

Third Quarter 2010

Quarterly Commentary

Ticker	Investment Advisor	Benchmark	Morningstar Category	Investment Objective
PPMGX	Turner/Mellon/Jacobs Levy	Russell Midcap Growth Index	Mid Cap Growth	Growth

Economy & Market Overview

Following second-quarter losses, U.S. and international stocks bounced back markedly in the third quarter as weakening in the U.S. and China appeared to have ended. Worries of a double-dip U.S. recession slowly ebbed when key economic data came in slightly ahead of expectations, and concerns about China's slowing growth faded as its economy picked up steam.¹

Meanwhile, data released in August showed that the euro zone grew at a 3.9% annual rate during the second quarter, driven by tremendous growth in Germany. However, in the third quarter the euro zone's growth rate began slowing, and worries mounted about the possibility of a sovereign debt default or restructuring for some of the region's more troubled members (e.g., Ireland, Greece, Portugal). Additionally, continued strikes by public workers raised concern that necessary government spending cuts might not be implemented.¹

Key U.S. economic data released during the quarter was mixed, but showed some slight, unexpected improvement: While the unemployment rate remained at 9.6%, an unexpected decrease in weekly initial jobless claims during September gave investors some hope that the unemployment situation may become less bleak.² Second-quarter 2010 GDP was positive at 1.7%; however, it was substantially lower than the 3.7% gain posted in the first quarter as inventories decreased and imports grew faster than exports.³ Housing market data was weak in July, but ended the quarter on a modestly favorable note. A drop in new-home sales during July tapered off in August to a seasonally-adjusted annual rate of 288,000.⁴ Existing-home sales rose 7.6% month-over-month in August, but still remained 19% below August 2009.⁵ After improving in August, consumer confidence fell in September, reflecting consumers' grim outlook on future economic growth and job prospects.⁶

In September, the National Bureau of Economic Research (NBER), which has sole responsibility for determining when U.S. recessions officially begin and end, determined that the recession that began in December 2007 ended in June 2009. The NBER also stated that at 18 months, it was the longest of any recession since World War II.⁷

Meanwhile, at its September meeting the Federal Reserve made no changes to its extremely accommodative monetary policy given the slowing pace of recovery in output and employment and noted that it is prepared to "provide additional accommodation if needed to support the economic recovery."⁸

During the third quarter, the broad U.S. stock market posted a return of 11.5% as all sectors within the Russell 3000 Index delivered positive returns. Telecommunications led the way, returning 20.1%, while financial stocks performed the weakest with a modest 5.5% gain.⁹ Financials were under pressure as investors continued to grapple with the changing landscape of regulatory reform and how it might impact the capital structure and growth opportunities for the industry. For the quarter, growth styles outperformed value, and small-cap stocks underperformed large-caps.¹⁰

International markets performed even better than U.S. markets, with developed markets delivering a third-quarter return of 16.5%, led by the energy, telecom and materials sectors. Emerging markets generated a return of 18.0% for the quarter, propelled by the consumer discretionary and industrial sectors.¹¹

Real estate outperformed the broad U.S. market, returning 13.2% for the quarter.¹² Although the sector's fundamentals remained uncertain, improved access to capital for commercial real estate properties, combined with their attractive dividend yield, fueled continued demand for the asset class.

In a change from their apparent risk aversion during the second quarter, investors seemed to favor riskier fixed-income asset classes in the third quarter. This switch likely reflected, in part, investors' need for yield at a time when U.S. Treasuries are delivering very low rates (for example, relatively low-risk 10-year Treasuries yielded just 2.52% at quarter-end).¹³ In terms of investment-grade bonds, commercial mortgage-backed securities led the way, outpacing duration-adjusted Treasuries by 4.05% for the quarter.¹⁴ High-yield bonds (which are below-investment-grade) also performed well, advancing 4.26% ahead of duration-adjusted Treasuries.¹⁵ Also during the period, the yield curve flattened as the distance between 2- and 10-year Treasury yields fell from 2.36% (at the end of the second quarter) to 2.09% (at the end of the third quarter).¹⁶

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Performance Contributors

Positive Contributors

During last quarter:

Positive stock selection within the materials and industrial sectors added to relative performance. Also, the portfolio had an average 1% overweight to the information technology sector, which benefited returns because this sector posted better performance than the benchmark Russell MidCap Growth Index. Additionally, the portfolio had greater exposure than the benchmark index to the most volatile stocks in the index, which contributed positively to returns.

During last 12 months:

Stock selection was positive overall, with the strongest selection within the industrial sector. Also, the portfolio's slight underweight to the utilities sector added to returns, as this sector greatly lagged the returns of the benchmark Russell MidCap Growth Index. Additionally, the portfolio had a higher relative strength profile (an overweight to stocks exhibiting upward price movement during the trailing 12-month period) than the benchmark index, which benefited returns.

Negative Contributors

During last quarter:

Negative overall stock selection detracted from returns, particularly in the consumer discretionary sector. Sector-positioning relative to the index also detracted from returns, led by an average 1% underweight to the consumer discretionary sector (which generated returns that beat the benchmark Russell MidCap Growth Index). Additionally, the portfolio had a lower average dividend yield than the index, which dragged on returns because equities with higher dividend yields were in favor during the period.

During last 12 months:

Sector-positioning relative to the Russell MidCap Growth Index detracted from returns, particularly an average 3% underweight to the industrial sector because this sector generated stronger returns than the index. Also, negative stock selection within the health care sector detracted from relative performance. Additionally, similar to the quarter, the portfolio had a lower average dividend yield than the index, which dragged on returns.

Changes to the investment option's structure or portfolio:

No material changes occurred in the portfolio structure.

MidCap Growth Fund III (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 09/30/2010	QTR	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception	Inception Date	06/28/2005
MidCap Growth Fund III (A) (excl. sales charge)	13.47	8.68	15.42	-6.67	1.58	-	-1.04	Ext. Perf. Inc. Date	12/06/2000
MidCap Growth Fund III (A) (incl. sales charge)	7.22	2.70	9.09	-8.41	0.45	-	-1.61	Total Inv. Exp Gross	1.98
Russell Midcap Growth Index	14.65	10.85	18.27	-3.90	2.86	-0.88	-	Total Inv Exp Net	1.73
Mid Cap Growth Category	13.54	9.58	15.98	-5.11	2.50	0.05	-	Waiver Date	02/28/2011
Morningstar Percentile Ranking	-	-	57	65	65	-	-	Contractual Cap Date	02/28/2011
Total Funds in Category	793	778	771	690	597	354	-	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. 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 Growth Fund III (A)

Statistics Summary as of 09/30/2010

	Risk and Return Statistics Summary						Upside/Downside Capture Ratio					
	Alpha	Beta	R2	Sharpe Ratio	Info Ratio	Std Dev	# of Months		Avg Returns %		Market Benchmark %	
							Up	Down	Up	Down	Up	Down
	3 Year Return vs. Rank						3 Year Upside/Downside Capture Ratio					
MidCap Growth Fund III (A)	-2.69	1.02	98.19	-0.15	-0.74	27.31	18	18	5.53	-7.50	99.95	107.25
Russell Midcap Growth Index	N/A	N/A	N/A	N/A	N/A	N/A	20	16	5.53	-6.99	100.00	100.00
	5 Year Return vs. Rank						5 Year Upside/Downside Capture Ratio					
MidCap Growth Fund III (A)	-1.09	1.04	96.55	0.07	-0.30	22.72	33	27	4.58	-5.58	103.02	107.44
Russell Midcap Growth Index	N/A	N/A	N/A	N/A	N/A	N/A	35	25	4.45	-5.19	100.00	100.00

Risk and return statistical data is provided by Markov Processes International (MPI). Risk & Return Statistics Summary results are based on performance excluding sales charges. Percentile rankings are based on total returns in accordance with the appropriate Morningstar peer group. Please see Important Notes section for definitions of Risk and Return Statistics.

Top Ten Holdings as of 08/31/2010

Security	Net Assets (%)
S&P MID 400 EMINI SEP10	2.80
F5 Networks, Inc.	2.04
Salesforce.com, Inc.	1.52
NetApp, Inc.	1.50
T. Rowe Price Group	1.38
Starwood Hotels & Resorts Worldwide, Inc.	1.37
Cummins, Inc.	1.28
IntercontinentalExchange, Inc.	1.17
Crown Castle International Corporation	1.16
Goodrich Corporation	1.14
Total % in Top 10	15.35

MidCap Growth Fund III (A)

Manager(s)	Start Date	Degree	Alma Mater
Christopher K. McHugh	12/06/2000	M.B.A.	St. Joseph's University
Tara Hedlund	10/01/2006	B.A.	Villanova University
Jason Schrotberger	10/01/2006	M.B.A.	University of Illinois
Adam T. Logan	11/21/2008	M.B.A.	University of Pittsburgh
Ken Levy	05/01/2009	M.B.A.	University of Pennsylvania (Wharton)

Fund Strategy

The investment seeks long-term growth of capital. The fund invests primarily in common stocks and other equity securities of U.S. companies with strong earnings growth potential. It normally invests at least 80% of assets in companies with market capitalizations similar to those of companies in the Russell Midcap Growth index.

About Jacobs Levy Equity Management

Jacobs Levy Equity Management, a registered investment adviser founded in 1986, is widely recognized as a leading provider of quantitative equity strategies for institutional clients. Building on the pioneering research of founders Bruce Jacobs and Ken Levy, the firm uses a dynamic, forward-looking, multidimensional investment approach designed to detect profit opportunities in U.S. equities. Insights from this approach are used to construct risk-managed portfolios engineered with the objective of providing consistent value-added performance. Jacobs Levy manages equity portfolios for a prestigious global roster of corporate pension plans, public retirement systems and endowments/foundations.

About Turner Investment Partners

Turner Investment Partners, Inc. (Turner or Turner Investment Partners), founded in 1990, is an employee-owned investment-management firm based in Berwyn, Pennsylvania. The firm was founded by Robert E. Turner, Mark D. Turner and Christopher K. McHugh and began managing assets on March 5, 1990 (the effective date of its SEC registration. Turner has distributed equity to those professionals who have made significant contributions to the success of their business. The firm's assets under management were \$17.7 billion as of December 31, 2009.

About Mellon Capital Mgmt

Mellon Capital Management Corporation (Mellon Capital) has been managing assets since August of 1983. Mellon Capital is a wholly-owned indirect subsidiary of The Bank of New York Mellon Corporation, a publicly traded company. As of December 31, 2009, Mellon Capital managed approximately \$177.9 billion in assets (including \$9.9 billion in overlay assets).

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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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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. 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.

Effective May 1, 2009, Jacobs Levy was added as an additional sub-advisor. Performance results displayed reflect all sub-advisors managing this portfolio during the time periods displayed.

The manager of the Fund, Principal Management Corporation, invests between 10% and 40% of the Fund's assets in common stocks in an attempt to match or exceed the performance of the Fund's benchmark index for performance.

Effective July 1, 2010, this fund is closed to new investors. Effective August 5, 2010, this fund is closed to new assets.

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Important Notes

Russell Midcap Growth Index is a market-weighted total return index that measures the performance of companies within the Russell Midcap Index having higher price-to-book ratios and higher forecasted growth values.

Extended Performance Inception Date (Ext. Perf. Inc. Date) - Inception date of the oldest share class of the fund.

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 On the Other Hand: Economic Insights, Third Quarter 2010 edition, by Bob Baur and the Principal Global Investors Economic Committee

² U.S. Bureau of Labor Statistics: Employment Situation Summary 9/3/2010 www.bls.gov)

³ Bureau of Economic Analysis, US Dept of Commerce (www.bea.gov)

⁴ National Association of Home Builders (www.nahb.com)

⁵ National Association of Realtors (www.realtor.org)

⁶ Conference Board's Consumer Confidence Index, September 28, 2010 (www.conference-board.org)

⁷ Business Cycle Dating Committee, National Bureau of Economic Research, September 20, 2010 (www.nber.org)

⁸ Federal Reserve Board press release dated September 21, 2010 (www.federalreserve.gov)

⁹ Russell 3000 Index

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Important Notes

¹⁰ Russell family of indexes

¹¹ Developed international markets: MSCI EAFE Index; emerging international markets: MSCI EM Index

¹² MSCI US REIT Index

¹³ Source: FactSet, constant maturity US Treasury yield

¹⁴ As measured by components of Barclays Capital Aggregate Bond Index

¹⁵ As measured by components of Barclays Capital High Yield Index

¹⁶ Source: FactSet, constant maturity US Treasury yield

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

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