Third Quarter 2010

Quarterly Commentary

Ticker	Investment Advisor	Benchmark	Morningstar Category	Investment Objective
PLRAX	T.Rowe / Clearbridge Advisors	Standard & Poor's 500 Index	Large Blend	Capital Appreciation

Economy & Market Overview

Following second-quarter losses, U.S. and international stocks bounced back markedly in the third quarter as weakening in the U.S. and China appeared to have ended. Worries of a double-dip U.S. recession slowly ebbed when key economic data came in slightly ahead of expectations, and concerns about China's slowing growth faded as its economy picked up steam.[1]

Meanwhile, data released in August showed that the euro zone grew at a 3.9% annual rate during the second quarter, driven by tremendous growth in Germany. However, in the third quarter the euro zone's growth rate began slowing, and worries mounted about the possibility of a sovereign debt default or restructuring for some of the region's more troubled members (e.g., Ireland, Greece, Portugal). Additionally, continued strikes by public workers raised concern that necessary government spending cuts might not be implemented.[1]

Key U.S. economic data released during the quarter was mixed, but showed some slight, unexpected improvement: While the unemployment rate remained at 9.6%, an unexpected decrease in weekly initial jobless claims during September gave investors some hope that the unemployment situation may become less bleak.[2] Second-quarter 2010 GDP was positive at 1.7%; however, it was substantially lower than the 3.7% gain posted in the first quarter as inventories decreased and imports grew faster than exports.[3] Housing market data was weak in July, but ended the quarter on a modestly favorable note. A drop in new-home sales during July tapered off in August to a seasonally-adjusted annual rate of 288,000.[4] Existing-home sales rose 7.6% month-over-month in August, but still remained 19% below August 2009.[5] After improving in August, consumer confidence fell in September, reflecting consumers' grim outlook on future economic growth and job prospects.[6]

In September, the National Bureau of Economic Research (NBER), which has sole responsibility for determining when U.S. recessions officially begin and end, determined that the recession that began in December 2007 ended in June 2009. The NBER also stated that at 18 months, it was the longest of any recession since World War II.[7]

Meanwhile, at its September meeting the Federal Reserve made no changes to its extremely accommodative monetary policy given the slowing pace of recovery in output and employment and noted that it is prepared to "provide additional accommodation if needed to support the economic recovery."[8]

During the third quarter, the broad U.S. stock market posted a return of 11.5% as all sectors within the Russell 3000 Index delivered positive returns. Telecommunications led the way, returning 20.1%, while financial stocks performed the weakest with a modest 5.5% gain.[9] Financials were under pressure as investors continued to grapple with the changing landscape of regulatory reform and how it might impact the capital structure and growth opportunities for the industry. For the quarter, growth styles outperformed value, and small-cap stocks underperformed large-caps.[10]

International markets performed even better than U.S. markets, with developed markets delivering a third-quarter return of 16.5%, led by the energy, telecom and materials sectors. Emerging markets generated a return of 18.0% for the quarter, propelled by the consumer discretionary and industrial sectors.[11]

Real estate outperformed the broad U.S. market, returning 13.2% for the quarter.[12] Although the sector's fundamentals remained uncertain, improved access to capital for commercial real estate properties, combined with their attractive dividend yield, fueled continued demand for the asset class.

In a change from their apparent risk aversion during the second quarter, investors seemed to favor riskier fixed-income asset classes in the third quarter. This switch likely reflected, in part, investors' need for yield at a time when U.S. Treasuries are delivering very low rates (for example, relatively low-risk 10-year Treasuries yielded just 2.52% at quarter-end).[13] In terms of investment-grade bonds, commercial mortgage-backed securities led the way, outpacing duration-adjusted Treasuries by 4.05% for the quarter.[14] High-yield bonds (which are below-investment-grade) also performed well, advancing 4.26% ahead of duration-adjusted Treasuries.[15] Also during the period, the yield curve flattened as the distance between 2- and 10-year Treasury yields fell from 2.36% (at the end of the second quarter) to 2.09% (at the end of the third quarter).[16]

Performance Contributors

Positive Contributors

During last quarter:

Stock selection in the energy sector added to returns; in particular, an overweight to National Oilwell Varco benefited performance. The information technology sector also experienced positive stock selection; overweights to Juniper Networks and Autodesk added to performance. Having a smaller market capitalization than that of the benchmark S&P 500 Index added to returns, as smaller-market-cap stocks within the index generally outperformed larger-market-cap stocks.

During last 12 months:

Positive stock selection in the health care sector added to performance, particularly in the health care equipment & supplies industry. Information technology also experienced positive stock selection; in particular, an overweight to Apple Inc. added to performance. The portfolio's holdings that were not held by the index generally outperformed those within the index, which benefited returns. Additionally, though the portfolio's sector weightings were similar to those of the benchmark index, the small variances in sector weightings within the portfolio aided performance.

Negative Contributors

During last quarter:

Overall stock selection detracted from performance; selections within financials and materials detracted the most. In financials, overweights to Wells Fargo and Charles Schwab detracted, and in materials, an overweight to Newmont Mining hurt performance. The portfolio's holdings that were not held by the benchmark index generally underperformed those within the index, also detracting from returns. Although the portfolio's sector weightings were similar to those of the index, the small variances in sector weightings within the portfolio negatively contributed.

During last 12 months:

Poor stock selection in the consumer discretionary sector detracted from performance, particularly an overweight to retailer Staples Inc. In financials, poor selection in the real estate investment trust industry added to the underperformance. Also, having a smaller market capitalization than that of the benchmark index hurt performance, as smaller-market-cap stocks within the index generally underperformed larger-market-cap stocks.

Changes to the investment option's structure or portfolio:

No material changes occurred in the portfolio structure.

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 09/30/2010	QTR	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception
LargeCap Blend Fund II (A) (excl. sales charge)	10.66	1.87	7.90	-7.43	0.37	-	0.95
LargeCap Blend Fund II (A) (incl. sales charge)	4.56	-3.75	2.00	-9.15	-0.75	-	0.34
Standard & Poor's 500 Index	11.29	3.89	10.16	-7.16	0.64	-0.43	-
Large Blend Category	11.13	3.21	8.88	-7.22	0.41	0.18	-
Morningstar Percentile Ranking	-	-	66	54	52	-	-
Total Funds in Category	2072	2017	1965	1723	1422	761	-

Inception Date	06/28/2005
Ext. Perf. Inc. Date	12/06/2000
Total Inv. Exp Gross	1.67
Total Inv Exp Net	1.42
Waiver Date	11/12/2010
Contractual Cap Date	11/12/2010
Contingent Deferred Sales Charge	-
Maximum Up-front Sales Charge	5.50

These calculated returns reflect the historical performance of the oldest share class of the fund, adjusted to reflect a portion of the fees and expenses of this share class. Please see the fund's prospectus for more information on specific expenses, and the fund's most recent shareholder report for actual date of first sale. Expenses are deducted from income earned by the fund. As a result, dividends and investment results will differ for each share class.

LargeCap Blend Fund II (A)

Statistics Summary as of 09/30/2010

	Risk and Return Statistics Summary						Upside/Downside Capture Ratio					
	Alpha	Beta	R2	Sharpe Ratio	Info Ratio	Std Dev	# of Months		Avg Returns %		Market Benchmark %	
							Up	Down	Up	Down	Up	Down
	3 Year Return vs. Rank						3 Year Upside/Downside Capture Ratio					
LargeCap Blend Fund II (A)	-0.25	1.00	99.64	-0.29	-0.20	21.88	19	17	4.45	-5.90	100.73	101.40
Standard & Poor's 500 Index	N/A	N/A	N/A	N/A	N/A	N/A	19	17	4.41	-5.82	100.00	100.00
	5 Year Return vs. Rank						5 Year Upside/Downside Capture Ratio					
LargeCap Blend Fund II (A)	-0.24	1.00	99.59	-0.03	-0.23	17.68	36	24	3.19	-5.07	100.11	101.22
Standard & Poor's 500 Index	N/A	N/A	N/A	N/A	N/A	N/A	38	22	3.19	-5.01	100.00	100.00

Risk and return statistical data is provided by Markov Processes International (MPI). Risk & Return Statistics Summary results are based on performance excluding sales charges. Percentile rankings are based on total returns in accordance with the appropriate Morningstar peer group. Please see Important Notes section for definitions of Risk and Return Statistics.

Top Ten Holdings as of 08/31/2010

Security	Net Assets (%)
ExxonMobil Corporation	2.85
Apple, Inc.	2.79
Microsoft Corporation	2.38
S&P FUTURE - SEP2010	2.31
Wells Fargo Company	1.96
Procter & Gamble Company	1.93
General Electric Company	1.78
J.P. Morgan Chase & Co.	1.74
PepsiCo, Inc.	1.66
Philip Morris International Inc	1.56
Total % in Top 10	**20.99**

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

LargeCap Blend Fund II (A)

Manager(s)	Start Date	Degree	Alma Mater
Anna M. Dopkin	04/01/2007	B.S.	University of Pennsylvania (Wharton)
Ann M. Holcomb	03/02/2009	M.S.	Loyola College, Maryland (Sellinger)
Mariateresa Monaco	06/02/2009	M.B.A.	Massachusetts Institute of Technology
Scott Glasser	10/01/2009	M.B.A.	Pennsylvania State University
Michael Kagan	10/01/2009	B.A.	Harvard College

Fund Strategy

The investment seeks long-term growth of capital. The fund normally invests at least 80% of assets in common stocks of companies with large market capitalizations (those with market capitalizations within the range of companies in the S&P 500 index) at the time of purchase. As a blend fund, the fund assets will be invested in equity securities with both growth and value characteristics. The fund has approximately the same industry weightings as compared to the S&P 500 index.

About T. Rowe Price Associates, Inc.

Founded in 1937, T. Rowe Price is a global investment management firm committed to providing investment management excellence, world-class service and guidance to institutional and individual investors worldwide. T. Rowe Price provides a broad array of proprietary mutual funds, sub-advisory investment services and separate account management for individual and institutional investors, retirement plans and financial intermediaries. Headquartered in Baltimore, Maryland, T. Rowe Price has offices in Buenos Aires, Hong Kong, London, Toronto, Sydney, Luxemburg, Stockholm, Singapore, Denmark, Amsterdam, Tokyo and Zurich.As of December 31, 2009, T. Rowe Price managed more than $391.3 billion in assets for some of the world's leading corporations, public retirement plans, foundations, endowments and individual clients. The investment management services span the full range of U.S. and non-U.S. equity, fixed-income and multi-asset-class investment styles. T. Rowe Price's disciplined, risk-aware investment approach focuses on diversification, style consistency and fundamental research. The T. Rowe Price investment approach strives to achieve superior performance but is always mindful of the risks incurred relative to the potential rewards.

About Clearbridge Advisors

ClearBridge Advisors (ClearBridge) was introduced in December 2005 following Legg Mason's transaction with Citigroup, but traces back its asset management expertise more than 45 years to several prominent firms, including Smith Barney Asset Management, Davis Skaggs Investment Management and Salomon Brothers Asset Management.ClearBridge benefits from the formidable strength of the Legg Mason organization, while continuing to operate with investment independence - maintaining its own investment strategies, philosophies and investment decision-making authority. ClearBridge is the largest equity manager of Legg Mason Inc. (NYSE: LM), managing approximately $53.7 billion in client assets as of December 31, 2009.ClearBridge offers the services of experienced portfolio managers who focus exclusively on equities covering all major market capitalizations, across a wide range of equity-focused disciplines. ClearBridge combines research-driven fundamental investing with the insights of its veteran portfolio managers to seek long-term competitive portfolio performance for its institutional and retail clients. In many cases, portfolio managers who built a portfolio's performance record over several decades continue to manage those assets today.

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Principal Funds is a leading provider of mutual fund solutions for individual investors and retirement plans, with approximately $55.1 billion in mutual fund assets under management (as of June 30, 2010). Principal Funds has special expertise in providing asset allocation solutions, and is the 5th largest manager of lifecycle funds in the nation based on target-date and target-risk mutual fund assets under management (according to Financial Research Corporation, as of March 31, 2010). Principal Funds are distributed through a nationwide network of independent financial professionals affiliated with brokerage and financial planning firms.

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Before investing in mutual funds, investors should carefully consider the investment objectives, risks, charges and expenses of the funds. This and other information is contained in the free prospectus, which can be downloaded from our site, by visiting principal.com, or by contacting us at 1.800.222.5852. Please 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.

These calculated returns reflect the historical performance of the oldest share class of the fund, adjusted to reflect a portion of the fees and expenses of this share class. Please see the fund's prospectus for more information on specific expenses, and the fund's most recent shareholder report for actual date of first sale. Expenses are deducted from income earned by the fund. As a result, dividends and investment results will differ for each share class.

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 October 1, 2009, ClearBridge Advisors was added as an additional sub-advisor. Performance results displayed reflect all sub-advisors managing this portfolio during the time periods displayed.

Effective July 1, 2010, this fund is closed to new investors. Effective August 5, 2010, this fund is closed to new assets.

Standard & Poor's 500 Index is a market capitalization-weighted index of 500 widely held stocks often used as a proxy for the stock market.

Extended Performance Inception Date (Ext. Perf. Inc. Date) - Inception date of the oldest share class of the fund.

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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.

[1] On the Other Hand: Economic Insights, Third Quarter 2010 edition, by Bob Baur and the Principal Global Investors Economic Committee

[2] U.S. Bureau of Labor Statistics: Employment Situation Summary 9/3/2010 www.bls.gov)

[3] Bureau of Economic Analysis, US Dept of Commerce (www.bea.gov)

[4] National Association of Home Builders (www.nahb.com)

[5] National Association of Realtors (www.realtor.org)

[6] Conference Board's Consumer Confidence Index, September 28, 2010 (www.conference-board.org)

[7] Business Cycle Dating Committee, National Bureau of Economic Research, September 20, 2010 (www.nber.org)

[8] Federal Reserve Board press release dated September 21, 2010 (www.federalreserve.gov)

[9] Russell 3000 Index

[10] Russell family of indexes

[11] Developed international markets: MSCI EAFE Index; emerging international markets: MSCI EM Index

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Important Notes

[12] MSCI US REIT Index

[13] Source: FactSet, constant maturity US Treasury yield

[14] As measured by components of Barclays Capital Aggregate Bond Index

[15] As measured by components of Barclays Capital High Yield Index

[16] Source: FactSet, constant maturity US Treasury yield

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

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