

First Quarter 2017

## Quarterly Commentary

Ticker	Inv Manager or Sub-Advisor	Benchmark	Morningstar Category	Investment Objective
PMVPX	Principal Global/Barrow Hanley	Russell Midcap Value Index	Mid Cap Value	Growth and Income

## Economic Overview

The first quarter of 2017 saw the dawning of the Trump administration. That factor was by far the biggest driver of the markets. Initially, the markets reacted with euphoria, as the expectation was that the new Trump administration would usher in a regime change of lower taxes and lower regulatory burdens. This excitement continued well into March when the Dow, S&P 500, and Nasdaq all hit record highs. Interestingly, seemingly left behind were small-cap stocks, as evidenced by the Russell 2000 which underperformed their larger counter parts substantially (Russell 2000 +2.47 vs Russell 1000 +6.03) year-to-date.<sup>1</sup> The idea being that larger companies would benefit more from Trump's policies.

The cyclical reflation continued through the first quarter of 2017. The market continues its back and forth and the world's underlying economic fundamentals have stayed robust and are improving in Europe and Japan. The rebound in commodity prices has slowed, headline inflation has eased, and sentiment indicators are positive. But, deflation is over and for the first time since 2010, no major country is encountering deflation in producer or consumer prices.

In the United States, despite the rally in risk assets, longer-term interest rates declined slightly due to increasing global political risks. Meanwhile, the Federal Reserve (Fed) raised its target rate in March and is expected to make additional rate hikes in 2017. Consumer and business confidence is strong, the housing market is improving, and manufacturing output has seen steady gains in recent months. In addition, wage growth is accelerating and the unemployment rate continues to decline. Business surveys in Europe were positive. Core inflation, excluding food and energy, fell in March to 0.7% over the prior year. In Japan, the unemployment rate dropped to 2.8%, its lowest level since 1994. Manufacturing surveys stayed solid. In China, reflation remains entrenched as growth stabilized at a good level and industrial profits surged 31.5% in January and February. At the end of the quarter, the S&P 500 and the Dow Jones 30 Industrials total return indices were both almost perfectly flat in March after hitting record highs earlier in March. Most European and developing countries looked better. The MSCI Europe and MSCI Emerging Market indices were each up 3.6% and 2.4% for March and surged 6.5% and 11.2% for the quarter, both respectively. Emerging market bonds had good returns as developing country interest rates slid a bit or were flat during the first quarter and the improving economic data led to narrower credit yield spreads. Euro area stocks were on the leader boards of both the March and the first quarter as economic data steadily improved, rising above expectations.

## Small/Mid U.S. Equity

U.S. mid-cap equities were up 5.2% for the quarter, outpacing U.S. small-caps (up 2.5%), but falling behind U.S. large-caps (up 6.0%). U.S. small-caps and U.S. mid-caps underperformed international equities in emerging markets and international equities in developed markets (which returned 11.5% and 7.3%, respectively).<sup>2</sup> Within value, mid-cap equities beat small-caps, due primarily to the smaller weight in the financials sector and stronger performance from stocks held in the industrial and energy sectors within the Russell MidCap Value Index (up 3.8%) compared to the Russell 2000 Value Index (down 0.1%). Within growth, once again mid-cap equities outperformed small-caps, where better results from specific stocks in the industrial and information technology sectors helped the Russell MidCap Growth Index (up 6.9%) versus the Russell 2000 Growth Index (up 5.4%).<sup>3</sup> Within mid-caps, growth beat value, due in large part to a larger weighting to the information technology sector within the Russell Mid-Cap Growth Index, along with better performing stocks in the healthcare sector. Similar to mid-caps, small-cap growth outperformed small-cap value. The majority of outperformance for the Russell 2000 Growth Index was due to the larger weight to the healthcare and information technology sectors, as well as better performing consumer discretionary stocks within the Russell 2000 Growth Index versus the Russell 2000 Value Index.<sup>3</sup>

### Performance Contributors

#### Positive Contributors

##### During last quarter:

Stock selection overall contributed, especially in the industrials sector. Overweight to the consumer discretionary and industrials sectors contributed. Underweight to the energy, real estate, and telecommunication services sectors contributed to results.

##### During last 12 months:

Stock selection in and underweight to the real estate sector contributed. Stock selection in the consumer staples and materials sectors contributed. Underweight to the utilities and telecommunication services contributed.

#### Negative Contributors

##### During last quarter:

Stock selection in the consumer discretionary, energy and financials sectors hindered performance. Underweight to the information technology sector held back returns. Underweight to the utilities sector detracted.

##### During last 12 months:

Stock selection overall detracted, especially in the consumer discretionary and energy sectors. Overweight to the consumer discretionary and consumer staples sectors hindered results. Underweight to the energy and information technology sectors detracted.

##### Changes to the investment option's structure or portfolio:

No material changes occurred in the portfolio structure.

# MidCap Value Fund III (P)

## 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](http://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 03/31/2017	QTR	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception	Inception Date	06/03/2014
MidCap Value Fund III (P) (excl. sales charge)	4.36	4.36	16.18	6.23	12.06	6.46	8.39	Ext. Perf. Inc. Date	12/06/2000
Russell Midcap Value Index	3.76	3.76	19.82	8.94	14.07	7.47	-	Total Inv. Exp Gross	3.42
Mid Cap Value Category	3.50	3.50	18.86	7.04	12.02	6.68	-	Total Inv Exp Net	0.84
Morningstar Percentile Ranking	-	-	79	70	53	55	-	Waiver Date	02/28/2018
Total Funds in Category	406	406	398	341	301	212	-	Contractual Cap Date	02/28/2018
								Contingent Deferred Sales Charge	-
								Maximum Up-front Sales Charge	-

**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.

# MidCap Value Fund III (P)

## Top Ten Holdings as of 02/28/2017

Security	Net Assets (%)
S&P Mid 400 Emini Mar 17	3.89
Stanley Black & Decker Inc	2.32
CenterPoint Energy Inc	1.91
Owens-Corning Inc	1.83
SunTrust Banks Inc	1.73
Devon Energy Corp	1.59
Royal Caribbean Cruises Ltd	1.51
Unum Group	1.49
Spirit AeroSystems Holdings Inc	1.48
Everest Re Group Ltd	1.41
<b>Total % in Top 10</b>	<b>19.16</b>

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

## MidCap Value Fund III (P)

Manager(s)	Start Date	Degree	Alma Mater
James W. Fennessey	06/16/2010	B.S.	Truman State University
Randy L. Welch	06/16/2010	M.B.A.	Drake University

### Fund Strategy

The investment seeks long-term growth of capital. Under normal circumstances, the fund invests at least 80% of its net assets, plus any borrowings for investment purposes, in equity securities of companies with medium market capitalizations at the time of purchase. It invests in value equity securities, an investment strategy that emphasizes buying equity securities that appear to be undervalued. The fund invests in real estate investment trusts.

### About Barrow Hanley

Barrow, Hanley, Mewhinney & Strauss (Barrow Hanley), founded in Dallas in 1979, is one of the largest value-oriented investment managers in the U.S. Barrow Hanley provides U.S. and international equity, fixed income and balanced investment management services. In all strategies, the firm seeks to exploit market inefficiencies through adherence to a value-oriented investment process dedicated to the selection of securities on a bottom-up basis.

### About Principal Global Investors

Principal Global Investors - a member of the Principal Financial Group® - uses a unified investment philosophy and process that emphasize independent fundamental research and superior stock selection. The firm's capabilities encompass large-, mid-, and small-cap stocks in developed and emerging markets worldwide.

## Important Notes

Principal Funds, Inc. is distributed by Principal Funds Distributor, Inc., member of the Principal Financial Group®. Principal Funds Distributor, Principal Shareholder Services, Principal Management Corporation and its affiliates, and Principal Funds, Inc. are collectively referred to as Principal Funds.

**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](http://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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Small-cap and mid-cap stocks may have additional risks, including greater price volatility.

Small-cap and mid-cap investment options are subject to more fluctuation in value and may have additional risks than other investment options with stocks of larger, more stable companies.

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.

The manager of the Fund, Principal Management Corporation, invests between 10% and 40% of the Fund's assets in common stocks in an attempt to match or exceed the performance of the Fund's benchmark index for performance.

Class P shares are available only to certain investors. See the prospectus for more information.

### 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

Russell Midcap Value Index is a market-weighted total return index that measures the performance of companies within the Russell Midcap index having lower price-to-book ratios and lower forecasted growth values.

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.

\*All data sourced to Bloomberg, unless footnoted

<sup>1</sup>FTSE Russell

<sup>2</sup>U.S. mid-cap stocks: Russell Midcap Index; U.S. small-cap stocks: Russell 2000 Index; U.S. large-cap stocks: Russell 1000 Index; international developed markets: MSCI EAFE Index; international emerging markets: MSCI Emerging Market Index

<sup>3</sup>U.S. mid-cap growth stocks: Russell Midcap Growth Index; U.S. mid-cap value stocks: Russell Midcap Value Index; U.S. small-cap growth stocks: Russell 2000 Growth Index; U.S. small-cap value stocks: Russell 2000 Value Index

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



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