First Quarter 2012

Quarterly Commentary

Ticker	Inv Manager or Sub-Advisor	Benchmark	Morningstar Category	Investment Objective
PRDAX	Multiple Sub-Advisors	Diversified Real Asset Custom Index	Moderate Allocation	Growth and Income

Economic Overview

Global equity markets rallied strongly during the quarter as headwinds that faced global economies in 2011 waned, driven in large part by resolution of the Greek debt crisis (which had dampened performance in global markets for much of the past two years) and continued stronger-than-expected economic data in the U.S. The crisis in Greece was averted when European governments successfully negotiated an orderly writedown of Greek debt with the country's creditors. This settlement was largely responsible for averting defaults by other struggling European governments, clearing the way for global markets to move higher.

In the U.S., economic fundamentals showed continued strength. Corporate earnings were strong throughout the recovery as demonstrated by the S&P 500 Index, which posted 16% earnings growth for 2011. With the S&P 500 Index trading at the end of 2011 at essentially the same level it was at a year prior (1258), its trailing price-to-earnings ratio dropped by 2% over the one-year period, from 15 to 13. Put in perspective, this result positioned the S&P 500 Index, at the end of 2011, at its cheapest price level since 1984 for each dollar of earnings.[1] The growth in corporate earnings was driven largely by efficiency gains on the part of corporations, which had been slow to replace workers laid off during the downturn. However, the pace of hiring picked up over the six-month period ending March 31, 2012, helping to lower the unemployment rate from 9.1% six months ago to its current level of 8.2%.[2] As the employment picture improved, so did personal income, growing at a pace of approximately 5% during 2011.[3]

Perhaps the one warning sign of possible trouble ahead is the Consumer Price Index (CPI). The year-over-year CPI was at 2.9% as of February 2012. To put this in context, the 2.9% CPI resulted in a negative 2.83% real yield against the U.S. government 3-month T-bill (3-month T-bill rate of 0.07% as of March 30, minus 2.9% CPI). This negative real yield means that should the CPI and T-bill rates remain static over the course of a full year, an investor in the 3-month T-bill would lose nearly 3% in purchasing power during that year.[4]

While part of the reason for extremely low yields on Treasuries is the Federal Reserve's accommodative monetary policy, there have been other key causes as well, including investors' risk aversion due to the situation in Europe and concerns about the U.S. economy's slow recovery. However, as resolution of the Greek debt woes began to unfold and the U.S. economy improved, yields on longer-dated Treasuries began to increase. If rates continue moving higher, prices of existing lower-rate Treasuries will decline. Thus, investors may choose to exercise caution when evaluating the prospects of fixed income investing.

Balanced/Asset Allocation

During the quarter, U.S. large- and mid-cap stocks performed similarly, returning 12.9%. Small-cap stocks trailed with a return of 12.4%. Growth stocks beat value, due in part to limited exposure to utilities, a traditional value sector. The utilities sector posted negative returns as investors moved into riskier sectors that were participating more fully in the upward-trending market environment. Within international stocks, emerging markets outperformed developed markets. Emerging markets' strong performance was led by Brazil, Russia, India, South Korea and Taiwan. In real estate, U.S. real estate investment trusts (REITs) returned 10.4%, underperforming the U.S. equities market. Meanwhile, global REITs delivered 12.9%, due in large part to strong performance by diversified REITs, especially in Hong Kong and Japan.[5]

Within fixed income, riskier asset classes, such as corporate bonds (both high-yield and investment-grade) and commercial mortgage-backed securities, performed best during the quarter. High-yield corporates outperformed duration-adjusted Treasuries by 5.91%. Within investment-grade bonds, corporates led with a 3.78% duration-adjusted excess return.[6] Treasury yields generally rose during the period. The yield on the 10-year Treasury rose from 1.89% to 2.23%, while the yield on the 2-year Treasury moved only modestly, from 0.25% to 0.33%.[7]

Performance Contributors

Positive Contributors

During last quarter:

The overall portfolio benefited from an underweight to the commodities sleeve. Also, the natural resource stocks, commodities and master limited partnerships (MLPs) sleeves contributed positively to overall performance by outperforming their respective indexes during the period. Within the natural resource stocks sleeve, energy stocks were the top performers (particularly oil and gas exploration and production companies).

During last 12 months:

The overall portfolio benefited from an underweight to the commodities sleeve. All sleeves except the TIPS and natural resource stocks sleeves outperformed their respective indexes for the period, led by the MLPs sleeve. Within the MLPs sleeve, security selection within the natural gas pipelines subsector and the gathering and processing subsector contributed positively to results.

Negative Contributors

During last quarter:

An overweight to cash detracted from performance. Underperformance in the U.S. Treasury Inflation-Protected Securities (TIPS) and global real estate investment trusts (REITs) sleeves also negatively impacted results. Within the TIPS sleeve, curve positioning detracted the most from performance. Within the global REITs sleeve, weak security selection in Japan was the key detractor.

During last 12 months:

An underweight to the TIPS sleeve and an overweight to cash detracted from returns for period. Also, the natural resource stocks and TIPS sleeves negatively impacted overall portfolio performance by underperforming their respective benchmarks. Within the TIPS sleeve, the short duration position was the largest detractor from performance over the 12-month period. Within the natural resource stocks sleeve, holdings that negatively affected returns included a mix of metals and mining stocks as well as energy sector holdings (although exploration and production companies were the most prevalent among the leading detractors).

Changes to the investment option's structure or portfolio:

During the quarter, an infrastructure sleeve and a floating-rate debt sleeve were added to Diversified Real Asset. Also, the scope of the REITs sleeve was broadened, from U.S. REITs to global REITs.

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 03/31/2012	QTR	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception
Diversified Real Asset Fund (A) (excl. sales charge)	3.66	3.66	-0.68	-	-	-	9.37
Diversified Real Asset Fund (A) (incl. sales charge)	-0.26	-0.26	-4.41	-	-	-	7.34
Diversified Real Asset Custom Index	3.75	3.75	1.01	-	-	-	-
Moderate Allocation Category	8.09	8.09	3.82	16.74	2.60	4.72	-
Morningstar Percentile Ranking	-	-	94	-	-	-	-
Total Funds in Category	1021	1021	969	839	749	404	-

Inception Date	03/16/2010
Ext. Perf. Inc. Date	03/16/2010
Total Inv. Exp Gross	1.32
Total Inv Exp Net	1.25
Waiver Date	12/31/2012
Contractual Cap Date	12/31/2012
Contingent Deferred Sales Charge	-
Maximum Up-front Sales Charge	3.75

Diversified Real Asset Fund (A)

Top Ten Holdings as of 02/29/2012

Security	Net Assets (%)
Us 10yr Note Fut Jun12	2.72
US Treasury Bond 2.375%	1.96
US Treasury Note	1.90
US Treasury Note 0.5%	1.77
Us 5yr Note (Cbt) Jun12	1.56
US Treasury Bond 3.875%	1.55
Us Ultra Bond(Cbt Jun12	1.54
Swedish Export Credit; Dow Jones - Ubs Commodity Index Linked Notes	1.45
US Treasury Bond 3.625%	1.40
US Treasury Bond	1.32
Total % in Top 10	**17.17**

Information is current as of the date noted. Keep in mind that all current and future portfolio holdings are subject to risk.

Diversified Real Asset Fund (A)

Manager(s)	Start Date	Degree	Alma Mater
Kelly Grossman	03/16/2010	B.A.	University of Northern Iowa
Michael P. Finnegan	03/16/2010	M.A.	University of Iowa
Dave Reichart	12/30/2011	M.B.A.	Drake University

Fund Strategy

The investment seeks a long-term total return in excess of inflation. The fund invests at least 80% of assets among the following general investment categories: inflation-indexed bonds, real estate investment trusts (REITs), commodity index-linked notes, fixed-income securities, securities of natural resource companies, master limited partnerships (MLPs), publicly-listed infrastructure, and floating rate debt. It may concentrate its investments (invest more than 25% of its net assets) in securities in the real estate and energy/natural resources industries.

About Brookfield Investment Mgmt Inc

Brookfield Investment Management Inc. (the firm) is a global investment manager focused on specialized equity and fixed income securities. The firm is a subsidiary of Brookfield Asset Management, a global alternative asset manager with approximately $150 billion in assets under management as of December 31, 2011 and more than 100 years of ownership and operating experience in real estate, infrastructure, power and private equity. Brookfield Investment Management encompasses all of the public securities investment capabilities of Brookfield Asset Management.

About Principal Real Estate Inv

Principal Real Estate Investors is the dedicated real estate asset manager for Principal Global Investors; Principal Global Investors is the 9th largest manager of real estate assets managed on behalf of pension funds (Global Alternatives Survey 2011, Towers Watson, June 2011, data as of December 31, 2010). The firm's capabilities include commercial mortgage-backed securities, real estate equity securities and a broad range of private market real estate equity and debt alternatives. As of December 31, 2011, Principal Real Estate Investors managed $38.5 billion in commercial real estate assets.

About Tortoise Capital Advisors, LLC

Tortoise Capital Advisors, L.L.C. (Tortoise) focuses on the energy-infrastructure sector, primarily investin in Master Limited Partnerships (MLPs). The firm was founded in 2002 and is headquartered in Leawood, Kansas (a suburb of Kansas City, Missouri). As of December 31, 2011, Tortoise had approximately $7.5 billion in assets under management.

About Symphony Asset Management LLC

Symphony Asset Management LLC (Symphony) is a diversified alternative investment manager headquartered in San Francisco, California with offices in New York, New York. An SEC-registered Investment Adviser since inception in 1994, Symphony is structured to meet the needs of institutional and retail clients. As of December 31, 2011, the firm managed $8.4 billion in assets across an integrated platform of long-only strategies, hedge funds and structured products investing in senior bank loans, high-yield bonds, convertible bonds and equities.

About BlackRock Financial Mgmt, Inc.

BlackRock is a premier provider of global investment management, risk management and advisory services. As of December 31, 2011, the firm managed $3.51 trillion across equity, fixed income, real estate, liquidity and alternative investments. Clients include corporate, public and union pension plans, insurance companies, mutual funds, endowments, foundations, charities, corporations, official institutions and individuals worldwide. Through BlackRock Solutions®, the firm offers risk management and advisory services that combine capital markets expertise with proprietarily-developed systems and technology. BlackRock serves clients in North and South America, Europe, Asia, Australia, Africa and the Middle East. Headquartered in New York, the firm maintains offices in 24 countries around the world.

About Jennison Associates, LLC

Jennison Associates (Jennison) was founded in July 1969 as a Registered Investment Adviser primarily for domestic large-cap growth equity accounts and began managing assets in that year. The firm has since expanded its investment capabilities to include a range of equity strategies - small-cap, mid-cap growth, multi-cap, large-cap value, blend, and long/short - as well as balanced and fixed income management. Jennison uses fundamental team-based research to manage portfolios for institutional, sub-advisory and private clients through separately managed and commingled vehicles, including mutual funds. As of December 31, 2011, Jennison had $135.7 billion in assets under management.In 1985, Jennison became a wholly owned subsidiary of The Prudential Insurance Company of America. In 2000, Jennison was given oversight for Prudential's public active equity asset management capabilities. Prudential demutualized in December 2001 and became a public company. Jennison is now an indirect subsidiary of Prudential Financial Inc.

About Credit Suisse

Founded in 1856, Credit Suisse Group has a long tradition of meeting the complex financial needs of a wide range of clients. The history of Credit Suisse Asset Management, LLC dates back to 1935, when Credit Suisse Asset Management (New York) was founded as BEA (Basic Economic Appraisals) Associates. All institutional investment management divisions within the Credit Suisse Group were re-branded in 1997 under the one entity: Credit Suisse Asset Management. As one of the world's leading banks, Credit Suisse provides its clients with private banking, investment banking and asset management services worldwide. Credit Suisse Asset Management, LLC had more than $55.6 billion in assets as of December 31, 2010. The firm's asset management business offers products across a broad spectrum of investment classes - including alternative investments such as commodities, private equity, hedge funds, real estate and credit, as well as multi-asset-class strategies (which includes equities and fixed income products). Credit Suisse's asset management business manages portfolios, mutual funds and other investment vehicles for a broad spectrum of clients ranging from governments, institutions and corporations to private individuals. The Credit Suisse asset management business is operated as a globally integrated network to deliver the bank's best investment ideas and capabilities to clients around the world.

You're in good company with Principal Funds

GLOBAL INVESTMENT MANAGEMENT

- A wide range of mutual funds in all core asset classes and investment styles, as well as several niche funds to help you explore new investment opportunities for your clients.
- The extensive asset management capabilities of a number of leading sub-advisors including Principal Global Investors and its boutique affiliates.

ASSET ALLOCATION EXPERTISE

- Turnkey assets allocation solutions--including target-risk and target-date funds--to help deepen your client relationships and simplify your life.
- Asset allocation strategies powered by our risk-managed funds, including alternative asset classes.

RETIREMENT LEADERSHIP

- Training, advanced strategies, and dedicated retirement specialists to help you capture a greater share of the rollover IRA market.

principalfunds.com

Principal Funds is a leading provider of mutual fund solutions for individual investors and retirement plans, with approximately $77.2 billion in mutual fund assets under management (as of March 31, 2012). Principal Funds has special expertise in providing asset allocation solutions, and is the 4th largest manager of lifecycle funds in the nation based on target-date and target-risk mutual fund assets under management (according to Financial Research Corporation, as of December 31, 2011). Principal Funds are distributed through a nationwide network of independent financial professionals affiliated with brokerage and financial planning firms.

Important Notes

Principal Funds, Inc. is distributed by Principal Funds Distributor, Inc., member of the Principal Financial Group®. Principal Funds Distributor, Principal Shareholder Services, Principal Management Corporation and its affiliates, and Principal Funds, Inc. are collectively referred to as Principal Funds.

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.

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. or any other government entity. Concentrating investments in natural resources industries can be affected significantly by events relating to those industries, such as variations in the commodities markets, weather, disease, embargoes, international, political and economic developments, the success of exploration projects, tax and other government regulations and other factors. Investment in derivatives entails specific risks relating to liquidity, leverage and credit that may reduce returns and/or increase volatility. REIT securities are subject to risk factors associated with the real estate industry and tax factors of REIT registration. An MLP that invests in a particular industry (e.g., oil and gas) may be harmed by detrimental economic events within that industry. As partnerships, MLPs may be subject to less regulation (and less protection for investors) under state laws than corporations. In addition, MLPs may be subject to state taxation in certain jurisdictions, which may reduce the amount of income paid by an MLP to its investors.

Diversified Real Asset Custom Index is composed of 30% Barclays Capital U.S. Treasury TIPS Index, 20% Dow Jones UBS Commodity Index, 10% S&P N.A. Natural Resources Index, 10% Tortoise MLP Index, 10% Dow Jones Brookfield Global Infrastructure Index, 10% Credit Suisse Leveraged Loan Index, and 10% FTSE EPRA/NAREIT Developed Index. The blended index historic returns reflect the allocation as of the time of production. Previous allocation changes are not restated.

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.

principalfunds.com

Principal® Funds

Principal Life Insurance Company, Des Moines, Iowa 50392-0001, principal.com 03/2012
#t12040501hj

Important Notes

[1] pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/spearn.htm (Raw data for this table was obtained from Bloomberg and S&P.)

[2] As of March 2012; www.dol.gov

[3] research.stlouisfed.org/fred2/series/PI

[4] CPI: www.bls.gov/cpi/; U.S. T-bill and Treasuries rates: research.stlouisfed.org/fred2/categories/115; real yield = current yield minus CPI

[5] Performance sources: U.S. large-cap stocks: Russell 1000 Index; U.S. mid-cap stocks: Russell Midcap Index; U.S. small-cap stocks: Russell 2000 Index; international developed markets: MSCI EAFE Index; international emerging markets: MSCI Emerging Markets Index; U.S. REITs: MSCI US REIT Index; global REITs: FTSE EPRA/NAREIT Developed Index

[6] Source: Barclays Point (Barclays Capital US Corporate High Yield Index and components of the Barclays Capital Aggregate Bond Index)

[7] Source: FactSet (U.S. Treasury Constant Maturity 10-year and 2-year yields)

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

principalfunds.com

Principal® Funds

Principal Life Insurance Company, Des Moines, Iowa 50392-0001, principal.com 03/2012
#t12040501hj