Third Quarter 2010

Quarterly Commentary

Ticker	Investment Advisor	Benchmark	Morningstar Category	Investment Objective
PPVAX	AllianceBernstein / Westwood	Russell 1000 Value Index	Large Value	Growth and Income

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:

Sector allocations relative to the index contributed positively during the period. Leading the way was an average 6% underweight to the financial sector, which was the worst-performing sector in the benchmark index (the Russell 1000 Value Index). Also, positive stock selection in the industrial sector added to returns. A slightly higher beta (meaning the portfolio was positioned to benefit more than the index in upward-trending markets) proved beneficial to returns as well.

During last 12 months:

Similar to the quarter, sector weights relative to the index contributed positively, particularly an average 5% underweight to the financial sector. Positive stock selection within the industrial sector also added to returns during the period. Additionally, the portfolio had a price-to-book ratio that was slightly higher than that of the benchmark index, which was beneficial during the 12-month period.

Negative Contributors

During last quarter:

Stock selection was slightly negative overall, with the worst selection occurring in the consumer discretionary and energy sectors. An average 1% underweight to the telecommunication services sector also detracted, as this was the best-performing sector within the index. Additionally, having a lower dividend yield than the index hurt returns during the period, as investors favored equities with higher dividend yields.

During last 12 months:

Stock selection was negative overall, with the worst selection occurring in the financial sector. During the period the portfolio had an average 4% overweight to the information technology sector, which detracted from returns because this sector underperformed the benchmark index. Having a larger market capitalization than the index detracted from returns as well, because large-cap equities generally underperformed small-caps during the period.

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 Value Fund III (A) (excl. sales charge)	10.07	1.84	6.53	-13.24	-3.60	-	1.52
LargeCap Value Fund III (A) (incl. sales charge)	3.98	-3.79	0.67	-14.85	-4.69	-	0.90
Russell 1000 Value Index	10.13	4.49	8.90	-9.39	-0.48	2.59	-
Large Value Category	10.59	3.00	8.02	-8.44	-0.28	2.47	-
Morningstar Percentile Ranking	-	-	64	95	93	-	-
Total Funds in Category	1309	1274	1264	1127	942	490	-

Inception Date	06/28/2005
Ext. Perf. Inc. Date	12/06/2000
Total Inv. Exp Gross	1.88
Total Inv Exp Net	1.14
Waiver Date	02/28/2011
Contractual Cap Date	02/28/2011
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 Value Fund III (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 Value Fund III (A)	-4.46	0.99	99.03	-0.55	-1.69	22.88	16	20	4.64	-5.97	92.94	106.66
Russell 1000 Value Index	N/A	N/A	N/A	N/A	N/A	N/A	17	19	4.99	-5.60	100.00	100.00
	5 Year Return vs. Rank						5 Year Upside/Downside Capture Ratio					
LargeCap Value Fund III (A)	-3.19	0.99	98.93	-0.24	-1.61	18.68	35	25	3.29	-5.33	93.77	106.71
Russell 1000 Value Index	N/A	N/A	N/A	N/A	N/A	N/A	36	24	3.51	-5.00	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 (%)
J.P. Morgan Chase & Co.	3.04
Johnson & Johnson	2.93
Wells Fargo Company	2.79
AT&T, Inc.	2.74
Pfizer Inc.	2.68
Bank of America Corporation	2.39
S&P FUTURE - SEP2010	2.19
Chevron Corporation	2.18
Procter & Gamble Company	2.10
General Electric Company	1.58
Total % in Top 10	**24.61**

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

LargeCap Value Fund III (A)

Manager(s)	Start Date	Degree	Alma Mater
John D. Phillips, Jr.	11/01/2002	M.B.A.	Harvard University
Christopher W. Marx	03/01/2006	M.B.A.	Stanford University
Scott D. Lawson	07/15/2008	M.B.A.	St. Louis University
Mark R. Freeman	07/15/2008	M.S.	Louisiana State University
Susan M. Byrne	07/15/2008	-	University of California, Berkeley

Fund Strategy

The investment seeks long-term growth of capital. The fund generally invests at least 80% of assets in companies with large market capitalizations (those with market capitalizations similar to companies in the Russell 1000 Value index) at the time of purchase. It invests primarily in undervalued equity securities of companies that it believes offer above-average potential for earnings growth.

About AllianceBernstein LP

AllianceBernstein is one of the world's largest investment management firms. As of December 31, 2009, AllianceBernstein managed $496 billion (US) in assets under management. They offer an extensive selection of global equity services based on their long-standing expertise in growth and value management, as well as a wide array of fixed-income and style-blend products. All of these services draw on the intensive research efforts of their 200-plus fundamental and quantitative buy-side equity, fixed-income and economic analysts. Their buy-side analysts are part of a larger research complement that - along with the firm's highly regarded sell-side arm -numbers well over 250, all sharing a culture in which insightful research is paramount.

About Westwood Management Corp

Westwood Management Corporation, founded in 1983 by Chairman and Chief Investment Officer Susan M. Byrne, is an investment advisory firm primarily serving the institutional marketplace. Westwood Management Corp. and Westwood Trust are wholly owned subsidiaries of Westwood Holdings Group, Inc., a publicly traded company on the NYSE. Westwood focuses on domestic value equities and manages approximately $5.1 billion in large cap assets and over $10.0 billion in total assets as of December 31, 2009. Westwood's mission statement is Exceeding client expectations through exceptional performance and ethical conduct. Meeting clients' needs with integrity, efficiency and consistency is the cornerstone of the corporate culture. The firm's growth has been driven by exceptional risk-adjusted performance and excellent client service, which in turn have resulted in long-term relationships with satisfied clients.

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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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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.

From March 1, 2006, to December 31, 2007, Bank of New York served as a sub-advisor for managing the cash portion of this investment option.

Effective July 15, 2008, Westwood Management Corp. was added as an additional sub-advisor. Performance results displayed reflect all sub-advisors managing this portfolio during the time periods displayed.

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

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.

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Important Notes

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

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

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Important Notes

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

[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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