

Third Quarter 2017

# Quarterly Commentary

Inv Manager or Sub-Advisor	Benchmark	Morningstar Category	Investment Objective
Morley Capital Management	Bloomberg Barclays 1-3 Yr Government Index	Stable Value	Income

## 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%.<sup>1</sup>

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.<sup>2</sup>

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May lose value • Not a deposit • No bank or credit union guarantee  
Not insured by any Federal government agency

## Performance Contributors

### Positive Contributors

#### During last quarter:

The return for the quarter exceeded the return of the Bloomberg Barclays 1-3 Year Government Index and the iMoneyNet Index. Interest rates in short-intermediate maturities increased during the quarter producing a positive return from the Bloomberg Barclays 1-3 Year Government Index. Relative performance benefited from higher relative returns from stable value investments due to the longer maturity higher yielding holdings in corporate, asset-backed, and residential and commercial mortgage backed securities. Allocation to intermediate maturity securities in sub-advised assets provided higher yields due to the positive slope of the yield curve.

#### During last 12 months:

The return for the one year period exceeded the return of the Bloomberg Barclays 1-3 Year Government Index and the iMoneyNet Index. The rise in rates earlier in the period reduced returns from the market index. The portfolio benefited from the stable value contracts and the higher yield on underlying holdings of corporate, asset-backed, and residential and commercial mortgage backed securities held in those vehicles. Allocation to intermediate maturity securities in sub-advised assets provided higher yields due to the positive slope of the yield curve.

### Negative Contributors

#### During last quarter:

Allocations to U.S. Treasury and agency securities, while providing low risk liquid core holdings, detracted from performance due to lower yields earned relative to spread sector alternatives. The allocation to cash held to provide fund liquidity detracted from returns as it provided lower returns than longer term wrap contracts.

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

No material changes occurred in the portfolio structure.

# Principal Stable Value 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 09/30/2017	QTR	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception	Inception Date	01/09/1997
Principal Stable Value Fund	0.33	0.92	1.21	1.09	0.99	1.69	3.22	Ext. Perf. Inc. Date	01/09/1997
Bloomberg Barclays 1-3 Yr Government Index	0.24	0.72	0.27	0.78	0.65	1.79	-	Total Inv. Exp Gross	0.89
Stable Value Category	-	-	-	-	-	-	-	Total Inv Exp Net	0.89
Morningstar Percentile Ranking	-	-	-	-	-	-	-	Waiver Date	-
Total Funds in Category	-	-	-	-	-	-	-	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.

# Principal Stable Value Fund

## 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					
Principal Stable Value Fund	0.73	0.02	4.18	10.61	0.39	0.04	36	0	0.09	0.09	47.81	-59.90
Bloomberg Barclays 1-3 Yr Government Index	N/A	N/A	N/A	N/A	N/A	N/A	23	13	0.19	-0.15	100.00	100.00
	5 Year						5 Year					
Principal Stable Value Fund	0.75	0.01	1.85	12.50	0.53	0.06	60	0	0.08	0.08	51.75	-65.34
Bloomberg Barclays 1-3 Yr Government Index	N/A	N/A	N/A	N/A	N/A	N/A	38	22	0.16	-0.13	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 06/30/2017

Security	Net Assets (%)
Prudential Ins Co of America	22.41
Metropolitan Life Ins Co	14.82
TIAA-CREF Life Ins Co	9.93
Transamerica Life Ins Co	9.82
Principal Life Ins Co	9.62
New York Life Ins Co	8.77
American General Life Ins Co	7.45
Massachusetts Mutual Life Ins Co	7.29
State Street Bank	3.82
<b>Total % in Top 10</b>	-

## Principal Stable Value Fund

Manager(s)	Start Date	Degree	Alma Mater
Management Team	01/01/1997	-	-

### Investment Strategy

The objective of the Fund is to provide preservation of capital, relatively stable returns consistent with its comparatively low risk profile, and liquidity for benefit responsive plan or participant payments.

### About Morley Capital Management

Morley Financial Services, Inc. (Morley Financial), founded in 1982, is one of the nation's oldest stable value managers. Morley Financial provides stable value investment services to corporate, government and Taft-Hartley pension plans through collective investment funds and separately managed portfolios, and offers advisory services to banks and other financial institutions.

## 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 are offered through Principal Securities Inc., 800-547-7754, member SIPC and/or independent brokers/dealers. Principal Funds Distributor, Principal Securities 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.

**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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Bloomberg Barclays 1-3 Yr Government Index is comprised of both the Treasury Bond Index and the Agency Bond 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.

The Principal Stable Value Fund (the Fund), is a collective investment trust maintained by Principal Global Investors Trust Company, (the Trust Company). The Trust Company has retained Morley Capital Management (the Adviser), to serve as investment adviser with respect to the Fund, subject to the Trust Company's supervision and review. The Adviser is an indirect wholly owned subsidiary of Principal Financial Group® and is under common control with the Trust Company.

The Fund is not a mutual fund and is not registered with the Securities and Exchange Commission, the State of Oregon, or any other regulatory body. Units of the Fund are not deposits or obligations of, guaranteed by, or insured by the Trust Company or any affiliate, and are not insured by the FDIC or any other federal or state government agency. The value of the Fund may fluctuate so that when redeemed, units may be worth more or less than the original cost.

### 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

The declaration of trust, participation agreement, and disclosure documents contain important information about investment objectives, risks, fees and expenses associated with investment in the Fund and should be read carefully before investing.

Direct investment in the Fund is limited to participating trusts (also known as investing plan/trust) that meet certain requirements described in the declaration of trust, that enter into a participation agreement with the Trust Company. The Fund cannot accept investment directly from individuals and is subject to restrictions regarding transfer and withdrawal of assets including potential deferral of withdrawal requests by up to 12 months, as defined in the applicable declaration of trust.

### **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



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## Important Notes

<sup>1</sup>U.S. Treasury Constant Maturity 30-year, 10-year and 2-year yields

<sup>2</sup>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. Treasuries with a similar duration profile.

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



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