

# Quarterly Commentary

Ticker	Inv Manager or Sub-Advisor	Benchmark	Morningstar Category	Investment Objective
PABEX	TS&W / Herndon	Russell 1000 Value Index	Large Value	Growth and Income

## Economic Overview

The first quarter of 2014 was largely dominated by geopolitical influences. Strife in the Ukraine as well as Chinese financial concerns took the primary focus of the global markets. Domestically, the economy grew at a slower pace due in part to continued removal of the Quantitative Easing (QE) stimulus by the Federal Reserve, and the toll of extreme winter weather.

After posting very strong gains in 2013, equity markets moved sideways for the first quarter. The S&P 500 was down in January, up in February, and now stands virtually unchanged for the year as of quarter-end 2014. Meanwhile, the bond market has shown gains as QE tapering has proven a non-event. Rates of the U.S. Treasury ten year note fell from 3.04% at year-end 2013, to 2.73% at end of first quarter 2014.<sup>1</sup>

International markets have largely shadowed the U.S., showing very little movement thus far in 2014. The exception is emerging markets, which are down an additional 0.8% so far this year. A slowdown in the Chinese economy, the turmoil in the Ukraine, and the fragility of numerous emerging markets have influenced the lackluster performance. Within the BRIC nations, Brazil is up 1.97%, Russia is down -14.45%, and China is down -5.87%. India is posting gains, up 7.84%.<sup>2</sup>

On the domestic front, U.S. employment trends continue to look strong. While the headline unemployment rate has held at 6.7%<sup>3</sup>, the trend in weekly jobless claims continued to fall, hitting 311,000 the week of 3/22.<sup>3</sup> This is the best performance in labor statistics since 2007 (except for a few months in late 2013). The housing market continues to post growth, with the Case-Shiller Index of 20 cities showing a 13.2% gain year-over-year, even after a 0.1% decline in January.<sup>4</sup> And, overall consumer spending continues to grow at about a 3.0% overall pace.<sup>5</sup>

Globally, China has shown signs of a weaker and more fragile economy, marked by increased credit defaults and more volatile currency. Prices of some commodities are plunging, especially those at the heart of China's economic growth, including copper, iron ore and coal. Rising financial stresses are evident as profit growth shrinks dramatically, due in part to rising labor costs, particularly relative to other Asian nations. Trouble in China could have a significant impact on the economic fortunes of both emerging and developed markets, particularly the European financial system, which has significant loan exposure to the emerging markets.

## Large U.S. Equity

U.S. large-cap equities returned 2.1% during the quarter, outperforming U.S. small-caps but underperforming U.S. mid-caps (which returned 1.1% and 3.5%, respectively). U.S. large-cap equities also outperformed international equities in developed countries and international equities in emerging markets (which respectively delivered 0.7% and -0.4%).<sup>6</sup>

From a style perspective, large-cap value equities outperformed large-cap growth (as measured by the Russell 1000 Value Index, which returned 3.0%, and the Russell 1000 Growth Index, which returned 1.1%). Large-cap value's outperformance was driven by the financial and health care sectors. The financial sector is the largest sector in the Russell 1000 Value Index and it performed significantly better than the financial stocks in the Russell 1000 Growth Index. Within the health care sector, the stocks held within the Russell 1000 Value Index performed significantly better than the health care stocks held within the Russell 1000 Growth Index.

## Performance Contributors

### Positive Contributors

#### During last quarter:

Stock selection within the energy sector aided performance. An average 3% underweight to the industrials sector also contributed to returns. In addition, LargeCap Value I's higher price-to-book ratio (a comparison of market value to book value, a higher price-to-book ratio could mean an investment option is overvalued) than the index added value.

#### During last 12 months:

Sector positioning relative to the index aided returns led by an average 4% overweight to the information technology sector. In addition, stock selection was strong within the health care sector; the largest individual contributor was Endo Health Solutions Inc. Similar to the quarter, LargeCap Value I's higher price-to-book ratio (a comparison of market value to book value, a higher price-to-book ratio could mean an investment option is overvalued) than the index also helped returns.

### Negative Contributors

#### During last quarter:

Stock selection was negative overall, led by the financial sector. Sector positions relative to the index also diminished performance led by an average 4% underweight to the health care sector, the strongest performing sector within the index. On average, stocks held within LargeCap Value I exhibited more price volatility (experienced more price movement than those within the index) which detracted from returns.

#### During last 12 months:

Stock selection was negative overall, led by the consumer discretionary sector. An average 2% overweight to the energy sector also detracted from performance. On average, stocks held within LargeCap Value I exhibited more price volatility (experienced more price movement than those within the index) than stocks held within the index, which detracted from returns.

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

Effective close of business on 6/6/2014 and pending shareholder approval, Principal LargeCap Value I will merge into Principal LargeCap Value III. The Separate Account invests in I shares of the fund.

# LargeCap Value I R2 Fund

## 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](http://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 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 03/31/2014	QTR	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception	Inception Date	06/01/2004
LargeCap Value I R2 Fund	1.12	1.12	17.72	11.76	18.52	-	5.59	Ext. Perf. Inc. Date	06/01/2004
Russell 1000 Value Index	3.02	3.02	21.57	14.80	21.75	7.58	-	Total Inv. Exp Gross	1.52
Large Value Category	2.27	2.27	20.74	13.09	19.82	6.91	-	Total Inv Exp Net	1.51
Morningstar Percentile Ranking	-	-	82	78	75	-	-	Waiver Date	02/28/2015
Total Funds in Category	1304	1304	1239	1068	951	626	-	Contractual Cap Date	02/28/2015

**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.

# LargeCap Value I R2 Fund

## Statistics Summary as of 03/31/2014

	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					
LargeCap Value I R2 Fund	-3.04	1.03	97.79	0.88	-1.47	13.73	23	13	3.35	-3.14	95.57	112.07
Russell 1000 Value Index	N/A	N/A	N/A	N/A	N/A	N/A	23	13	3.50	-2.80	100.00	100.00
	5 Year						5 Year					
LargeCap Value I R2 Fund	-3.42	1.04	97.14	1.17	-1.20	15.55	40	20	3.98	-3.39	95.76	109.81
Russell 1000 Value Index	N/A	N/A	N/A	N/A	N/A	N/A	40	20	4.15	-3.08	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 02/28/2014

Security	Net Assets (%)
E-mini S&P 500 Index Future Mar14	4.94
Chevron Corp	2.86
Exxon Mobil Corporation	2.47
Aflac Inc	2.11
International Business Machines Corp	1.99
American Express Co	1.66
Wells Fargo & Co	1.63
PPL Corp	1.53
Citigroup Inc	1.51
Microsoft Corporation	1.45
<b>Total % in Top 10</b>	<b>22.15</b>

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

## LargeCap Value I R2 Fund

Manager(s)	Start Date	Degree	Alma Mater
James W. Fennessey	06/02/2009	B.S.	Truman State University
Randy L. Welch	06/02/2009	M.B.A.	Drake University

### Investment 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 securities of companies with large market capitalizations at the time of each purchase. For this Fund, companies with large market capitalizations are those with market capitalizations within the range of companies comprising the Russell 1000 (R) Value Index. It invests in value equity securities, an investment strategy that emphasizes buying equity securities that appear to be undervalued.

### About Herndon Capital Mgmt, LLC

Herndon Capital Management, LLC (Herndon Capital) is an institutional investment management firm specializing in large- and mid-cap equity strategies. Founded and registered with the U.S. Securities and Exchange Commission in 2001, the firm is an affiliate of Atlanta Life Financial Group (ALFG), a 107-year-old financial services firm. Herndon Capital began managing assets in June 2002. As of December 31, 2013, the firm had more than \$10.2 billion in assets under management.

### About Thompson, Siegel & Walmsley

Thompson, Siegel & Walmsley LLC (TS&W), based in Richmond, Virginia, is an investment adviser focused on value investing. TS&W is large enough to have a stable client base, but small enough to have a true boutique-style investment process, with a focus on best-in-class client service. As of December 31, 2013, TS&W had \$7.3 billion in assets under management.

## Important Notes

Insurance products and plan administrative services, if applicable, are provided by Principal Life Insurance Company. Principal mutual funds are part of the Principal Funds, Inc. series. Principal Funds, Inc. is distributed by Principal Funds Distributor, Inc. Securities sold or services offered by a Princor® Registered Representative are offered through Princor Financial Services Corp, 800-547-7754, member SIPC and/or independent brokers/dealers. Principal Funds Distributor, Princor and Principal Life are members of the Principal Financial Group®, Des Moines, IA 50392. Certain investment options may not be available in all states or U.S. commonwealths.

Principal Funds Distributor, Principal Shareholder Services, Principal Management Corporation, and Principal Funds, Inc. are collectively referred to as Principal Funds.

**Investors should carefully consider a mutual 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 [principal.com](http://principal.com), or calling 1-800-547-7754. 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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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.

Effective June 27, 2011, this portfolio is sub-advised by TS&W and Herndon. Prior to June 27, 2011, the portfolio was sub-advised by UBS Global Asset Management and TS&W. The portfolio has had various sub-advisors since its inception. Performance results displayed reflect all sub-advisors managing this portfolio during the time periods displayed.

Russell 1000 Value Index is a market-capitalization weighted index of those firms in the Russell 1000 with lower price-to-book ratios and lower forecasted growth values.

### 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

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.

**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.

<sup>1</sup>US Treasury

<sup>2</sup>MSCI

<sup>3</sup>Bureau of Labor Statistics



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## Important Notes

<sup>4</sup>Bloomberg

<sup>5</sup>St Louis Fed/ BEA; <http://research.stlouisfed.org/fred2/series/PCE>

<sup>6</sup>U.S. large-cap equities: Russell 1000 Index; U.S. mid-cap equities: Russell Midcap Index; U.S. small-cap equities: Russell 2000 Index; international emerging markets: MSCI Emerging Markets Index; international developed markets: MSCI EAFE Index.

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



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