

# Principal MidCap Value I Portfolio

Co-sub-advised by Goldman Sachs Asset Management  
and LA Capital Management



**Asset  
Management**

Building on Goldman, Sachs & Co.'s tradition of excellence since 1869, Goldman Sachs Asset Management, L.P. (GSAM) serves the investment management needs of preeminent institutions and individual investors worldwide. GSAM offers the resources of a large global firm and the specialization of a boutique with independent investment teams, while seeking to deliver strong performance over full market cycles through a team-driven, research-intensive approach to investing.

## Investment Philosophy and Process

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

### Philosophy

GSAM's Value Equity Team believes that value investing begins with balancing price and prospects — investing in good companies opportunistically when they are undervalued:

- **Price.** Good companies become undervalued when uncertainty exists and their real economic value is not recognized in the marketplace.
- **Prospects.** The Team seeks quality companies that have sustainable operating/competitive advantages, excellent stewardship of capital, the capability to earn above their cost of capital and strong or improving balance sheets and cash flow.

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

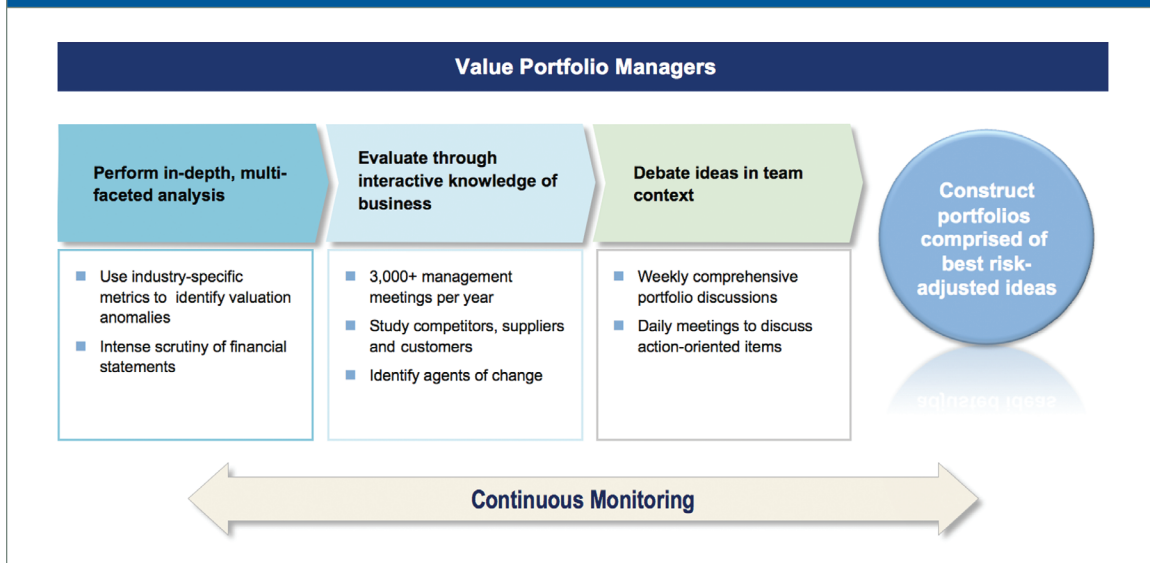
### Process

Within the firm's investment process (Figure 1 on page 2), GSAM emphasizes stock selection based upon rigorous fundamental research and portfolio construction in a risk-managed context.

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: Goldman Sachs Asset Management's Investment Process**



The investment process consists of three key elements.

- 1. Use industry-specific measures to evaluate the universe.** Create a focus list for further research using industry-specific metrics to narrow the investment universe by valuation, profitability and business characteristics. Identify changing business trends or potential catalysts for improvement.
- 2. Perform in-depth fundamental research.** Conduct proprietary operational, financial and cash-flow analysis to help determine competitive advantages, profitability, transparency and industry dynamics. Test assumptions and assess management quality through meetings with company management, competitors, customers and suppliers. Develop an investment thesis by utilizing company-specific valuation analysis to establish upside targets, downside risks, investment time horizons and potential catalysts.
- 3. Construct risk-managed portfolios.** Build portfolios from the bottom up according to the risk/reward profile for each security. Provide broad diversification by owning the firm's best value ideas in each sector. Continuously scrutinize market developments and industry and company exposures versus the benchmark to better track progress toward target prices and avoid any unintended macro "bets" in the portfolios. Monitor overall portfolio characteristics to maintain style and market-cap consistency. Carefully track analyst recommendations and performance to ensure that financial incentives are aligned with investors' success.

GSAM's value equity portfolios benefit from the expertise of seasoned investment professionals, the firm's strong, team-based approach to research and stock selection and the application of industry-specific metrics in valuing each prospective investment idea. The investment team is organized by industry — portfolio managers and research analysts focus on a particular area of expertise to deliver depth and breadth of research views.

Portfolio decision makers are actively involved in the research, which brings intensity and focus to their process and provides responsive implementation of their strategy. Strategy benefits include:

- Quality-oriented investment philosophy
- Seasoned, integrated team focused solely on value investing
- Industry-specific valuation
- An intense research culture

### **Portfolio management team**

**Andrew Braun** has been with Goldman Sachs Asset Management since 1993. He earned a B.A. in Economics from Harvard University and an M.B.A. in Finance and Economics from the Stern School of Business at New York University.

**Sean Gallagher** has been with Goldman Sachs Asset Management since 2000. He earned a B.S. in Finance from Drexel University and an M.B.A. in Finance and Accounting from Stern School of Business at New York University.

**Dolores Bamford** has been with Goldman Sachs Asset Management since 2002. She earned a B.A. from Wellesley College and an M.S. from MIT Sloan School of Management. Ms. Bamford has earned the right to use the Chartered Financial Analyst designation.



LA Capital Management (LA Capital) is an employee-owned firm that utilizes a quantitative approach for security selection and portfolio management. Portfolios are tailored to meet the unique return and risk objectives of each assignment. The investment team developed the investment process at Wilshire Asset Management, where they worked together for sixteen years beginning in 1986. In March 2002, the team purchased the business from Wilshire Associates to set up an independent investment boutique.

## Investment Philosophy and Process

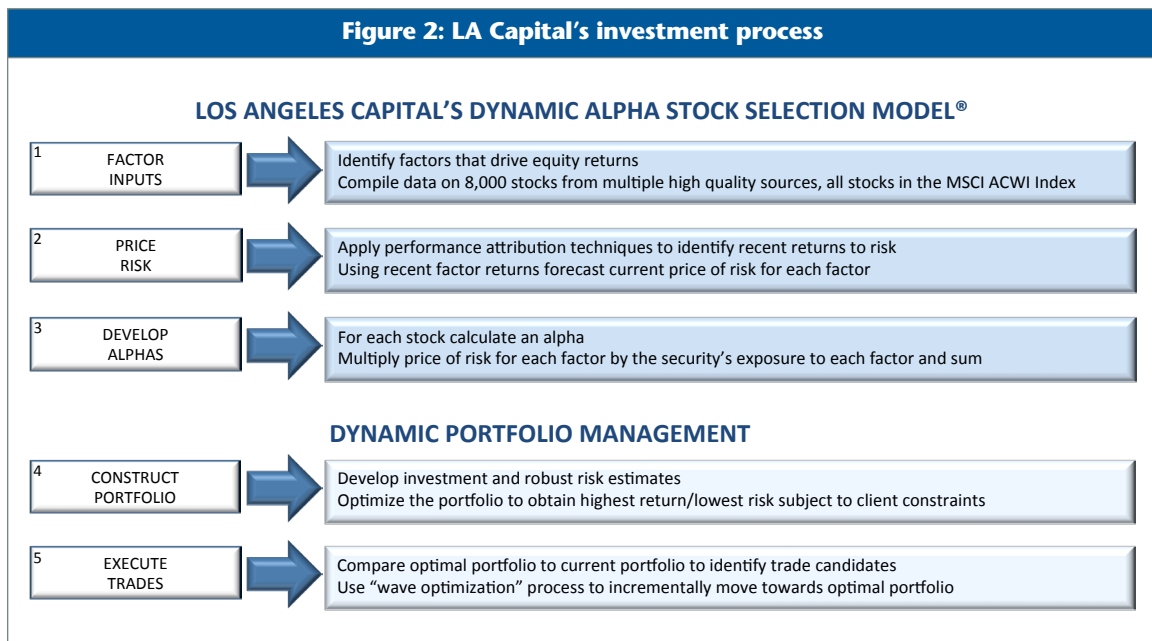
### Philosophy

LA Capital believes that investor preferences for specific risk characteristics evolve with changing market conditions.

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

### Process

The firm’s investment process (Figure 2) includes a robust research process that seeks to identify investor preferences for specific risk characteristics by analyzing valuation, income statement, balance sheet, industry and market-related factors.



The firm's Dynamic Alpha Stock Selection Model then calculates expected returns for a universe of mid-capitalization securities based on a security's exposure and the model's expected return for each factor. On a daily basis, the model is updated to capture new fundamental data as well as price and dividend information.

On a weekly basis, the investment team identifies the target portfolio that maximizes the portfolio's expected return while maintaining a risk profile similar to the Russell Midcap Value Index. The portfolio is diversified across industries, common risk factors and securities. Portfolio risks and implementation costs are tightly controlled and minimized through a proprietary optimization process. The investment team monitors portfolio returns and risks on a daily basis. The firm's Portfolio Review Committee formally reviews the portfolio for compliance with investment objectives and guidelines on a monthly basis.

LA Capital's investment team is highly dedicated to the research process with more than half of the firm's resources dedicated to various areas of research — including Factor Research, Model Development, Risk Management and Information Technology, which combine to form an integrated global research platform. The goal of the investment research process is to enhance returns, control risk and reduce trading costs. Accordingly, the investment team focuses on four areas of research:

1. Identification of new risk factors which explain security returns
2. Improved statistical techniques to more accurately price risk factors
3. Enhancements to the risk management and portfolio construction process
4. Low-cost trading strategies

Each research project is evaluated for its ability to add value to the investment process. The firm believes the distinguishing feature of the research process is its ability to identify and adapt to changing market conditions.

### **Portfolio management team**

**Hal W. Reynolds** co-founded LA Capital in 2002. He earned a B.A. from the University of Virginia and an M.B.A. from the University of Pittsburgh. Mr. Reynolds has earned the right to use the Chartered Financial Analyst designation.

**Thomas D. Stevens** co-founded LA Capital in 2002. He earned a B.B.A. and M.B.A. from the University of Wisconsin. Mr. Stevens has earned the right to use the Chartered Financial Analyst designation.

**Daniel E. Allen** joined LA Capital in 2009. Previously, he was with Wilshire Associates Incorporated and Wilshire Consulting Division. He earned a B.B.A. from Pacific Lutheran University and an M.B.A. from University of Chicago Booth School of Business. Mr. Allen has earned the right to use the Chartered Financial Analyst Designation.

# MidCap Value I

## Core-Satellite Structure

Goldman Sachs and LA Capital employ unique investment philosophies which we believe are complementary to one another. Historically, these sub-advisors have exhibited strong performance in different market environments. For MidCap Value I, we combined these sub-advisors with the goal of improving the consistency of the overall portfolio.

### Core-satellite structure overview

A core-satellite investment option is comprised of a “core” portfolio plus two or more “satellite” portfolios. As seen in Figure 3, Goldman Sachs and LA Capital are the satellite sub-advisors for Principal MidCap Value I, and the core portfolio manager is Principal Management Corporation.<sup>1</sup>



The core portfolio serves as the foundation, or “home base,” for the investment option. It is actively managed within narrow risk constraints. A key focus for the core portfolio is to help reduce volatility within the investment option. Principal Management Corporation does this by maintaining a core composition that tilts MidCap Value I away from stocks having certain return-generating characteristics that may bring greater volatility to the portfolio. The core is actively managed within narrow risk constraints.

On the other hand, the satellite portfolios — also actively managed — strive to deliver excess return relative to the benchmark. Due to their mandate to strive for higher returns than the core, the satellite portfolios have correspondingly wider risk constraints.

The core portfolio’s goal is to improve performance consistency by reducing volatility (risk), while the goal of each satellite portfolio is to provide investment diversification and generate outperformance relative to the benchmark.

<sup>1</sup> Principal Management Corporation is the advisor to Principal Funds, Inc.

## Potential Benefits Provided By the Core-Satellite Structure

Our goal is to provide for a more consistent return pattern, by striving to hit first and second quartile Morningstar peer group performance more consistently. The essence of this strategy is to minimize the probability that the option falls into the fourth quartile within peer groups.

Besides offering the potential for improved performance consistency, this structure provides additional benefits:

**A truly active product.** While the primary goal is to provide competitive performance with a more consistent return pattern, our portfolio advisors are very conscious of maintaining characteristics within the fund that are reflective of a truly active strategy. Often, a misperception exists that combining multiple managers can result in a strategy that closely resembles the market at large. Our portfolio advisors are focused on helping to ensure that each fund maintains an Active Share that keeps it distinct from market indexes. Active Share is simply the percentage of the portfolio that is not held in common with a corresponding index. It is a measure of how “active” an active strategy truly is.

**Helps to maintain availability of certain investment options in typically capacity-constrained asset classes.** The multi-manager aspect of the core-satellite structure offers increased capacity so that investment options in asset classes prone to capacity issues - for example small- and mid-cap equities – will be less likely to experience closures. As a result, these asset classes are more likely to remain available, providing additional diversification for use by investors.

**Broader range of satellite managers.** The structure makes it easier to leverage talented investment managers who maintain concentrated or wide-constraint portfolios that may experience greater volatility than more diverse or risk-controlled portfolios. The structure helps make it easier to utilize these managers without having to worry about investor reactions to extreme performance characteristics over short time periods.

**Mitigates impact of adverse manager events.** The core-satellite structure can potentially limit risk should a qualitative event negatively impact one of the sub-advisors (i.e. portfolio manager lift out, firm sale, etc.) and facilitate a smooth transition process should a manager need to be replaced.

## Portfolio management team

**Randy L. Welch** is a Senior Vice President and Portfolio Manager of Principal Management Corporation. He joined the Principal Financial Group in 1989 and oversees the functions of the Investment Services group, which includes investment manager research, investment consulting, performance analysis, and investment communication. He is also responsible for the due diligence program that monitors investment managers used by Principal Funds, Inc. Randy has FINRA Series 7, 24, 63 and 66 registrations and is also an affiliate member of the Chartered Financial Analysts (CFA) Institute. He earned his undergraduate degree from Grand View College and an M.B.A. from Drake University.

**James Fennessey** is a Vice President and Portfolio Manager of Principal Management Corporation. He joined the Principal Financial Group in 2000. He is the Head of the Manager Research Team that is responsible for analyzing, interpreting and coordinating investment performance data and evaluation of the investment managers under the due diligence program that monitors investment managers used by Principal Funds, Inc. James graduated from Truman State University with a B.S. in Business Administration, with an emphasis in Finance, and a minor in Economics. He has earned the right to use the Chartered Financial Analyst designation.

## About Principal Management Corporation

In addition to serving as the advisor to Principal Funds, Principal Management Corporation has responsibility for portfolio management of the core portion for all of the core-satellite investment options. In managing the core portion, Principal Management Corporation utilizes a team approach overseen by a portfolio manager. Principal Management Corporation has been registered with the SEC as an investment adviser under the Investment Advisers Act of 1940 since 1968. As advisor to Principal Funds, Principal Management Corporation oversees our proprietary due diligence process for identifying, selecting and monitoring investment managers. Principal Funds offers a full range of investment options covering all core style boxes and several niche options. The Funds are sub-advised by a variety of investment managers representing some of the nation's leading asset managers and investment boutiques.

## 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](http://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](http://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.*

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.

Sub-Advised Investment Options include separate accounts available through a group annuity contract with Principal Life Insurance Company and mutual funds available through Principal Funds, Inc.



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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.