

Third Quarter 2017

# Quarterly Commentary

Ticker	Inv Manager or Sub-Advisor	Benchmark	Morningstar Category	Investment Objective
PICAX	Principal Global Investors	MSCI World Ex US Small Cap Index	Foreign Small/Mid Blend	Foreign Stock

## Economic Overview

The global economic recovery that began in early 2016 appears to have reached self-sustaining velocity. The consensus now recognizes the evidence: strong industrial production, robust growth, and improved capital spending. Plus, business and consumer confidence is surging to high or record levels. Bank indices had better returns than the overall market. Mildly rising interest rates also suggest that investors appreciate some of the more recent worries (i.e., risks of deflation, political turmoil in Europe, or a China hard landing) have fallen significantly.

Economic sentiment in the Eurozone is within a whisker of a 17-year high. Confidence improved in every sector and country. Even Italian CEOs have the most optimistic outlook in a decade. The final survey of manufacturing purchasing managers was the highest in over six and a half years. The flash composite of service and manufacturing indices rose. Private demand is driving growth in both consumer spending and investment. In September, inflation stayed modest. Unemployment is falling and job gains are healthy. The 5.6% jobless rate in Germany is the lowest it's been since reunification in the early 1990s. Even Brexit fears can't keep the UK economy from expanding, or household spending from growing. Purchasing manager indices from the National Bureau of Statistics suggest that both manufacturing and service businesses are improving in China. The private-sector gauge from Caixin/Markit slipped a bit, but still shows growth. The People's Bank of China revealed a targeted cut in required reserves for banks that increase lending to small and very small enterprises, so while fiscal stimulus has faded some, there will be plenty of liquidity. Growth is not accelerating, but no near-term hard landing seems anywhere in sight. The U.S. economy has been strong and steady. Real economic growth averaged 2.2%, matching the rate over the entire expansion. Confidence is high, job growth is robust, and inflation is subdued. Profit growth is rebounding, and capital spending is picking up. We expect third-quarter growth to be cut a few tenths by the tragedies that came with Hurricanes Harvey, Irma, and Maria. Rebuilding efforts could add a bit to growth in following quarters.

As the synchronized global economic expansion continues robust and unabated, central banks are re-evaluating the extraordinary policies put in place after the financial crisis. Robust world growth, higher oil prices, and rising investor confidence in the self-sustaining expansion, pushed government bond yields higher, reversing their July-August dip.

## International Equity

Global equity had robust and broad-based gains during the third quarter of 2017, in a continuation of favorable market conditions for the year to date. For another consecutive quarter, the market advance was led by emerging markets and international shares. The synchronized global expansion remained on track. Despite a reversal in September, the U.S. dollar weakened, while industrial commodity prices firmed, both consistent with signs of improving global growth trends. After a prolonged period of returns being driven by multiple rerating in recent years, 2017 has been defined by margin expansion and earnings growth. Corporate profits have returned to health with modest but meaningful top line growth and further extension of cost controls and capital redeployment. Much of the market action during the quarter conveyed a "risk-on" sentiment with sector leadership having a cyclical tilt. The S&P 500 advanced 4.5%, the MSCI EAFE index return posted a 5.5% return, while the MSCI Emerging Markets Index notched another sharp advance of 8.0%, in U.S. dollar terms.<sup>1</sup>

## Performance Contributors

### Positive Contributors

#### During last quarter:

Outperformance was consistent across all major regions with Europe and Japan providing the biggest contributions to relative performance. Within Europe, the United Kingdom, Sweden, and France had the strongest contributions. Outperformance was consistently strong across most sectors, led by the industrials, consumer discretionary, and materials sectors. German producer of silicon wafers Siltronic, Japanese chemical company Showa Denko, Italian motorway operator SIAS SpA, online payment processing service provider Worldpay Group, and Canadian gold miner Kirkland Lake Gold were the biggest individual contributors to relative performance.

#### During last 12 months:

Stock selection across most regions contributed, led by Europe, Japan, and other Asian markets. Within Europe, the United Kingdom and France contributed the most to relative performance. Within Asia, stock selection in Australia and Hong Kong was the strongest. Israel was another strong contributor to relative performance. Stock selection across most sectors contributed, with the consumer discretionary, healthcare, and materials sectors providing the biggest contribution to relative performance. German silicon wafer producer Siltronic, Japanese chemical producer Tosoh Corp., Japanese semiconductor manufacturing equipment maker Ulvac, British online clothing retailer boohoo.com, and UK beverage producer Fevertree Drinks were the biggest individual contributors to relative performance.

### Negative Contributors

#### During last quarter:

Belgium and Germany were the biggest detractors from relative performance. The telecom sector was the lone detractor from relative performance. Lack of allocation to European payment processing company Wirecard, and allocation to Swiss healthcare device maker Ypsomed, Japanese household products maker Lion Corporation, UK online fashion retailer boohoo.com, and Japanese food manufacturer Nichirei were the biggest individual detractors to relative performance.

#### During last 12 months:

Canada stood out as the most notable detractor, led by the energy sector. Switzerland and Denmark were laggards. Canadian oil and gas company Seven Generations Energy, Japanese real estate developer and operator Ichigo, German private equity investment company Aurelius, Japanese producer of dairy products Megmilk Snow Brand and Canadian Detour Gold were the biggest individual detractors from relative performance.

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

No material changes occurred in the portfolio structure.

# International Small Company 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](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 09/30/2017	QTR	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception	Inception Date	06/11/2014
International Small Company Fund (A) (excl. sales charge)	9.36	28.60	23.14	11.21	-	-	7.59	Ext. Perf. Inc. Date	06/11/2014
International Small Company Fund (A) (incl. sales charge)	3.31	21.48	16.38	9.12	-	-	5.77	Total Inv. Exp Gross	2.48
MSCI World Ex US Small Cap Index	7.26	23.82	20.42	9.59	11.16	4.04	-	Total Inv Exp Net	1.60
Foreign Small/Mid Blend Category	7.00	25.29	22.43	9.05	11.06	4.04	-	Waiver Date	06/30/2018
Morningstar Percentile Ranking	-	-	47	10	-	-	-	Contractual Cap Date	06/30/2018
Total Funds in Category	128	115	100	72	63	36	-	Contingent Deferred Sales Charge	1.00
								Maximum Up-front Sales Charge	5.50

**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.

# International Small Company Fund (A)

## Statistics Summary as of 09/30/2017

	Risk and Return Statistics Summary						Upside/Downside Capture Ratio					
	Alpha	Beta	R2	Sharpe Ratio	Info Ratio	Std Dev	# of Months		Avg Returns %		Benchmark %	
							Up	Down	Up	Down	Up	Down
3 Year							3 Year					
International Small Company Fund (A)	2.30	0.91	89.93	0.97	0.43	11.35	20	16	2.87	-1.76	94.93	77.87
MSCI World Ex US Small Cap Index	N/A	N/A	N/A	N/A	N/A	N/A	21	15	3.02	-2.26	100.00	100.00

Risk and return statistical data is calculated by Morningstar, Inc. Please see Important Notes section for definitions of Risk and Return Statistics.

## Top Ten Holdings as of 08/31/2017

Security	Net Assets (%)
ASR Nederland NV	0.93
Georg Fischer AG	0.92
Rheinmetall AG	0.91
Aalberts Industries NV	0.88
Moncler SpA	0.86
BUWOG AG	0.85
New Flyer Industries Inc	0.85
Showa Denko KK	0.84
Bellway PLC	0.83
Furukawa Electric Co Ltd	0.82
<b>Total % in Top 10</b>	<b>8.69</b>

## International Small Company Fund (A)

Manager(s)	Start Date	Degree	Alma Mater
Tiffany N. Lavastida	06/11/2014	M.B.A.	University of Iowa
Brian W. Pattinson	06/11/2014	M.B.A.	University of Iowa

### 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 small market capitalizations at the time of purchase. It invests primarily in foreign equity securities. The fund typically invests in foreign securities of more than 10 countries but has no limitation on the percentage of assets that is invested in each country or denominated in any currency.

### 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

**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 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.

International and global investment options are subject to additional risk due to fluctuating exchange rates, foreign accounting and financial policies, and other economic and political environments.

MSCI World Ex US Small Cap Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed markets. It offers an exhaustive representation of the Small Cap segment by targeting companies that are in the Investable Market Index but not in the Standard Index in a particular 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

### **Risk and Return Statistics:**

**Alpha** - The difference between an investment's actual returns and its expected performance, given its level of risk (as measured by beta).

**Beta** - An investment's sensitivity to market movements.

**R-squared** - Ranges from 0 to 100 and reveals how closely an investment's returns track those of a benchmark index.

**Standard Deviation** - Measures how much an investment's returns are likely to fluctuate.

**Sharpe Ratio** - Measures how an investment balances risks and rewards. The higher the Sharpe ratio, the better the investment's historical risk-adjusted performance.

**Information Ratio** - A risk-adjusted measure commonly used to evaluate an active manager's involvement skill. It's defined as the manager's excess return divided by the variability or standard deviation of the excess return.

**Up-Market Capture Ratio** - A statistical measure of an investment option's performance relative to a comparative index in months in which that index has risen. An up-market capture ratio of greater than 100 would indicate that the investment option performed better than the comparative index during months in which the index had risen over a specified time period.

**Down-Market Capture Ratio** - A statistical measure of an investment option's performance relative to a comparative index in months in which that index has fallen. A down-market capture ratio of greater than 100 would indicate that the investment option performed worse than the comparative index during months in which the index had fallen over a specified time period.

\*Unless otherwise stated, all data from Bloomberg

<sup>1</sup>International developed markets: MSCI EAFE Index; broad U.S. market: Russell 3000 Index; international emerging markets: MSCI Emerging Markets Index

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

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