MidCap Blend Fund (A)

Fourth Quarter 2011

Quarterly Commentary

Ticker	Inv Manager or Sub-Advisor	Benchmark	Morningstar Category	Investment Objective
PEMGX	Principal Global Investors	Russell Midcap Index	Mid Cap Blend	Growth and 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]

Performance Contributors

Positive Contributors

During last quarter:

Williams Companies (an energy company with a portfolio of natural gas assets) contributed positively to results. The stock was up 37% due to the firm's decision to spin off the exploration and production business; the announcement of this transaction helped to realize the value of the assets. EOG Resources (an energy company with a portfolio of both oil and natural gas assets) benefited results; during the quarter the stock increased 39% due to higher commodity prices. (EOG has a track record of low production costs and high returns on capital.) The portfolio benefited from owning O'Reilly Automotive (a leader in the auto parts aftermarket), which serves consumers and professional mechanics. O'Reilly has benefited from a strong auto parts aftermarket and the integration of the CSK Auto acquisition (from the second quarter of 2008).

During last 12 months:

Strong performance was led by stock selection in the consumer discretionary and information technology sectors. The portfolio benefited from owning O'Reilly Automotive, which has benefited from a strong auto parts aftermarket and the integration of CSK Auto. Liberty Media (a diversified media company, including the premium movie channel, Starz, and investments in several other attractive businesses) benefited the portfolio during the period as Starz continued to grow subscribers and provide predictable cash flow to the company. (Liberty Media's stock was up 25% over the 12-month period.) Additionally, the portfolio benefited from Valeant Pharmaceuticals Intl. (a manufacturer/distributor of neurological, dermatological and other branded generic drugs); Valeant was up 65% in the period as it has completed several value-added acquisitions while leveraging its distribution networks.

Negative Contributors

During last quarter:

Covanta Holding Corporation (the largest operator of waste-to-energy facilities in the U.S.) detracted from the portfolio's results; the stock was down 9% during the quarter due to a decline in electricity prices. Iron Mountain (the largest document storage company) detracted; the stock was down 2% over the quarter as growth continued to be slow in the firm's core storage business. Echostar (a technology and video or data distribution firm) also detracted; the stock was down 7% due to lower growth as temporary factors in the set top box business and Hughes Communications impacted results.

During last 12 months:

Brookfield Asset Mgmt. detracted from the performance over the period; the stock was down 16% (after significantly outperforming the year before). Covanta Holding Corporation also detracted from the portfolio; the stock was down 19% over the period due to weak electricity prices. CIT Group (a finance company catering to small- and mid-market businesses) emerged from bankruptcy in 2009; the stock was down 26% over the period.

Changes to the investment option's structure or portfolio:

No material changes occurred in the portfolio structure.

MidCap Blend 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
MidCap Blend Fund (A) (excl. sales charge)	13.09	7.63	7.63	20.64	4.76	8.13	7.35
MidCap Blend Fund (A) (incl. sales charge)	6.90	1.72	1.72	18.38	3.58	7.52	6.81
Russell Midcap Index	12.31	-1.55	-1.55	20.17	1.41	6.99	-
Mid Cap Blend Category	12.72	-3.81	-3.81	17.41	0.46	5.62	-
Morningstar Percentile Ranking	-	-	3	19	5	8	-
Total Funds in Category	441	424	424	378	312	200	-

Inception Date	06/28/2005
Ext. Perf. Inc. Date	12/06/2000
Total Inv. Exp Gross	1.15
Total Inv Exp Net	1.15
Waiver Date	02/29/2012
Contractual Cap Date	02/29/2012
Contingent Deferred Sales Charge	-
Maximum Up-front Sales Charge	5.50

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.

MidCap Blend Fund (A)

Statistics Summary as of 12/31/2011

	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					
MidCap Blend Fund (A)	4.17	0.78	94.72	1.16	0.07	17.47	23	13	4.89	-3.32	83.53	69.98
Russell Midcap Index	N/A	N/A	N/A	N/A	N/A	N/A	22	14	5.85	-4.74	100.00	100.00
	5 Year						5 Year					
MidCap Blend Fund (A)	2.96	0.82	95.22	0.27	0.57	19.10	36	24	4.20	-4.25	87.59	77.20
Russell Midcap Index	N/A	N/A	N/A	N/A	N/A	N/A	34	26	4.80	-5.50	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 11/30/2011

Security	Net Assets (%)
Liberty Media Corporation A	3.54
O'Reilly Automotive Inc	3.15
Loews Corporation	2.66
Brookfield Asset Management Inc Class A	2.57
Laboratory Corporation of America Holdings	2.44
Williams Companies Inc	2.43
TJX Companies	2.37
Franco-Nevada Corp	2.27
Markel Corporation	2.25
EOG Resources	2.15
Total % in Top 10	**25.83**

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

MidCap Blend Fund (A)

Manager(s)	Start Date	Degree	Alma Mater
K. William Nolin	12/06/2000	M.B.A.	Yale University

Fund Strategy

The investment seeks long-term growth of capital. The fund invests primarily in common stocks and other equity securities of medium-capitalization companies. It normally invests at least 80% of net assets in companies with market capitalizations similar to those of companies in the Russell Midcap(R) Index. Management's security selection is based on stocks with value and/or growth characteristics, and management constructs an investment portfolio that has a "blend" of stocks with these characteristics.

About Principal Global Investors

Principal Global Investors managed $47.8 billion in global equity assets as of December 31, 2010. The firm's capabilities encompass large-cap, mid-cap and small-cap stocks in developed and emerging equity markets worldwide. Principal Global Investors draws on a unified investment philosophy focused on independent fundamental research and superior stock selection. 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.

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 Midcap Index includes firms 201 through 1000, based on market capitalization, from the Russell 3000 Index.

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 12/2011
#t1201030322

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.

[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

principalfunds.com

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

Important Notes

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