Second Quarter 2017

Quarterly Commentary

Economic Overview

The world economy appears to be in the midst of a synchronized economic upturn. Central bankers are now talking in a synchronized fashion about reducing the massive monetary accommodation put in place since the financial crises. In June the European Central Bank (ECB) President Mario Draghi spoke positively about euro-area economic activity and the U.S. Federal Reserve hiked the Fed funds rate another 0.25% and unveiled a specific plan to shrink its huge portfolio of bonds. Capital spending has been picking up, loan growth has improved, financial conditions have been easing; job gains have been excellent, and unemployment has fallen.

In China, purchasing manager indices (PMIs) picked up in June and trade data has been excellent. Even in Japan, confidence is at or near the highs of the cycle. Industrial production and machine orders have rebounded, and retail sales have been strong. Profits have been picking up at a double-digit pace, and the labor market is the best in decades. Robust activity has failed to inspire pricing power, and core inflation is still running well below 1%. Sentiment in the Eurozone is the highest in decades. Soft data soared over the last few months. Investors, businesses, and consumers have cheered the fading political risk and better growth prospects. Some German measures are the best since reunification, but Italian and French sentiment has been robust too. Hard data has picked up also with German industrial production and factory orders rebounding from contractionary territory. Retail sales have grown at a healthy 2.5% pace across the entire Eurozone. Spain’s unemployment rate dropped to 17.7% from a peak of 26.3%; Germany’s unemployment rate is currently 5.7%. U.S. consumer and business sentiment has soared to the best levels of this cycle with hard data rebounding from the first-quarter slump. Core retail sales (the number included in GDP) soared over 5% on a three-month annualized pace in May. Industrial production expanded 3.8%. Both manufacturing and non-manufacturing PMIs from the Institute for Supply Management (ISM) surprised to the upside in June. Fed regional surveys were also solid. Consumer confidence has edged lower from recent highs, but remains well above 2016 levels. Housing starts have lost some momentum, since the multifamily real estate cycle peaked; but, single-family sales remain strong.

German and U.S. yields rose sharply during the last week of June. German 10-year yields more than doubled, reaching 0.56% on July 6th. Other sovereign yields pushed higher too; rates on 10-year British gilts surged to 1.31% at the end of June 30 from 1.0% or so earlier in the month. Even ten-year Japanese government bond yields jumped to 0.09% from 0.0% in April.

Balanced Asset Allocation/Lifecycle

International and U.S. equities delivered positive results for the quarter. The broad U.S. equities market, as measured by the Russell 3000, returned 3.0%, while the international developed and emerging markets returned 6.3% and 5.0%, respectively. U.S. large-caps (3.1%) outperformed both U.S. mid-caps (2.7%) and small-caps (2.46%). From a style perspective, growth outperformed value across large-, mid- and small-cap equities. 1

Real estate investment trusts (REITs) posted positive but lower results, underperforming the broad U.S. equities and international developed markets. U.S. REITs returned 1.3% for the quarter with global REITs returning 3.0%. 2 The Federal Reserve (Fed) raised short-term interest rates 25 basis points (bps) at its June 2017 meeting, moving the Fed funds rate to 1.0-1.25%. 3 Most fixed income spread products performed positively during the quarter, led by high yield and core fixed income, delivering returns of 2.4% and 1.3%, respectively. Treasury Inflation Protected Securities (TIPS) had negative performance for the quarter coming in at -0.4%. 4
Performance Contributors

Positive Contributors

During last quarter:

The allocation to high yield bonds contributed to positive absolute returns driven by strong security selection in banking, pharmaceuticals, healthcare, while remaining underweight commodity-related sectors. These positive effects were partially offset by the negative effect produced by the energy sector holdings driven by lower oil prices. The allocation to global infrastructure stocks contributed to positive absolute returns against a backdrop of positive economic data. Security selection was strongest in Airport and European toll roads. Returns for the communications infrastructure companies were mixed. Energy continued to be a drag. The allocation to emerging market debt contributed to positive absolute returns as sovereign credits from Sub-Saharan Africa (SSA) generated the highest total returns for the quarter. Ghana and Mozambique posted negative spread and total returns.

During last 12 months:

The allocation to high yield bonds contributed to positive absolute returns driven by strong security selection in Energy, Communications & Basic Energy. The overweight to Consumer Non-Cyclical and an underweight to the Communications sector resulted in slight negative allocation effects. The allocation to emerging market debt contributed positively as the largest contributions to excess returns came from positioning in Central Europe, Middle East and Africa. Overweights and issue selection in Gabonese Republic and Ghana were the top contributors. The allocation to commercial mortgage-backed securities (CMBS) contributed to positive absolute returns as exposure to 2012-2014 vintage BBB-rated bonds benefited from the credit curve continuing to flatten as investors continued to move down-in-credit to find yield during the quarter.

Negative Contributors

During last quarter:

The allocation to opportunistic mortgage-backed securities (OMBS) was a slight drag on relative returns due to negative performance of the IO/IIO (Interest Only/Inverse Interest Only) sector, as a result overall spread widening within the sector as well as the flattening yield curve. While the allocation to global value equities contributed positively, the large-cap portion did underperform relative to its benchmark led by poor stock selection and dividend yield companies being out of favor. Stock selection was weak overall in financials, health care and consumer discretionary. The call overlay strategy also detracted from returns as call options were the main driver of underperformance. Options spreads and cash equitization posted modest gains, primarily led by call options that track the EAFE, which was up over 6% for the quarter, and negatively impacted option returns.

During last 12 months:

While the allocation to global value equities contributed to positively, underperform relative to its benchmark was led by poor stock selection in financials, health care and consumer staples. Regionally, underperformance was led by the United States, the United Kingdom and France. While the opportunistic mortgage-backed securities (OMBS) was slightly positive, relative performance was hindered by the negative performance of the IO/IIO (Interest Only/Inverse Interest Only) sector due to a combination of spread widening within the sector and a flattening yield curve. The call overlay strategy detracted slightly from returns as equity markets have generally performed very well during the period which is a challenging environment for call option strategies.

Changes to the investment option's structure or portfolio:

No material changes occurred in the portfolio structure.
Global Diversified Income Inst 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, 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.

<table>
<thead>
<tr>
<th>Average Annual Total Returns (%) as of 06/30/2017</th>
<th>QTR</th>
<th>YTD</th>
<th>1 Year</th>
<th>3 Year</th>
<th>5 Year</th>
<th>10 Year</th>
<th>Since Inception</th>
<th>Inception Date</th>
<th>Ext. Perf. Inc. Date</th>
<th>Total Inv. Exp Gross</th>
<th>Total Inv Exp Net</th>
<th>Waiver Date</th>
<th>Contractual Cap Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Global Diversified Income Inst Fund</td>
<td>2.09</td>
<td>5.58</td>
<td>8.96</td>
<td>3.42</td>
<td>6.60</td>
<td>-</td>
<td>11.54</td>
<td>12/15/2008</td>
<td>12/15/2008</td>
<td>0.87</td>
<td>0.77</td>
<td>06/30/2018</td>
<td>06/30/2018</td>
</tr>
<tr>
<td>Global Diversified Income Blended Index</td>
<td>3.16</td>
<td>6.43</td>
<td>10.67</td>
<td>2.66</td>
<td>6.49</td>
<td>-</td>
<td>-</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Allocation--30% to 50% Equity Category</td>
<td>1.84</td>
<td>4.90</td>
<td>7.22</td>
<td>2.85</td>
<td>5.73</td>
<td>4.26</td>
<td>-</td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Morningstar Percentile Ranking</td>
<td>-</td>
<td>-</td>
<td>19</td>
<td>37</td>
<td>22</td>
<td>-</td>
<td>-</td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Total Funds in Category</td>
<td>528</td>
<td>514</td>
<td>503</td>
<td>400</td>
<td>348</td>
<td>240</td>
<td>-</td>
<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
</tbody>
</table>

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.
# Top Ten Holdings as of 05/31/2017

<table>
<thead>
<tr>
<th>Security</th>
<th>Net Assets (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Us 2yr Note (Cbt) Sep17</td>
<td>1.29</td>
</tr>
<tr>
<td>Us Syr Note (Cbt) Sep17</td>
<td>1.01</td>
</tr>
<tr>
<td>Hrg Grp 7.75%</td>
<td>0.71</td>
</tr>
<tr>
<td>Fremf Mtg Tr 2016-Kbam CMO</td>
<td>0.56</td>
</tr>
<tr>
<td>NextEra Energy Inc</td>
<td>0.55</td>
</tr>
<tr>
<td>National Grid PLC</td>
<td>0.52</td>
</tr>
<tr>
<td>Argentina(Rep Of) 7.82%</td>
<td>0.48</td>
</tr>
<tr>
<td>Foresight Engy 144A 11.5%</td>
<td>0.46</td>
</tr>
<tr>
<td>Microsoft Corp</td>
<td>0.46</td>
</tr>
<tr>
<td>Tenet Healthcare 6.75%</td>
<td>0.45</td>
</tr>
<tr>
<td><strong>Total % in Top 10</strong></td>
<td><strong>6.47</strong></td>
</tr>
</tbody>
</table>

Information is current as of the date noted. Keep in mind that all current and future portfolio holdings are subject to risk.
Manager(s) | Start Date | Degree | Alma Mater
--- | --- | --- | ---
Kelly A. Grossman | 03/01/2010 | B.A. | University of Northern Iowa
Benjamin E. Rotenberg | 03/07/2014 | B.A. | Pomona College
Marcus W. Dummer | 03/07/2014 | M.B.A. | University of Utah
Jessica S. Bush | 03/07/2014 | B.A. | University of Michigan
Jake S. Anonson | 03/07/2014 | M.B.A. | Iowa State University

**Investment Strategy**

The investment seeks income. The fund generally invests a majority of its assets in fixed income securities, such as high yield bonds (also known as "junk" bonds), preferred securities, commercial mortgage-backed securities, and emerging market debt securities, in an effort to provide incremental yields over a portfolio of government securities. In addition, it invests in equity securities to provide incremental dividend yields and diversify fixed-income related risks in the fund.

**About Logan Circle Partners, L.P.**

Logan Circle Partners, L.P. (Logan Circle) is an asset management firm providing primarily separate account, fixed income investment management services to institutional clients. The firm was founded on April 2007 by Mr. Jude T. Driscoll, Chief Executive Officer and Chief Investment Officer. Prior to founding Logan Circle, Mr. Driscoll was the President and CEO of Delaware Investments, where he was responsible for overseeing all firm activities. On April 16, 2010, Logan Circle was acquired by Fortress Investment Group LLC, a publicly traded company (NYSE: FIG) and a leading global investment management firm, as its traditional asset management arm. Fortress offers a range of alternative investment strategies for institutional and private investors around the world. Fortress has in excess of 1,100 employees working across four business lines: private equity funds, credit funds, hedge funds and traditional asset management. Logan Circle retained its name and Mr. Driscoll continues as the firm’s CEO and CIO. We believe that the key to unlocking value within the fixed income marketplace revolves around understanding asset quality and valuation. Whether in the sovereign market or the corporate market, understanding the underlying fundamentals of each potential investment is paramount to our process and will help us frame how we view a position within a potential portfolio. Secondly, we seek to understand how the volatility or potential volatility of a particular idea fits within our macro view of the market, our willingness to take risk, and our determination of whether that idea is appropriate for our blended portfolio.

**About First State Investments**

First State Investments, the consolidated asset management division of the Commonwealth Bank of Australia, is a global asset manager with experience across a range of asset classes and specialist investment sectors. The firm has been committed to delivering quality investment strategies for more than 140 years.
About W.H. Reaves and Co., Inc

Reaves Asset Management (Reaves), an SEC Registered Investment Adviser, has been managing institutional portfolios since 1978. Reaves' portfolios target a disciplined balance of earnings growth and income in a wide variety of critical, non-discretionary, infrastructure industries. The firm is located in Jersey City, New Jersey.

About Analytic Investors

Analytic believes that a quantitative investment process produces the best and most consistent risk adjusted returns over the long run. Short option strategies have exposure to the volatility risk premium (VRP) and Analytic believes that a VRP exists across global markets and asset classes. Short VRP exposure has a consistent positive payoff that is relatively uncorrelated to other risk premiums. They believe that our volatility forecasting model will outperform other forecasts such as implied volatility and historical realized volatility and will on average identify the largest (most negative) VRPs. It is not just a volatility forecast, it is a valuation model which actively targets the most underpriced contracts. Their expected return model allows the ranking of options on different underlying indexes or ETFs with different expiration dates and strikes. Employing an optimizer allows their portfolio manager to utilize more data effectively than in a qualitative process. The resulting option portfolios have the highest expected return with a tracking error versus the underlying less than the target level and with other exposures equal to client specified levels.

About Stone Harbor

Stone Harbor Investment Partners LP (Stone Harbor) is a global institutional fixed income investment manager specializing in credit and asset allocation strategies. The firm manages institutional clients’ assets across a range of investment products. The firm’s investment strategies are based on fundamental insights, derived from a combination of proprietary research and the in-depth knowledge and specialized experience of the firm’s team. Based in New York, Stone Harbor employs more than 100 people across its headquarters and offices in London and Singapore.

About Post Advisory Group

Post Advisory Group, LLC (Post), founded in 1992 by Larry Post, is a global investment manager specializing in high-yield fixed income securities with a multi-strategy, value-oriented investment approach. The firm’s team of highly experienced investment professionals applies Post’s investment philosophy - which emphasizes intensive credit research and detailed analysis of covenant terms and capital structure - in a consistent, conservative manner with the goal of maximizing returns and minimizing risk. Post combines world-class investment expertise, detailed fundamental analysis and risk management capabilities in its efforts to provide the firm’s client base with the investment objectives of consistent and attractive risk-adjusted returns.

About Principal Global Investors

Principal Global Investors - a member of the Principal Financial Group® - uses a unified investment philosophy and process that emphasize independent fundamental research and superior stock selection. The firm’s capabilities encompass large-, mid-, and small-cap stocks in developed and emerging markets worldwide.
About DDJ Capital Management, LLC
DDJ Capital Management, LLC (DDJ) is a Massachusetts-based limited liability company that was founded in 1996 to specialize in high yield and distressed and special situations investing. DDJ is 100% privately owned by its founders and key employees.

About Principal Real Estate Inv
Principal Real Estate Investors is the dedicated real estate asset manager for Principal Global Investors. Principal Real Estate Investors’ capabilities include commercial mortgage-backed securities, real estate equity securities and a broad range of private market real estate equity and debt alternatives.

About Spectrum
Spectrum Asset Management (Spectrum) - an affiliate of Principal Global Investors - offers specialized expertise in the management of preferred securities. The firm was founded in 1987 and is based in Stamford, Connecticut. Spectrum’s clients include insurance companies, corporations, pension funds, retirement plans, mutual funds, charitable trusts and financial institutions in the U.S. and abroad.
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, 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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Fixed-income investment options are subject to interest rate risk, and their value will decline as interest rates rise. Lower-rated securities are subject to additional credit and default risks. Risks associated with preferred securities differ from risks inherent with other investments. In particular, in the event of bankruptcy, a company's preferred securities are senior to common stock but subordinated to all other types of corporate debt. International investing involves increased risks due to currency fluctuations, political or social instability, and differences in accounting standards, these risks are magnified in emerging markets. REIT securities are subject to risk factors associated with the real estate industry and tax factors of REIT registration.

The risks associated with derivative investments include that the underlying security, interest rate, market index, or other financial asset will not move in the direction the Investment Adviser and/or Sub-Advisor anticipated, the possibility that there may be no liquid secondary market, the risk that adverse price movements in an instrument can result in a loss substantially greater than a fund's initial investment, the possibility that the counterparty may fail to perform its obligations; and the inability to close out certain hedged positions to avoid adverse tax consequences.

Principal Funds Class P shares automatically converted to Institutional Class shares effective close of business June 23, 2017.

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### 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

Global Diversified Income Blended Index is composed of 40% Bloomberg Barclays Global Credit Index, 30% Bloomberg Barclays Global High Yield Index, and 30% MSCI ACWI Value 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.

*Unless otherwise stated, all data from Bloomberg


2 U.S. REITs: DJ US Select REIT TR USD; Global REITs: FTSE/EPRA NAREIT Developed Markets Index; international equities in developed markets: MSCI EAFE Index; international emerging markets: MSCI Emerging Markets Index.

3 Federal Reserve Bank Federal Open Market Committee statement, released June 14, 2017;


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