

Third Quarter 2017

Quarterly Commentary

Ticker	Inv Manager or Sub-Advisor	Benchmark	Morningstar Category	Investment Objective
CMPGX	Principal Global Investors	Bloomberg Barclays US Agency Fixed Rate MBS Index	Intermediate Government	Govt Bond - Mortgage

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.

Fixed Income

Spreads continued their nearly uninterrupted tightening trend due to the combination of an improved macroeconomic backdrop and strong corporate fundamentals. In addition, reduced-expectations of monetary tightening helped risk assets outperform because central banks took a more-dovish tone due to weak inflation data. Despite escalating tension with North Korea, volatility remained exceptionally low. The Treasury curve flattened during the quarter with short-term interest rates rising faster than longer-term rates. The two-year U.S. Treasury rate rose 0.10% while the five-year U.S. Treasury rate rose 0.05%. The ten-year and thirty-year rates each increased 0.03%. The slope of the two-to-ten-year Treasury curve fell from 0.92% to 0.85%.¹

The Bloomberg Barclays U.S. Aggregate Index, a proxy for the overall fixed income market, had an excess return of 0.41% for the quarter when compared to similar-duration U.S. Treasury securities. The best-performing sectors were emerging market debt, below investment-grade corporate bonds, and investment-grade corporate bonds with excess returns of 1.86%, 1.60%, and 0.87%, respectively. Mortgage-backed securities (MBS) also outperformed with an excess return of 0.47%. Commercial mortgage-backed securities (CMBS), asset-backed securities (ABS), and U.S. agencies outperformed similar duration U.S. Treasury securities but underperformed the Bloomberg Barclays U.S. Aggregate Index with excess returns of 0.34%, 0.14%, and 0.05%, respectively.²

Performance Contributors

Positive Contributors

During last quarter:

An out-of-benchmark allocation to non-agency residential mortgage-backed securities (RMBS) aided performance. An out-of-benchmark allocation to non-agency commercial mortgage-backed securities (CMBS) aided performance. Issue selection in medium coupon Fannie Mae (FNMA) mortgage-backed-securities (MBS) bolstered returns.

During last 12 months:

An out-of-benchmark allocation to Ginnie Mae agency collateralized mortgage obligation (CMOs) was the strongest performer. An out-of-benchmark allocation to Fannie Mae Agency CMOs was the strongest performer. An out-of-benchmark allocation to non-agency commercial mortgage-backed securities (CMBS) helped performance.

Negative Contributors

During last quarter:

An out of benchmark allocation to Ginnie Mae Agency commercial mortgage-backed securities (CMBS) was the largest detractor. Allocation to U.S. Treasuries constrained performance. An out-of-benchmark allocation to Fannie Mae agency collateralized mortgage obligation (CMOs) hindered performance.

During last 12 months:

An out-of-benchmark allocation to Freddie Mac agency CMOs were the largest detractor. Issue selection in low coupon Fannie Mae (FNMA) agency mortgage-backed securities (MBS) constrained performance. An out-of-benchmark allocation to Ginnie Mae (GNMA) agency commercial mortgage-backed securities (CMBS) detracted.

Changes to the investment option's structure or portfolio:

No material changes occurred in the portfolio structure.

Government & High Quality Bond 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	05/04/1984
Government & High Quality Bond Fund (A) (excl. sales charge)	0.70	1.60	-0.63	1.64	1.39	3.62	6.20	Ext. Perf. Inc. Date	05/04/1984
Government & High Quality Bond Fund (A) (incl. sales charge)	-1.56	-0.66	-2.86	0.88	0.93	3.38	6.05	Total Inv. Exp Gross	0.91
Bloomberg Barclays US Agency Fixed Rate MBS Index	0.96	2.32	0.30	2.45	1.97	4.18	-	Total Inv Exp Net	0.91
Intermediate Government Category	0.52	1.75	-0.94	1.63	1.00	3.47	-	Waiver Date	06/30/2018
Morningstar Percentile Ranking	-	-	39	59	23	45	-	Contractual Cap Date	06/30/2018
Total Funds in Category	274	263	262	243	233	173	-	Contingent Deferred Sales Charge	1.00
								Maximum Up-front Sales Charge	2.25

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.

Government & High Quality Bond 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 %	
	3 Year						Up	Down	Up	Down	Up	Down
Government & High Quality Bond Fund (A)	-0.88	1.04	91.87	0.64	-1.39	2.01	3 Year					
Bloomberg Barclays US Agency Fixed Rate MBS Index	N/A	N/A	N/A	N/A	N/A	N/A	21	15	0.38	-0.42	86.35	122.87
	5 Year						5 Year					
Government & High Quality Bond Fund (A)	-0.43	0.91	90.45	0.55	-0.86	2.11	34	26	0.45	-0.41	84.10	97.44
Bloomberg Barclays US Agency Fixed Rate MBS Index	N/A	N/A	N/A	N/A	N/A	N/A	37	23	0.53	-0.42	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 (%)
US Treasury Note 3.125%	1.24
FHLMC 3.5%	1.07
GNMA CMO 3%	0.92
FNMA 3.5%	0.86
FNMA 4%	0.86
FNMA 4%	0.83
FNMA 3%	0.82
US Treasury Bond 5.25%	0.82
US Treasury Bond 6.25%	0.82
FNMA 3%	0.80
Total % in Top 10	9.04

Statistics as of 08/31/2017	
Average Eff Duration (yrs)	4.65
Average Eff Maturity (yrs)	6.81
Average Weighted Price	\$96.68
30-Day SEC Yield - Subsidized (Net) as of 08/31/2017	2.57%
30-Day SEC Yield - Non-Subsidized (Gross) as of 08/31/2017	2.47%

Government & High Quality Bond Fund (A)

Manager(s)	Start Date	Degree	Alma Mater
Scott J. Peterson	01/01/2010	M.B.A.	New York University
Ryan P. McCann	05/19/2010	B.A.	Washington State University
John R. Friedl	05/19/2010	M.S.	Seattle University

Fund Strategy

The investment seeks a high level of current income consistent with safety and liquidity. The fund invests at least 80% of its net assets, plus any borrowings for investment purposes, in securities issued by the U.S. government, its agencies or instrumentalities or securities that are rated AAA by S&P Global Ratings or Aaa by Moody's, or, if unrated, in the opinion of those selecting such investments, are of comparable quality including but not limited to mortgage securities such as agency and non-agency collateralized mortgage obligations, and other obligations that are secured by mortgages or mortgage-backed securities at the time of purchase.

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.

© 2017 Morningstar, Inc. All Rights Reserved. Part of the mutual fund data contained herein: (1) is proprietary to Morningstar and/or its content providers; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete, or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information.

For Government High Quality Bond Fund (A) the Distributor has voluntarily agreed to waive .10% which limits the investment option's 12b-1 fees to .15%. These limits apply now but may be terminated at any time.

Fixed-income and asset allocation investment options that invest in mortgage securities are subject to increased risk due to real estate exposure.

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.

Bloomberg Barclays US Agency Fixed Rate MBS Index covers the fixed-rate mortgage-backed pass-through securities issued by GinnieMae (GNMA), Fannie Mae (FNMA), and Freddie Mae (FHLMC).

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.

principalfunds.com



Principal Life Insurance Company, Des Moines, Iowa 50392-0001, principal.com 09/2017
#t17092109bj

Important Notes

Statistics:

30-Day SEC Yield - Subsidized (Net) - This yield citation reflects the income that the investment option produced taking into consideration all expense waivers, caps, and breakpoints in place during the 30 day period. Without these waivers, the investment option's yield would be lower.

30-Day SEC Yield - Non-Subsidized (Gross) - This yield citation reflects the income that the investment option would produce if the investment option did not have a portion of its total investment expense waived or capped.

Average Effective Duration - A measure of a fixed income investment option's interest-rate sensitivity and represents an approximate percent change in bond's price for a one percent change in interest rates-the longer a fund's duration, the more sensitive the portfolio is to shifts in interest rates. The duration of a fixed income investment option is determined by a formula that includes projected cash flows, such as coupons and principal payout at maturities for bonds.

Average Effective Maturity - Average effective maturity is a weighted average of all the effective maturities of the bonds in a portfolio.

Average Weighted Price - The statistic is calculated by weighting the price of each bond by its relative size in the portfolio. This number reveals if the investment option favors bonds selling at prices above or below face value (discount or premium securities, respectively). A higher number indicates a bias toward premiums. This statistic is expressed as a percentage of par (face) value.

Effective Duration - A measure of a fixed income investment option's interest-rate sensitivity and represents an approximate percent change in bond's price for a one percent change in interest rates-the longer a fund's duration, the more sensitive the portfolio is to shifts in interest rates. The duration of a fixed income investment option is determined by a formula that includes projected cash flows, such as coupons and principal payout at maturities for bonds.

*Unless otherwise stated, all data from Bloomberg

¹U.S. Treasury Constant Maturity 30-year, 10-year and 2-year yields

²Components of Bloomberg Barclays U.S. Aggregate Bond Index, via Barclays Live. Duration-adjusted excess return is a measure the relative performance to that of U.S. Treasurys with a similar duration profile.

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

principalfunds.com



Principal Life Insurance Company, Des Moines, Iowa 50392-0001, principal.com 09/2017
#t17092109bj