not have a portion of its total investment expense waived or capped.

Average Effective Duration - A measure of a fixed income investment option's interest-rate sensitivity and represents an approximate percent change in bond's price for a one percent change in interest rates-the longer a fund's duration, the more sensitive the portfolio is to shifts in interest rates. The duration of a fixed income investment option is determined by a formula that includes projected cash flows, such as coupons and principal payout at maturities for bonds.

Average Effective Maturity - Average effective maturity is a weighted average of all the effective maturities of the bonds in a portfolio.

Average Weighted Price - The statistic is calculated by weighting the price of each bond by its relative size in the portfolio. This number reveals if the investment option favors bonds selling at prices above or below face value (discount or premium securities, respectively). A higher number indicates a bias toward premiums. This statistic is expressed as a percentage of par (face) value.

Effective Duration - A measure of a fixed income investment option's interest-rate sensitivity and represents an approximate percent change in bond's price for a one percent change in interest rates-the longer a fund's duration, the more sensitive the portfolio is to shifts in interest rates. The duration of a fixed income investment option is determined by a formula that includes projected cash flows, such as coupons and principal payout at maturities for bonds.

*Unless otherwise stated, all data from Bloomberg

¹U.S. Treasury Constant Maturity 30-year, 10-year and 2-year yields

²Components of Bloomberg Barclays U.S. Aggregate Bond Index, via Barclays Live. Duration-adjusted excess return is a measure the relative performance to that of U.S. Treasuries with a similar duration profile.

This report is not complete unless all pages, as noted below, are included.

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