

Principal Preferred Securities Portfolio

Sub-advised by Spectrum

S P E C T R U M

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.

Investment Philosophy and Process

The Principal Preferred Securities portfolio is available as a mutual fund and as a separate account that invests wholly in Institutional class shares of the mutual fund.

Philosophy

Spectrum Asset Management’s specialized approach in the management of preferred securities provides a prudent alternative for clients who seek diversification opportunities and attractive total rates of return relative to traditional fixed-income securities such as corporate, asset-backed and government securities. Its approach is well-suited to clients seeking lower volatility and a higher-quality alternative to high yield corporate bonds. Spectrum’s investment strategy focuses on the active management of preferred securities in order to generate a high level of current income and effectively trade the inefficiencies found in the preferred securities markets. Spectrum’s success is the result of its fundamental, bottom-up credit approach as to company selection, expertise and experience in the security structure and selection and top-down approach as to trading-market and industry sector selection.

The investment advisor’s investment philosophy and strategy may not perform as intended and could result in a loss or gain.

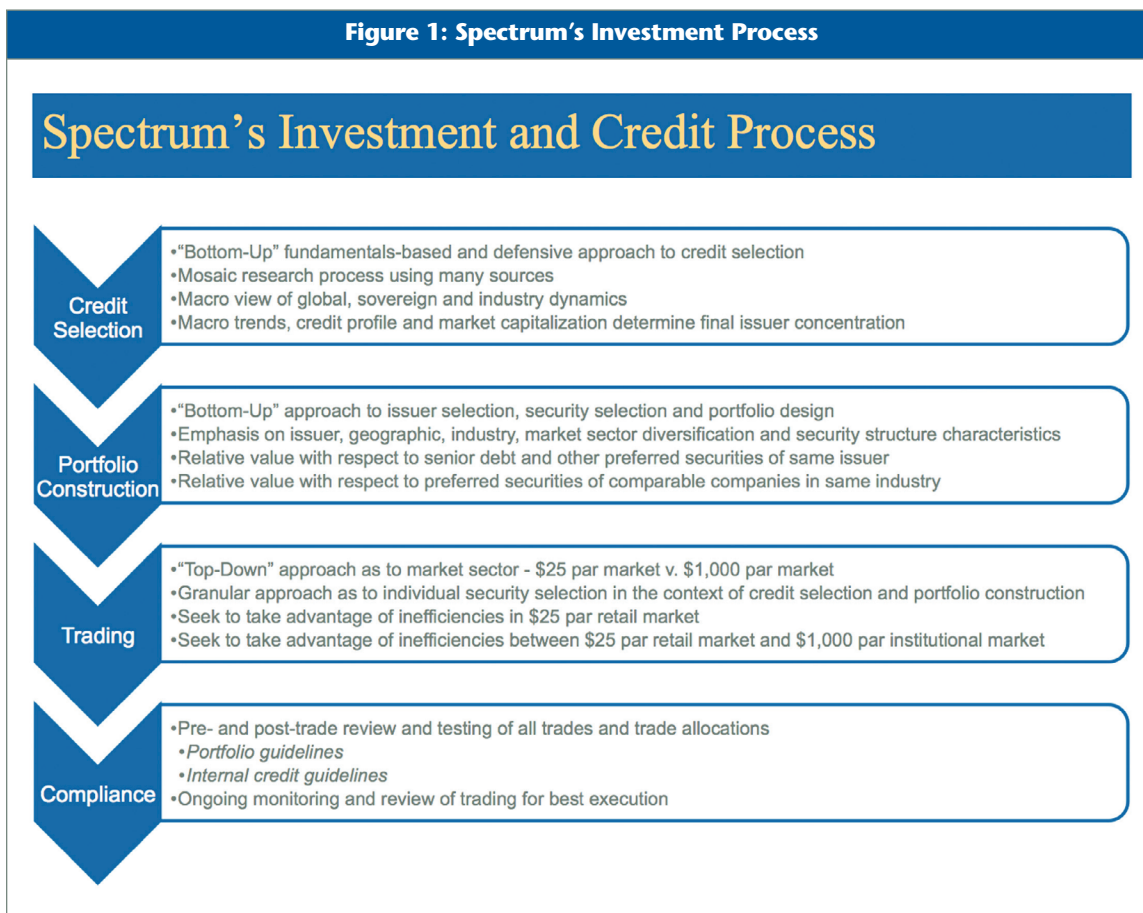
Process

Spectrum’s investment process (Figure 1 on page 2) emphasizes a rigorous credit approach to identifying superior investment alternatives.

Not FDIC or NCUA insured

May lose value • Not a deposit • No bank or credit union guarantee
Not insured by any Federal government agency

Figure 1: Spectrum's Investment Process



Primary emphasis is placed on high-grade hybrid preferred securities offering superior risk-adjusted yield premiums. Macroeconomic analysis is conducted to identify those economic sectors that are the most attractive in the near and long-term future. Spectrum's research efforts are supplemented by direct access to rating agency services/industry analysts at major investment banks and the extensive credit research capabilities of Principal Global Investors.

Attractive issues reflect credit ratings that are steady or improving and offer an appropriate premium yield, given the ratings and credit trends relative to other preferred securities and corporate senior debt. Features such as call protection, subordination or option-adjusted spreads are assessed to ensure sufficient yield premium to justify their inclusion in the portfolio. Portfolio construction results in a well-diversified selection of utility, financial and industrial securities.

When appropriate, the portfolio may be hedged to manage interest-rate risk to a targeted duration. Spectrum's hedges, when implemented, frequently utilize liquid CBOT-listed U.S. Treasury options and futures.

The portfolio typically holds 300 to 350 securities. Annual turnover generally ranges between 20% and 40%. Exposure to a single issuer is limited to 5% of the portfolio.

Spectrum's proprietary research is supplemented by direct access to rating agency services, industry analysts at major investment banks and the extensive research resources of Principal Global Investors. Research conducted by Principal Global Investors' core group of fixed income credit analysts makes a unique contribution to Spectrum's preferred securities research by providing in-depth coverage of over 800 major bond issues. Their analysis of issuers is made available to the preferred securities research team via the internally developed, real-time bond information tracking system at Principal Global Investors.

Portfolio management team

Fernando "Fred" Diaz joined Spectrum in 2000.

Roberto Giangregorio joined Spectrum in 2003. Mr. Giangregorio earned a B.S. and an M.S. in Mechanical Engineering from S.U.N.Y. at Stony Brook and the University of Wisconsin – Madison, respectively. He also earned an M.B.A. in Finance from Cornell University.

L. Phillip Jacoby, IV is Chief Investment Officer of Spectrum and Chairman of the Investment Committee. Mr. Jacoby joined Spectrum in 1995. He earned a B.S. in Finance from the Boston University School of Management.

Manu Krishnan joined Spectrum in 2004. Mr. Krishnan earned a B.S. in Mechanical Engineering from the College of Engineering, Osmania University, India, an M.S. in Mechanical Engineering from the University of Delaware and an M.B.A. in Finance from Cornell University. Mr. Krishnan has earned the right to use the Chartered Financial Analyst designation.

Mark A. Lieb founded Spectrum in 1987. Mr. Lieb earned a B.A. in Economics from Central Connecticut State College and an M.B.A. in Finance from the University of Hartford.

Additional Information

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.

Before directing retirement funds to a separate account, investors should carefully consider the investment objectives, risks, charges and expenses of the separate account as well as their individual risk tolerance, time horizon and goals. For additional information contact us at 1-800-547-7754 or by visiting principal.com.

Investment options are subject to investment risk. Shares or unit values will fluctuate and investments, when redeemed, may be worth more or less than their original cost.

This investment option is available through a separate account or Principal Funds, Inc. mutual fund. Separate accounts are made available through a group annuity contract with the Principal Life Insurance Company, Des Moines, IA 50392.

Fixed-income investment options are subject to interest rate risk, and their value will decline as interest rates rise. Neither the principal of bond investment options nor their yields are guaranteed by the U.S. government.

Preferred Securities have additional credit risk in comparison to other types of corporate debt and are subject to interest rate risk as well as other risks inherent with fixed income investing.



WE'LL GIVE YOU AN EDGE®

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Insurance products and plan administrative services are provided by Principal Life Insurance Company. Principal Funds, Inc. is distributed by Principal Funds Distributor, Inc. Securities are offered through Princor Financial Services Corporation, 800-547-7754, Member SIPC and/or independent broker/dealers. Securities sold by a Princor Registered Representative are offered through Princor®. Principal Funds Distributor, Princor and Principal Life are members of the Principal Financial Group®, Des Moines, IA 50392. Investment options may not be available in all states or U.S. commonwealths. Separate accounts are available through a group annuity contract with Principal Life Insurance Company. See the group annuity contract for the full name of the separate account. Principal Life Insurance Company reserves the right to defer payments or transfers from Principal Life separate accounts as permitted by the group annuity contracts providing access to the separate accounts or as required by applicable law. Such deferment will be based on factors that may include situations such as: unstable or disorderly financial markets; investment conditions which do not allow for orderly investment transactions; or investment, liquidity, and other risks inherent in real estate (such as those associated with general and local economic conditions). If you elect to allocate funds to a separate account, you may not be able to immediately withdraw them.