Third Quarter 2010

Quarterly Commentary

Ticker	Investment Advisor	Benchmark	Morningstar Category	Investment Objective
PLNAX	Am Century/Montag & Caldwell	Russell 1000 Growth Index	Large Growth	Growth

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:

Positive stock selection in the information technology and industrial sectors added to relative performance. Also, the portfolio had an average 1% underweight to the energy sector, which helped returns. Additionally, the portfolio's average market capitalization was larger than that of the benchmark Russell 1000 Growth Index, which added value because large-cap equities tended to outperform small-caps during the period.

During last 12 months:

Strong stock selection in the materials sector aided returns during the period. Also, the portfolio's average 3% overweight to the consumer staples sector helped returns because this sector outperformed the benchmark index. Additionally, having a higher relative strength profile (an overweight to stocks exhibiting upward price movement during the period) than the index added to returns.

Negative Contributors

During last quarter:

Sector allocations relative to the benchmark index detracted from returns, particularly an average 3% overweight to the health care sector. Additionally, stock selection was negative overall, led by weak selection in the consumer discretionary sector. The largest individual detractor from returns was an underweight to Amazon.com Inc., which posted strong returns during the period. The portfolio, on average, held stocks that were less volatile than those held by the index, which hurt performance during the period.

During last 12 months:

Similar to the quarter, stock selection was negative overall, led by weak selection in the information technology, financial and consumer staples sectors. The largest individual detractor was an out-of-index holding in Research In Motion Ltd. Also, the portfolio had an average 1% overweight to the health care sector; this detracted from relative performance because the sector lagged the benchmark index. Additionally, the portfolio, on average, had a larger market capitalization profile than that of the index, which detracted from returns during the period.

Changes to the investment option's structure or portfolio:

No material changes occurred in the portfolio structure.

LargeCap Growth Fund II (A)

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 Growth Fund II (A) (excl. sales charge)	11.36	1.52	9.05	-5.33	1.60	-	-1.78
LargeCap Growth Fund II (A) (incl. sales charge)	5.30	-4.05	3.09	-7.10	0.45	-	-2.35
Russell 1000 Growth Index	13.00	4.36	12.65	-4.36	2.06	-3.44	-
Large Growth Category	12.66	3.38	10.34	-6.06	1.18	-2.22	-
Morningstar Percentile Ranking	-	-	61	40	41	-	-
Total Funds in Category	1789	1759	1743	1518	1279	752	-

Inception Date	06/28/2005
Ext. Perf. Inc. Date	12/06/2000
Total Inv. Exp Gross	2.96
Total Inv Exp Net	1.69
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 Growth 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 Growth Fund II (A)	-1.35	0.95	99.00	-0.20	-0.41	21.30	21	15	4.32	-5.39	90.66	94.99
Russell 1000 Growth Index	N/A	N/A	N/A	N/A	N/A	N/A	19	17	4.77	-5.68	100.00	100.00
	5 Year Return vs. Rank						5 Year Upside/Downside Capture Ratio					
LargeCap Growth Fund II (A)	-0.51	0.96	98.22	0.03	-0.19	17.40	34	26	3.62	-3.85	93.99	95.51
Russell 1000 Growth Index	N/A	N/A	N/A	N/A	N/A	N/A	33	27	3.85	-4.03	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 (%)
Apple, Inc.	4.21
Coca-Cola Company	3.15
S&P FUTURE - SEP2010	3.10
ExxonMobil Corporation	2.89
Abbott Laboratories	2.85
Google, Inc.	2.73
McDonald's Corporation	2.66
PepsiCo, Inc.	2.51
Costco Wholesale Corporation	2.14
Qualcomm, Inc.	1.95
Total % in Top 10	**28.18**

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

LargeCap Growth Fund II (A)

Manager(s)	Start Date	Degree	Alma Mater
Prescott LeGard	12/06/2000	B.A.	DePauw University
Gregory Woodhams	12/06/2000	M.A.	University of Wisconsin
Mariateresa Monaco	06/02/2009	M.B.A.	Massachusetts Institute of Technology
Charles E. Markwalter	07/14/2009	B.A.	Dartmouth College
Grover C. Maxwell III	07/14/2009	M.B.A.	Emory University

Fund Strategy

The investment seeks long-term growth of capital. The fund normally invests at least 80% of net assets in equity securities of companies with large market capitalizations (those with market capitalizations similar to companies in the Russell 1000 Growth index) at the time of purchase. It selects stocks of larger-sized companies it believes will increase in value over time using a growth investment strategy it developed.

About Montag & Caldwell

Montag & Caldwell has been offering investment management services since its inception in 1945, and is best known for its disciplined, high-quality large-cap growth approach. Montag & Caldwell's mission is to provide superior investment returns and the highest quality service to its clients. The cornerstone of Montag & Caldwell's success lies in the consistency of its people, philosophy and process. Montag & Caldwell has over 30 years' experience in the management of mutual funds, and currently sub-advises over 20 different fund portfolios under its large-cap growth discipline for both domestic and international clients. As of December 31, 2009, Montag & Caldwell had approximately $14 billion in client assets under management.

About American Century Inv. Mgmt.

American Century Investments® is a full-service investment management firm with an expanding range of investment products and services. Founded in 1958, and with more than $85 billion in assets under management as of December 31, 2009, American Century is committed to being a premier investment manager dedicated to the pursuit of solid, long-term performance for clients worldwide.American Century offers a broad spectrum of more than 80 mutual funds, with solid results across multiple disciplines and multiple fund classes suitable for a variety of investment products. The majority of domestic equity management and equity trading is conducted at the company's headquarters in Kansas City, Missouri. American Century's office in New York oversees the company's global equity management while its office in Mt. View, California oversees its fixed income, quantitative and asset allocation investment products. The firm has recently expanded to include international distribution via offices in London and Hong Kong. American Century gives investment professionals an increasingly rare commodity: a distinct, active investment style and a management approach that's grounded in solid market experience. For more than 50 years, American Century has stringently followed its investment practices. American Century's guiding principles of investment management have enabled the company to develop innovative quality investment products and consistently deliver results to 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.

Important Notes

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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 July 14, 2009, Montag & Caldwell 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.

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

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.