

Third Quarter 2017

Quarterly Commentary

Ticker	Inv Manager or Sub-Advisor	Benchmark	Morningstar Category	Investment Objective
PMDAX	Principal Global Investors	Russell 2500 Value Index	Mid Cap Value	Equity 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.

Small/Mid U.S. Equity

U.S equity markets continued their march higher, with major market indexes posting solid gains for the third quarter in a row to start 2017. Many asset classes rose during the period, with investors willing to take on more risk. Categories that are typically more volatile, such as small-cap and international stocks, led the way. Larger companies did maintain their lead over smaller peers, however, when considering all of 2017 to date. From a style perspective growth outpaced value for the third straight quarter. The Russell 2000 index produced a return of 5.67% and the Russel Midcap returned 3.47%. While volatility was apparent as the U.S. 10-year Treasury Yield started the quarter at 2.27%, it touched as low as 2.04% in early September, to only move higher and end the quarter at 2.31%.¹

Performance Contributors

Positive Contributors

During last quarter:

Allocation to HollyFrontier contributed because its refining capacity was unaffected by Hurricane Harvey, a storm which caused Gulf Coast refineries to come offline. Allocation to Adient contributed as it outperformed in part due to news of the acquisition of Futuris Group, a deal with geographic benefits, substantial synergies that is expected to be accretive in 2018. Allocation to Travelport contributed as earlier platform investments led to improved transaction growth.

During last 12 months:

Allocation to Harman, which was acquired by Samsung Electronics, contributed as the deal paid Harman stockholders. Allocation to BGC Partners contributed in part due to planning spin-off of its commercial real estate brokerage business before year-end. Allocation to Huntsman contributed due to firming commodity prices and industry fundamentals.

Negative Contributors

During last quarter:

Allocation to j2 Global detracted after debt ticked up as a result of year-to-date acquisitions. Allocation to B&G Foods detracted from relative returns due to a greater than expected decline in base business sales. Allocation to CLNS detracted as core operating trends were weak after a three-way merger in January.

During last 12 months:

Allocation to AmTrust Financial Services was a top detractor due to a delayed filing and prior year restatements brought on by a change in its auditor. Allocation to B&G Foods detracted in part due to news of Amazon buying Whole Foods, an announcement that rocked grocery stores and packaged food companies. Allocation to Medical Properties Trust detracted due to concerns over the financial strength of a large tenant.

Changes to the investment option's structure or portfolio:

No material changes occurred in the portfolio structure.

Small-MidCap Dividend Income Fund (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 09/30/2017	QTR	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception	Inception Date	06/06/2011
Small-MidCap Dividend Income Fund (A) (excl. sales charge)	3.96	9.04	19.04	12.60	14.23	-	12.98	Ext. Perf. Inc. Date	06/06/2011
Small-MidCap Dividend Income Fund (A) (incl. sales charge)	-1.74	3.04	12.46	10.49	12.94	-	11.98	Total Inv. Exp Gross	1.50
Russell 2500 Value Index	3.83	5.86	15.75	9.94	13.25	7.59	-	Total Inv Exp Net	1.50
Mid Cap Value Category	3.06	7.46	14.83	7.90	12.71	6.85	-	Waiver Date	-
Morningstar Percentile Ranking	-	-	17	3	26	-	-	Contractual Cap Date	-
Total Funds in Category	435	416	410	363	319	226	-	Contingent Deferred Sales Charge	1.00
								Maximum Up-front Sales Charge	5.50

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.

Small-MidCap Dividend Income Fund (A)

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					
Small-MidCap Dividend Income Fund (A)	3.29	0.90	91.16	1.07	0.74	11.44	22	14	2.73	-1.93	97.97	75.13
Russell 2500 Value Index	N/A	N/A	N/A	N/A	N/A	N/A	23	13	2.78	-2.57	100.00	100.00
	5 Year						5 Year					
Small-MidCap Dividend Income Fund (A)	2.46	0.87	91.23	1.26	0.27	10.85	39	21	2.77	-2.05	92.65	76.61
Russell 2500 Value Index	N/A	N/A	N/A	N/A	N/A	N/A	40	20	2.99	-2.67	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 08/31/2017

Security	Net Assets (%)
New Flyer Industries Inc	2.55
Bank of the Ozarks Inc	2.54
Fidelity National Financial Inc	2.42
Medical Properties Trust Inc	2.35
Omega Healthcare Investors Inc	2.34
Sinclair Broadcast Group Inc	2.33
STERIS PLC	2.32
Travelport Worldwide Ltd	2.10
PacWest Bancorp	2.05
Autoliv Inc	2.01
Total % in Top 10	23.02

Small-MidCap Dividend Income Fund (A)

Manager(s)	Start Date	Degree	Alma Mater
Daniel R. Coleman	06/06/2011	B.A.	University of Washington
David W. Simpson	06/06/2011	M.B.A.	University of Wisconsin

Fund Strategy

The investment seeks to provide current income and long-term growth of income and capital. The fund invests at least 80% of its net assets, plus any borrowings for investment purposes, in dividend-paying equity securities of companies with small to medium market capitalizations at the time of purchase. It invests in the securities of foreign issuers, real estate investment trusts, preferred securities, convertible securities, master limited partnerships, and royalty trusts.

About Principal Global Investors

Principal Global Investors - the institutional asset management affiliate of the Principal Financial Group - the firm focuses on delivering consistently competitive investment performance and superior service on behalf of its clients. Principal Global Investors has expertise in equities, fixed income and real estate investments, as well as specialized overlay and advisory services. The firm upholds the highest standards of excellence in investment research, risk management, ethics, fiduciary responsibility and client service. (Principal Global Investors is the asset management arm of the Principal Financial Group® (The Principal®) and includes the asset management operations of the following subsidiaries of The Principal: Principal Global Investors, LLC; Principal Real Estate Investors, LLC; Spectrum Asset Management, Inc.; Post Advisory Group, LLC; Columbus Circle Investors; Edge Asset Management, Inc.; Principal Global Investors (Europe) Limited; Principal Global Investors (Singapore) Ltd.; Principal Global Investors (Australia) Ltd.; and the majority owned affiliates of Principal International, Inc.).

Important Notes

Investors should carefully consider a 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 principalfunds.com, or calling 800-222-5852. 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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Small-cap and mid-cap stocks may have additional risks, including greater price volatility.

Small-cap and mid-cap investment options are subject to more fluctuation in value and may have additional risks than other investment options with stocks of larger, more stable companies.

Effective December 1, 2016, the Principal Small-MidCap Dividend Income Fund will close to certain new investors. Please see the prospectus for more complete information.

Russell 2500 Value Index measures the performance of the small to mid-cap value segment of the U.S. equity universe. It includes those Russell 2500 Index companies with lower price-to-book ratios and lower forecasted growth values.

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.

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

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

¹U.S. small-cap stocks: Russell 2000 Index; U.S. mid-cap stocks: Russell Midcap Index

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

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