

Third Quarter 2016

Quarterly Commentary

Ticker	Inv Manager or Sub-Advisor	Benchmark	Morningstar Category	Investment Objective
PCEAX	Principal Global Investors	Bloomberg Barclays Global Aggregate Corp USD Hedged Index	Multisector Bond	Income

Economic Overview

Overall, the economic environment has improved.

After weak U.S. reports in early September, the latest data suggests that a sustainable expansion- characterized by rising wages, robust job growth, and good household spending, which generates corporate profits and capital spending-could be starting. Initial claims for unemployment compensation have stayed low, under 300,000 weekly, for well over a year;¹ wage growth disappointed a bit in the last payroll report, but is up 2.4% over the prior year.²

It's not just the U.S. driving the mild upturn. Confidence and business has improved in greater Europe, in China, and in emerging markets. The impact of the U.K. vote to exit the European Union may haunt the area in the longer term, but the economies are paying little heed at the moment. U.K. factories are doing very well with the collapse of the currency.³ Across the Eurozone growth has been driven by solid household spending. Lending standards have eased and credit is more available; loan demand is rising from both businesses and households, albeit slowly, as interest rates have fallen. Business optimism in Germany is the best since May 2014 and consumer confidence is rising in France, Germany, and Italy.⁴ Industrial production and exports have accelerated in emerging Asia.⁵ The good trade numbers are driven by China. Industrial earnings jumped 19.5% year-over-year in August. Business surveys, both official and private, are well up off their early-year lows for both services and manufacturing. Confidence has improved. The driver of the modest revival has been fiscal spending, so this is no economic boom. But, the economy has stabilized and, with deflation easing, is picking up.⁶

Central banks have pursued extraordinarily easy monetary policy for years with mixed results. Recently, the Federal Reserve took no action at its September meeting, except to signal that fed funds would likely go up in December⁷. The Bank of Japan (BoJ) made two changes at its September meeting. First, bond purchases will be used to peg the yield on 10-year government bonds at 0.0%, so the amount of monthly bond purchases will be flexible. Second, the BoJ committed to keep the current policy in place until well after inflation reaches the 2% target.⁸

Fixed Income

The U.S. Treasury yield curve flattened due to larger increases at the front end of the curve. The 2-, 10-, and 30-year Treasuries increased 18, 13, and 4 basis points (bps), ending at 0.76%, 1.60%, and 2.32% respectively.⁹ This slight increase in overall rates can in part be attributed to a modest improvement in the labor market and economic activity during the quarter. While the case for an increase in the Federal Funds rate has strengthened, the Federal Reserve (Fed) held interest rates steady at its September 2016 meeting, citing a desire to wait for further evidence of continued progress toward its objectives.¹⁰

All fixed-income spread products outperformed duration-adjusted U.S. Treasuries amid slightly lower global volatility. For the second consecutive quarter, below investment-grade corporate bonds led the way, delivering duration-adjusted excess returns of 5.76%. This was followed by investment-grade corporate bonds of 1.73%, among which industrial, financials, and utility sub-sector excess returns were 1.91%, 1.49% and 1.22% respectively. Commercial mortgage-backed securities (CMBS), agency mortgage-backed securities (MBS), and asset-backed securities (ABS) also delivered excess returns of 0.91%, 0.64%, and 0.26% respectively.¹¹

Performance Contributors

Positive Contributors

During last quarter:

The portfolio outperformed the Barclays Global Aggregate Corporate index, driven mainly by security selection within investment-grade corporate bonds. An out-of-index allocation to below investment-grade corporate bonds contributed. Security selection within U.S. Treasury securities contributed.

During last 12 months:

Security selection within investment-grade corporate bonds contributed. Security selection within U.S. Treasury securities contributed. Security selection within mortgage-backed securities contributed.

Negative Contributors

During last quarter:

An out-of-index allocation to U.S. Treasury securities detracted. Macro volatility hedges (investments to reduce the risk of adverse price movements in an asset) detracted. Positioning within investment-grade corporate bonds detracted.

During last 12 months:

The portfolio underperformed the Barclays Global Aggregate Corporate index, driven mainly by a short duration position as rates fell. Security selection within below investment-grade corporate bonds detracted. An out-of-index allocation to U.S. Treasury securities detracted.

Changes to the investment option's structure or portfolio:

No material changes occurred in the portfolio structure.

Credit Opportunities Explorer 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 09/30/2016	QTR	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception	Inception Date	09/10/2014
Credit Opportunities Explorer Fund (A) (excl. sales charge)	1.72	6.24	5.10	-	-	-	0.53	Ext. Perf. Inc. Date	09/10/2014
Credit Opportunities Explorer Fund (A) (incl. sales charge)	-2.06	2.29	1.17	-	-	-	-1.32	Total Inv. Exp Gross	1.40
Bloomberg Barclays Global Aggregate Corp USD Hedged Index	1.86	8.52	8.59	5.56	5.63	5.30	-	Total Inv Exp Net	1.11
Multisector Bond Category	2.71	7.93	7.33	3.88	5.31	5.55	-	Waiver Date	12/30/2016
Morningstar Percentile Ranking	-	-	81	-	-	-	-	Contractual Cap Date	12/30/2016
Total Funds in Category	403	370	354	254	201	105	-	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.

Credit Opportunities Explorer Fund (A)

Top Ten Holdings as of 08/31/2016

Security	Net Assets (%)
Us 10yr Note (Cbt)dec16	25.74
US Treasury Note 1.125%	17.21
Us 10yr Ultra Fut Dec16	5.98
Long Gilt Future Dec16	5.36
US Treasury Note 1.5%	5.17
Us Ultra Bond Cbt Dec16	4.85
Euro-Bund Future Dec16	4.75
Euro-Bobl Future Dec16	4.56
Metlife FRN	4.17
Bank of Montreal FRN	3.89
Total % in Top 10	81.67

Statistics as of 08/31/2016	
Average Eff Duration (yrs)	6.48
Average Eff Maturity (yrs)	9.46
Average Weighted Price	\$100.54

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

Credit Opportunities Explorer Fund (A)

Manager(s)	Start Date	Degree	Alma Mater
Darryl Trunnel	09/10/2014	B.S.	Iowa State University
Tina Paris	09/10/2014	M.B.A.	University of Iowa
William C. Armstrong	09/10/2014	M.A.	University of Iowa

Fund Strategy

The investment seeks to achieve long-term returns, comprised of income and capital appreciation, with an emphasis on managing volatility. Under normal circumstances, the fund invests at least 80% of its net assets, plus any borrowings for investment purposes, in a diversified portfolio of credit-related instruments, represented by bonds and derivatives. A derivative is a financial arrangement, the value of which is derived from, or based on, a traditional security, asset, or market index.

About Principal Global Investors

Principal Global Investors' fixed income capabilities emphasize a broad array of global credit, mortgage, asset-backed and government debt markets worldwide. Reflective of its credit management expertise, the firm also offers extensive capabilities in tax-advantaged municipal fixed income strategies. The municipal investment team's independent and fundamental research efforts span state and local government debt markets nationwide and draw from an experienced team of fixed income professionals. A disciplined and consistent investment research process is combined with bottom-up and top-down portfolio construction techniques that focus on broad diversification and relative value. Principal Global Investors is a member of the Principal Financial Group®.

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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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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.

Effective September 1, 2016, the Principal Credit Opportunities Explorer Fund closed to new investors. Please see the prospectus for complete information.

Bloomberg Barclays Global Aggregate Corporate USD Hedged Index provides a broad-based measure of the global investment-grade fixed income markets.

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.

¹ Department of Labor

² U.S. Bureau of Labor Statistics

³ The Guardian, September 1, 2016

⁴ Morningstar

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Important Notes

⁵ Bloomberg

⁶Bloomberg, Reuters, CLSA

⁷Reuters

⁸CNBC

⁹U.S. Treasury Constant Maturity 30-year, 10-year and 2-year yields

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¹⁰Federal Reserve Bank Federal Open Market Committee statement, September 21, 2016

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¹¹Components 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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