

Third Quarter 2017

Quarterly Commentary

Ticker	Inv Manager or Sub-Advisor	Benchmark	Morningstar Category	Investment Objective
PLLAX	Principal Global Investors	Russell 2000 Index	Small Blend	Small Company

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:

Information technology and consumer discretionary were key contributors. In information technology, semiconductor equipment companies benefitted from increasing demand for memory chips. In consumer discretionary, gaming and leisure stocks performed well amid continued consumer preferences for experiential consumption. Entegris, which produces products consumed in the process of manufacturing semiconductors, contributed due to broad-based strength in semiconductor demand. Brink's, a provider of secure transportation, cash management services, and other security-related services, contributed. Take-Two Interactive, a developer of video games, contributed due to ongoing strength in their Grand Theft Auto franchise. Eldorado Resorts, which operates regional casinos, contributed. Visteon, an automotive supplier focused on "infotainment" and other cockpit electronics, contributed as it continues to benefit from the growth in electronic content per vehicle and consumer demand.

During last 12 months:

Holdings in consumer discretionary, investment banking, and semiconductor equipment were key contributors. Consumer discretionary benefited from recovery in the U.S. housing market and steady consumer demand for entertainment and leisure. Investment banking holdings were beneficiaries of increased merger and acquisition activity and hopes that corporate tax reform could further boost such activity. Holdings in semiconductor equipment companies benefitted from increasing demand for memory chips. Visteon, an automotive supplier focused on "infotainment" and other cockpit electronics, contributed. Advanced Energy Industries, which manufactures power management subsystems that go into semiconductor manufacturing equipment, contributed. Installed Building Products, the second largest insulation installer in the U.S. for new residential construction, contributed driven by a recovering housing market, market share gains, and attractive acquisitions. Eldorado Resorts, which operates regional casinos, contributed. Entegris, contributed as it continues to benefit from broad-based strength in semiconductor demand.

Negative Contributors

During last quarter:

Healthcare, consumer staples, and industrials were key detractors. In healthcare, underweight to the biotechnology stocks detracted. Holdings in consumer staples faced competitive pressures. Dean Foods, the largest processor and distributor of fluid milk in the U.S., detracted as the company's efforts to grow branded milk volume appeared to stall, while the larger private-label milk segment faced margin pressure amid fierce grocery industry price competition. Carvana, an e-commerce retailer of used cars, detracted. Summit Hotel Properties, which owns premium-branded select-service hotels, detracted. Tile Shop Holdings, a retailer of tile and related products, detracted following a weak quarter despite healthy industry trends. Plantronics, a leading manufacturer of headsets for voice and music, detracted due to slowing consumer demand and unexpectedly higher expenses resulting from a competitor lawsuit.

During last 12 months:

Industrials, energy, and real estate were key detractors. In industrials, underweight to machinery industry and poor returns from its holdings in the sector detracted. In energy, selection of oil-focused exploration and production companies that were down sharply amid oil price volatility detracted. In real estate, poor returns from holdings in the sector and lack of participation in the strong rally among data-center properties, detracted. SUPERVALU, a food retailer and distributor, detracted amid concerns of food price deflation, heightened price competition among grocers, and the potential long-term threat posed by Amazon's acquisition of Whole Foods Market. Manhattan Associates, which provides retailers, grocers, and wholesalers with software systems, detracted. Dean Foods, the largest processor and distributor of fluid milk in the U.S., detracted. NETGEAR, detracted amid concerns that the increased marketing expense needed to drive market-share gains would diminish earnings growth.

Changes to the investment option's structure or portfolio:

No material changes occurred in the portfolio structure.

SmallCap A 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. 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	06/28/2005
SmallCap A Fund (excl. sales charge)	4.74	7.17	15.91	10.54	14.09	6.66	8.35	Ext. Perf. Inc. Date	12/06/2000
SmallCap A Fund (incl. sales charge)	-1.01	1.29	9.56	8.47	12.81	6.06	7.99	Total Inv. Exp Gross	1.26
Russell 2000 Index	5.67	10.94	20.74	12.18	13.79	7.85	-	Total Inv Exp Net	1.26
Small Blend Category	5.10	8.45	18.91	10.01	12.83	7.19	-	Waiver Date	-
Morningstar Percentile Ranking	-	-	82	53	32	65	-	Contractual Cap Date	-
Total Funds in Category	833	809	794	653	554	393	-	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.

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. For time periods prior to inception date of the fund, predecessor performance is reflected. 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.

SmallCap A Fund

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					
SmallCap A Fund	-0.29	0.89	95.22	0.80	-0.50	13.17	26	10	2.88	-3.04	89.00	91.06
Russell 2000 Index	N/A	N/A	N/A	N/A	N/A	N/A	24	12	3.24	-3.34	100.00	100.00
	5 Year						5 Year					
SmallCap A Fund	0.98	0.94	94.57	1.03	0.09	13.57	42	18	3.40	-2.95	98.00	94.31
Russell 2000 Index	N/A	N/A	N/A	N/A	N/A	N/A	39	21	3.47	-3.13	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 (%)
Visteon Corp	1.67
Aspen Technology Inc	1.65
Vishay Intertechnology Inc	1.54
Blackbaud Inc	1.50
First Industrial Realty Trust Inc	1.49
Healthsouth Corp	1.48
PRA Health Sciences Inc	1.45
The Brink's Co	1.44
Prestige Brands Holdings Inc	1.41
Synnex Corp	1.40
Total % in Top 10	15.01

SmallCap A Fund

Manager(s)	Start Date	Degree	Alma Mater
Phil Nordhus	05/19/2006	M.B.A.	Drake University
Brian W. Pattinson	07/20/2011	M.B.A.	University of Iowa

Fund Strategy

The investment seeks long-term growth of capital. Under normal circumstances, the fund invests at least 80% of its net assets, plus any borrowings for investment purposes, in equity securities of companies with small market capitalizations at the time of purchase. For this fund, companies with small market capitalizations are those with market capitalizations within the range of companies comprising the Russell 2000(R) Index (as of December 31, 2016, this range was between approximately \$20.4 million and \$10.3 billion).

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.

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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Formerly known as SmallCap Blend Fund.

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.

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. For time periods prior to inception date of the fund, predecessor performance is reflected. 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.

Russell 2000 Index consists of the smallest 2000 companies in the Russell 3000 Index, representing approximately 10% of the Russell 3000 total market capitalization.

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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