

Quarterly Commentary

Ticker	Inv Manager or Sub-Advisor	Benchmark	Morningstar Category	Investment Objective
PCSXX	Principal Global Investors	Barclays Capital Treasury Bellwethers 3 Month Index	Money Market	Income

Economy & Market Overview

During the fourth quarter, equities markets rebounded globally from the prior quarter's extremely weak performance, though not enough to fully recover from their third-quarter losses. Interestingly, while it was generally accepted that excess debt among developed nations drove the third-quarter sell-off,¹ the fourth-quarter rebound had no clear spark to trigger the upward move (though improving fundamentals in the U.S. could have helped initiate the rally).

Europe remained in a state of crisis during the quarter as its countries' governments worked to plot a course out of the excess leverage of Greece, Portugal, Italy, Ireland and Spain. However, obstacles continued to obstruct progress. The key issue to be resolved was determining who should be responsible for the losses incurred by the banking sector when the write-offs of sovereign debt occur. In terms of Greece, Ireland and Portugal, their debt already is far in excess of their ability to pay. Greece has an agreement to write down its debt by 50%, and when some of the covenants are taken into account, the write-off is closer to 70-75%.² Should similar write-downs from other nations occur, the losses to the European banking system could wipe out most (if not all) of the banks' capital base. While Germany has argued that recapitalization of the banking system is the responsibility of each individual nation, countries such as France, Spain and Italy likely can't afford the additional liability. The question of where the capital will come from continues to be a major overhang on the markets. It is particularly so in the currency markets, where the U.S. dollar has rallied 10% against the euro since summer 2011.

In the U.S., Congress's debt ceiling stand-off earlier in 2011 has faded from immediate focus. However, it hasn't gone away and likely will play a significant role in the political debates leading to the November elections. For the time being, focus has shifted to economic fundamentals, which have shown some improvement. Third-quarter GDP came in at 1.8%;³ while not a strong growth report, it is nowhere near recession level. Similarly, corporate earnings continued to increase, exceeding analysts' expectations and leading to a drop in unemployment from 9.4% in December 2010 to a revised 8.7% in November 2011.⁴ Consumers responded with heightened interest in spending, as reflected by a 4.1% increase in holiday sales for 2011 vs. 2010.⁵

For the quarter, U.S. equities returned 12.1%, with small-cap stocks outpacing large-caps. Value stocks performed better than growth due in part to a rally in financials (the largest sector within the Russell 3000 Value Index). The strong fourth-quarter performance bumped U.S. equities to a positive 1.0% return for the year.⁶ Meanwhile, international equities delivered 3.7% for the quarter and were down -13.7% for the year.⁷

As risk aversion abated, fixed income generally underperformed stocks for the quarter. Interest rates rose initially, reaching nearly 2.40% in late October, but ended up falling modestly from 1.91% to 1.88% at quarter-end. The 2-year U.S. Treasury yield fell from 0.25% to 0.24%, leaving the shape of the yield curve roughly unchanged from the prior quarter.⁸ At its December meeting, the Federal Reserve decided to maintain its current target range for the federal funds rate at 0.00% to 0.25%, stating that economic conditions are "likely to warrant exceptionally low levels for the federal funds rate at least through mid-2013."⁹ This assurance is likely to anchor the short end of the yield curve.

With risk back in favor, high-yield corporate bonds led U.S. fixed income with an absolute return of 6.46% for the quarter.¹⁰ Commercial mortgage-backed securities also performed very well, outpacing duration-adjusted Treasuries by 2.49%.¹¹

Not FDIC or NCUA insured

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

Performance Contributors

Positive Contributors

During last quarter:

The portfolio performed in line with its peer group. The portfolio's allocation to variable rate demand notes (VRDNs) continued to be a positive contributor to performance as the yield on VRDNs was higher than other investment options with a seven-day maturity. The portfolio also had started investing a small percentage in securities rated as Tier 2; these securities, which have higher yields, have enabled the portfolio to diversify assets out of financials.

During last 12 months:

The portfolio performed in line with its peer group. Similar to the quarter, the portfolio's allocation to variable rate demand notes (VRDNs) continued to be a positive contributor. Also similar to the quarter, the small percentage invested in Tier 2 securities delivered higher yields and enabled the portfolio to diversify assets out of financials.

Negative Contributors

During last quarter:

Due to the uncertainty in Europe/European banks, the portfolio reduced exposure to these entities; having portfolio positions lower than peers and reducing exposures more significantly than the industry has lowered portfolio yield, as European banks have a higher yield than other alternatives. The portfolio's weighted average-days-to-maturity was in line with or shorter than the peer group for the quarter, exerting nominal downward pressure on portfolio yield.

During last 12 months:

Similar to the quarter, the portfolio's reduced exposure to Europe/European banks relative to peers lowered portfolio yield, detracting from results.

Changes to the investment option's structure or portfolio:

No material changes occurred in the portfolio structure.

Money Market 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 12/31/2011	QTR	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception	Inception Date	06/28/2005
Money Market Fund (A) (excl. sales charge)	0.00	0.00	0.00	0.06	1.51	1.63	1.82	Ext. Perf. Inc. Date	12/06/2000
Money Market Fund (A) (incl. sales charge)	0.00	0.00	0.00	0.06	1.51	1.63	1.82	Total Inv. Exp Gross	0.55
Barclays Capital Treasury Bellwethers 3 Month Index	0.00	0.11	0.11	0.16	1.55	1.99	-	Total Inv Exp Net	0.55
Money Market Category	0.01	0.02	0.02	0.08	1.37	1.65	-	Waiver Date	-
Morningstar Percentile Ranking	-	-	-	-	-	-	-	Contractual Cap Date	-
Total Funds in Category	1021	1016	1016	927	848	623	-	Contingent Deferred Sales Charge	-
								Maximum Up-front Sales Charge	-

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.

Money Market Fund (A)

Top Ten Holdings as of 11/30/2011

Security	Net Assets (%)
Deutsche Bank Repurchase Agreement	4.71
Credit Suisse Repurchase Agreement	3.61
BlackRock Liquidity Funds TempFund Portfolio	2.05
San Jose Redevelopment Agency	1.86
STIT - Liquid Assets Portfolio	1.78
New York Life Capital Corp	1.16
Memorial Health System/IL	1.11
ING USA Annuity & Life Insurance Co	1.08
MetLife	1.08
NGSP Inc	1.02
Total % in Top 10	19.47

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

Money Market Fund (A)

Manager(s)	Start Date	Degree	Alma Mater
Alice B. Robertson	12/06/2000	Master	DePaul University
Tracy Reeg	08/02/2004	B.S.	University of Northern Iowa

Fund Strategy

The investment seeks as high a level of current income as is considered consistent with preservation of principal and maintenance of liquidity. The fund invests assets in a portfolio of high quality, short-term money market instruments issued by banks, corporations (U.S. and non-U.S.), municipalities and the U.S. government. Such instruments include certificates of deposit, bankers acceptances, commercial paper, treasury bills, and bonds. The fund maintains a dollar weighted average portfolio maturity of 60 days or less.

About Principal Global Investors

Principal Global Investors' fixed income capabilities emphasize a broad array of global credit, mortgage, asset-backed and government debt markets worldwide. The firm also offers extensive capabilities in structured fixed-income strategies. Principal Global Investors managed \$71.0 billion in fixed income assets as of December 31, 2010. Its global fixed income research efforts span sovereign and corporate debt markets worldwide and draw from 161 fixed income professionals. The disciplined and repeatable investment research process combines bottom-up and top-down portfolio construction techniques with a strong focus on relative value and broad diversification. Principal Global Investors is a member of the Principal Financial Group®.

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 \$68.9 billion in mutual fund assets under management (as of December 31, 2011). 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 September 30, 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.

© 2012 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.

Money Market Funds are not guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although these Funds seek to preserve the value of your investment at \$1.00 per share, it is possible to lose money.

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.

Principal Management Corporation may voluntarily limit a certain portion of the fund's expenses collected from the Money Market Fund on a temporary basis. The Net Expense Ratio may be lower when expenses are limited.

Barclays Capital Treasury Bellwethers 3 Month Index is composed of public obligations of the U. S. Treasury with a maturity of three months.

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 Life Insurance Company, Des Moines, Iowa 50392-0001, principal.com 12/2011
#t1201030322

Important Notes

¹ "U.S. Stocks Tumble, Capping S&P 500's Worst Quarter Since 2008," businessweek.com, October 1, 2011; businessweek.com/news/2011-10-01/u-s-stocks-tumble-capping-s-p-500-s-worst-quarter-since-2008.html

² "A Voluntary Greek Debt Deal?", Matina Stevis, WSJ Blogs, December 30, 2011; blogs.wsj.com/brussels/2011/12/30/a-voluntary-greek-debt-deal

³ U.S. Dept. of Commerce, Bureau of Economic Analysis, December 22, 2011; bea.gov

⁴ U.S. Dept. of Labor, Bureau of Labor Statistics Economic News Release, January 6, 2011; bls.gov/news.release/pdf/empsit.pdf

⁵ National Retail Federation

⁶ Russell family of indexes

⁷ MSCI ACWI ex-U.S. Index

⁸ Source: FactSet

⁹ U.S. Federal Reserve Press Release, December 13, 2011; federalreserve.gov

¹⁰ BarCap High Yield Index: FactSet

¹¹ Barclays Capital Point

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 12/2011
#t1201030322