# U.S. Property Separate Account-R6

Third Quarter 2017

# Quarterly Commentary

| Inv Manager or Sub-Advisor | Benchmark | Morningstar Category | Investment Objective |
|---|---|---|---|
| Principal Real Estate Inv | NFI-ODCE Equal-Weight | Owned Real Estate | Speciality - Real Estate |

## 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.

## Fixed Income

Spreads continued their nearly uninterrupted tightening trend due to the combination of an improved macroeconomic backdrop and strong corporate fundamentals. In addition, reduced-expectations of monetary tightening helped risk assets outperform because central banks took a more-dovish tone due to weak inflation data. Despite escalating tension with North Korea, volatility remained exceptionally low. The Treasury curve flattened during the quarter with short-term interest rates rising faster than longer-term rates. The two-year U.S. Treasury rate rose 0.10% while the five-year U.S. Treasury rate rose 0.05%. The ten-year and thirty-year rates each increased 0.03%. The slope of the two-to-ten-year Treasury curve fell from 0.92% to 0.85%.[1]

The Bloomberg Barclays U.S. Aggregate Index, a proxy for the overall fixed income market, had an excess return of 0.41% for the quarter when compared to similar-duration U.S. Treasury securities. The best-performing sectors were emerging market debt, below investment-grade corporate bonds, and investment-grade corporate bonds with excess returns of 1.86%, 1.60%, and 0.87%, respectively. Mortgage-backed securities (MBS) also outperformed with an excess return of 0.47%. Commercial mortgage-backed securities (CMBS), asset-backed securities (ABS), and U.S. agencies outperformed similar duration U.S. Treasury securities but underperformed the Bloomberg Barclays U.S. Aggregate Index with excess returns of 0.34%, 0.14%, and 0.05%, respectively.[2]

# Performance Contributors

## Positive Contributors

### During last quarter:

Property value appreciation was the primary contributor. Assets in the office sector recorded the highest quarterly appreciation return, followed by assets in the industrial sector. All other operating sectors posted positive appreciation, though results varied widely. The income return, generated by property cash flow, also contributed, driven by leasing within the portfolio and continued growth in net operating income. The impact of leverage contributed. Leverage positively impacts returns when the portfolio's current cost of borrowing is below that of the return generated by real estate.

### During last 12 months:

Property level appreciation was the largest contributor, led by appreciation of assets in the industrial sector. Property appreciation varies greatly by property sector over the one year period and was positive for all sectors save for retail.

The property level income return, nearly equal to property level appreciation, was also a significant contributor. The income return was driven by the portfolio's high occupancy and significant positive absorption that generated continued growth in net operating income. Leverage contributed, a result of the substantial spread between the portfolio's aggregate cost of borrowing and the return generated by real estate holdings.

## Negative Contributors

### During last quarter:

The partner promote accrual was the largest detractor. The accrual is an indication of positive asset level performance that exceeds and offsets the negative impact of the partner promote. Cash holdings also detracted, as the return generated by cash was lower than that of the return generated by real estate assets. The impact of portfolio expenses was a marginal detractor.

### During last 12 months:

The partner promote accrual was the largest detractor. The accruals are an indication of positive asset level performance that exceeds and offsets the negative impact of the partner promote. Cash detracted as the return generated by cash was lower than that of the one year return generated by properties in the portfolio. Portfolio expenses marginally detracted.

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

No material changes occurred in the portfolio structure.

# U.S. Property Separate Account-R6

## 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. For more performance information, including most recent month-end performance, visit www.principal.com, contact your representative of the Principal Financial Group®, or contact our participant contact center at 1-800-547-7754.*

*In situations where the net and gross 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 investment option. The gross total investment expense figure does not reflect any waivers or caps on the mutual fund or underlying mutual fund in which a Separate Account invests. Returns displayed are always based on net total investment expense.*

| Average Annual Total Returns (%) as of 09/30/2017 | QTR | YTD | 1 Year | 3 Year | 5 Year | 10 Year | Since Inception |
|---|---|---|---|---|---|---|---|
| U.S. Property Separate Account-R6 | 2.03 | 5.97 | 8.58 | 10.85 | 11.18 | 4.10 | 6.84 |
| NFI-ODCE Equal-Weight | - | - | - | - | - | - | - |
| Owned Real Estate Category | - | - | - | - | - | - | - |
| Morningstar Percentile Ranking | - | - | - | - | - | - | - |
| Total Funds in Category | - | - | - | - | - | - | - |

| | |
|---|---|
| Inception Date | 01/01/1982 |
| Ext. Perf. Inc. Date | 12/31/1981 |
| Total Inv. Exp Gross | 1.15 |
| Total Inv Exp Net | 1.15 |
| Waiver Date | - |
| Contractual Cap Date | - |

**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.

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

| Security | Net Assets (%) |
|---|---|
| Office/Retail/Anaheim, CA | 4.36 |
| Office New York, NY | 3.68 |
| Office Seattle, WA | 3.42 |
| Office Cambridge, MA | 3.37 |
| Multi-family/Retail Cambridge, MA | 3.18 |
| Office Austin, TX | 3.09 |
| Retail Los Angeles, CA | 2.74 |
| Office Oakland, CA | 2.42 |
| Hotel San Antonio, TX | 2.10 |
| Multi-family/Retail Austin, TX | 2.10 |
| **Total % in Top 10** | **30.46** |

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

# U.S. Property Separate Account-R6

| Manager(s) | Start Date | Degree | Alma Mater |
|---|---|---|---|
| John Berg | 12/01/2003 | M.B.A. | University of Iowa |

## Investment Strategy

The investment invests the majority of assets in commercial real estate holdings. It focuses on properties that return both lease income and appreciation of the buildings' marketable value. The property holdings usually contain real estate from the multi-family, office, warehouse/manufacturing, and retail sectors. This investment option is subject to investment and liquidity risk and other risks inherent in real estate such as those associated with general and local economic conditions. You may not be able to immediately withdraw funds contributed to this Separate Account. A contractual limitation in the group annuity contract that provides access to this Separate Account may be implemented, which will allow management of this Separate Account, and satisfy withdrawal requests over time and fairly amongst all those who request a withdrawal.

## About Principal Real Estate Inv

Principal Real Estate Investors is the dedicated real estate asset manager for Principal Global Investors. Principal Real Estate Investors' capabilities include commercial mortgage-backed securities, real estate equity securities and a broad range of private market real estate equity and debt alternatives.

# Important Notes

Separate Accounts are available through a group annuity contract with Principal Life Insurance Company. Insurance products and plan administrative services, if applicable, are provided by Principal Life Insurance Company, a member of the Principal Financial Group, Des Moines, IA 50392. See the fact sheet for the full name of the Separate Account. Certain investment options may not be available in all states or U.S. commonwealths. Principal Life Insurance Company reserves the right to defer payments or transfers from Principal Life Separate Accounts as described in the group annuity contracts providing access to the Separate Accounts or as required by applicable law. Such deferment will be based on factors that may include situations such as: unstable or disorderly financial markets; investment conditions which do not allow for an orderly investment transactions; or investment, liquidity, and other risks inherent in real estate (such as those associated with general and local economic conditions). If you elect to allocate funds to a Separate Account, you may not be able to immediately withdraw them.

**Before directing retirement funds to a separate account, investors should carefully consider the investment objectives, risks, charges and expenses of the separate account as well as their individual risk tolerance, time horizon and goals. For additional information contact us at 1-800-547-7754 or by visiting principal.com.**

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.



This investment option is subject to investment and liquidity risk and other risks inherent in real estate such as those associated with general and local economic conditions. If you elect to contribute funds into the U.S. Property Separate Account, withdrawals may be delayed for up to 3 years.

Investment manager/sub-advisor means either the Investment Advisor or Sub-Advisor to the investment option or the underlying asset(s). Principal Life Insurance Company is the Investment Manager as defined by ERISA, with regard to the assets of the Separate Accounts. Principal Global Investors is a member of the Principal Financial Group.

## About Principal Financial Group

Principal℠

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

NFI-ODCE Equal-Weight is the NCREIF Fund Index - Open End Diversified Core Equity. It is a fund-level equal-weighted, time-weighted return index and includes property investments at ownership share, cash balances and leverage. The return series is net of the average fee charged by accounts that make up the index.

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.

[*]Unless otherwise stated, all data from Bloomberg

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

[2]Components 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. Treasurys with a similar duration profile.

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

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