

# Quarterly Commentary

Ticker	Investment Advisor	Benchmark	Morningstar Category	Investment Objective
SRCMX	Invesco	Barclays Capital Municipal Bond Index	Muni California Long	Income

## Economy & Market Overview

Following four positive quarters in a row, both U.S. and international stocks fell in the second quarter of 2010. The rally ended as investor concerns mounted about economic stability in Europe, slowing growth in China and the sustainability of the U.S. recovery.<sup>1</sup>

Europe's troubles, which started with the revelation of Greece's staggering deficit and debt load, broadened as it became apparent other countries (such as Spain and Portugal) faced similar issues. Markets reacted negatively to the exposure of European banks to the sovereign and corporate debt of these countries, despite the nearly \$1 trillion bail-out plan put in effect by the European Union and International Monetary Fund. In China, the government's decision to reign in real estate growth weighed on international investors, as did new data indicating a slowdown in China's pace of economic growth.<sup>2</sup>

Negative economic data reported during the quarter pointed to slowing growth across the U.S. economy: Employers continued their reluctance to add staff; May payrolls were meager, following gains in April and March.<sup>3</sup> Gross Domestic Product (GDP) for the first quarter came in lower than expected; the 2.7% gain was a sharp drop from the 5.6% increase for fourth quarter 2009.<sup>4</sup> After rising for three consecutive months, consumer confidence fell unexpectedly in June, reflecting consumers' uncertainty about jobs and income.<sup>5</sup> Following expiration of the home buyer tax credit in April, new-home sales fell in May to a seasonally adjusted, annual rate of 300,000 (the lowest number since the government began tracking the figure in 1963);<sup>6</sup> meanwhile, existing-home sales fell 2.2% in May after gaining 8% in April.<sup>7</sup>

After its June meeting, the Federal Reserve reaffirmed its belief that economic recovery is proceeding, but also acknowledged that "financial conditions have become less supportive of economic growth" and restated its intention to keep the fed funds interest rate very low "for an extended period."<sup>8</sup>

For the quarter, the broad U.S. stock market posted a return of -11.3% as all sectors within the Russell 3000 Index delivered negative performance. The economically sensitive materials sector struggled the most. Financial stocks also were under acute pressure, as investors grappled with the changing landscape of regulatory reform and how it might impact the industry. In this environment, growth and value performed similarly among large- and mid-cap stocks, while within small-caps, value slightly underperformed growth. From a market-cap perspective, small-caps outperformed large-caps.<sup>9</sup>

International stocks in developed markets returned -14.0%,<sup>10</sup> reflecting in part the precarious financial situation in Europe. Emerging markets performed better, but still delivered -8.37%.<sup>11</sup>

Real estate investment trusts returned -4.0%<sup>12</sup> to outperform the broad U.S. stock market. Although real estate fundamentals were still unfavorable, access to capital for commercial real estate had improved, which drew investors hoping to participate in the asset class's recovery.

Within fixed income, risk aversion was apparent as many investors turned to the "safe haven" of U.S. Treasuries, which outperformed other fixed-income sectors. By quarter-end, the yield on the benchmark 10-year Treasury had fallen from 3.84% to 2.95%. (Bond prices and yields move in opposite directions.) Meanwhile, investment-grade corporate bonds fell -2.25% relative to duration-adjusted Treasuries. Returns were slightly worse in the financial segment of the corporate bond market (down 2.97% relative to duration-adjusted Treasuries), due in part to uncertainty and anxiety surrounding financial regulation reform. Commercial mortgage-backed securities and asset-backed securities also lagged Treasuries, while mortgage-backed securities managed to outperform Treasuries by 0.01%.<sup>13</sup> Finally, high-yield bonds returned -3.86% relative to duration-adjusted Treasuries, with the lowest-rated (highest risk) high-yield bonds performing the worst.<sup>14</sup>

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## Performance Contributors

### Positive Contributors

#### During last quarter:

The portfolio's overweight to bonds rated BBB-or-below added to performance. Also, the portfolio's overweights to dedicated tax bonds and tobacco bonds were additive to returns.

#### During last 12 months:

Portfolio returns benefited from a large overweight to BBB-rated bonds. Also, the portfolio's overweights to tobacco bonds and dedicated tax bonds were additive to returns.

### Negative Contributors

#### During last quarter:

The portfolio's underweight to state General Obligation Bonds hindered performance. The portfolio's allocation to mid-term maturity (6-12 years) bonds also detracted from returns. Finally, the portfolio's underweight to higher quality bonds detracted from results.

#### During last 12 months:

The portfolio's underweight to state General Obligation Bonds hindered performance. The portfolio's underweight to higher quality bonds also detracted from results. Additionally, the portfolio was negatively impacted by an underweight to hospital bonds, as well as by the underperformance of its hospital bond holdings.

#### Changes to the investment option's structure or portfolio:

No material changes occurred in the portfolio structure.

# California Municipal 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](http://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 06/30/2010	QTR	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception	Inception Date	07/25/1989
California Municipal Fund (A) (excl. sales charge)	2.25	3.79	13.99	0.90	1.66	4.02	5.27	Ext. Perf. Inc. Date	07/25/1989
California Municipal Fund (A) (incl. sales charge)	-1.54	-0.06	9.70	-0.39	0.88	3.63	5.08	Total Inv. Exp Gross	0.91
Barclays Capital Municipal Bond Index	2.03	3.31	9.61	5.50	4.40	5.63	-	Total Inv Exp Net	0.91
Muni California Long Category	2.01	3.73	12.23	2.92	2.83	4.53	-	Waiver Date	-
Morningstar Percentile Ranking	-	-	13	91	91	81	-	Contractual Cap Date	-
Total Funds in Category	158	156	156	147	135	116	-	Contingent Deferred Sales Charge	-
								Maximum Up-front Sales Charge	3.75

## Risk and Return Statistics Summary as of 06/30/2010

	3 Year Return vs. Rank						5 Year Return vs. Risk					
	Alpha	Beta	R2	Sharpe Ratio	Info Ratio	Std Dev	Alpha	Beta	R2	Sharpe Ratio	Info Ratio	Std Dev
California Municipal Fund (A)	-6.06	1.47	77.91	-0.02	-0.83	9.97	-3.18	1.41	76.82	-0.10	-0.63	7.85

Relative to Barclays Capital Municipal Bond Index

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.

## California Municipal Fund (A)

### Upside/Downside Capture Ratio Summary as of 06/30/2010

	3 Year Upside/Downside Capture Ratio						5 Year Upside/Downside Capture Ratio					
	# of Months		Avg Returns %		Market Benchmark %		# of Months		Avg Returns %		Market Benchmark %	
	Up	Down	Up	Down	Up	Down	Up	Down	Up	Down	Up	Down
California Municipal Fund (A)	20	16	1.09	-3.30	96.10	174.80	33	27	1.01	-1.68	99.02	161.00
Barclays Capital Municipal Bond Index	28	8	1.13	-1.89	100.00	100.00	41	19	1.02	-1.04	100.00	100.00

### Top Ten Holdings as of 05/31/2010

Security	Net Assets (%)
Foothill / Eastern Transn Corr Toll Rd	2.29
Tob Securitization Auth 5.375%	1.80
Pomona Calif Pub Fing Auth 5%	1.61
San Jose Calif Arprt Rev Rev Bds 5%	1.53
California Pollutn Ctl Fing Au Solid 5%	1.44
Alhambra Calif Impt Bd Act 191 Re 6.125%	1.41
California St Pub Wks Brd Leas Lease 5%	1.38
Austin Tr Var Sts Ctfs 4.75%	1.32
San Francisco Calif City & Cnt Rev 5.25%	1.29
San Francisco Calif City & Cnt Rev Bd 5%	1.26
<b>Total % in Top 10</b>	<b>15.33</b>

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

## California Municipal Fund (A)

Manager(s)	Start Date	Degree	Alma Mater
Robert J. Stryker	05/21/2008	B.S.	University of Illinois, Chicago
Robert W. Wimmel	12/08/2009	M.A.	University of Illinois, Chicago
Thomas M. Byron	12/31/2009	M.B.A.	DePaul University

### Fund Strategy

The investment seeks to provide as high a level of current income that is exempt from federal and California state personal income tax as is consistent with prudent investment management and preservation of capital. The fund normally invests at least 80% of assets in intermediate- and long-term California municipal obligations (municipal obligations that generate interest which is exempt from California State personal income tax). It may invest up to 20% of assets in municipal obligations that are not exempt from California personal income tax and short-term municipal obligations. The fund is nondiversified.

### About Invesco

As one of the world's largest and most diversified independent investment management firms, Invesco has \$423.1 billion in assets as of December 31, 2009. The firm's single focus - money management - means all of its intellectual capital and resources are directed at helping investors achieve their financial objectives. Invesco's investment strategies include equities, asset allocation, fixed income, cash management and alternatives.

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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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Fixed-income investment options are subject to interest rate risk, and their value will decline as interest rates rise. A portion of the Fund's income may be subject to state and/or local taxes, and it may be subject to federal alternative minimum tax (AMT) for certain investors.

Effective June 15, 2010, references to Van Kampen Asset Management as investment advisor was replaced with Invesco Advisors, Inc. This is a name change only and does not affect the management, objective, or strategy of this investment option.

Barclays Capital Municipal Bond Index represents the long-term, investment-grade tax-exempt bond market.

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## 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.

<sup>1</sup> Source: On the Other Hand: Economic Insights, Second Quarter 2010, by Bob Baur and the Principal Global Investors Economic Committee

<sup>2</sup> Source: The Conference Board Leading Economic Index® (LEI) for China, measuring economic activity, increased 0.3% in April following increases of 1.2% in March and 0.4% in February.

<sup>3</sup> Source: U.S. Bureau of Labor Statistics: Employment Situation Summary 6/4/2010 (available at [www.bls.gov](http://www.bls.gov))

<sup>4</sup> Source: Bureau of Economic Analysis, US Dept of Commerce (data available at [www.bea.gov](http://www.bea.gov))

<sup>5</sup> Source: Data available at [www.conference-board.org](http://www.conference-board.org)

<sup>6</sup> Source: National Association of Home Builders (data available at [www.nahb.com](http://www.nahb.com))

<sup>7</sup> Source: National Association of Realtors (data available at [www.realtor.org](http://www.realtor.org))

<sup>8</sup> Source: Federal Reserve press release dated 6/23/10 (available at [www.federalreserve.gov](http://www.federalreserve.gov))

<sup>9</sup> Source: As measured by Russell family of indexes

<sup>10</sup> Source: As measured by the MSCI EAFE Index

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## Important Notes

<sup>11</sup> Source: As measured by the MSCI EM Index

<sup>12</sup> Source: As measured by the MSCI U.S. REIT Index

<sup>13</sup> Source: As measured by components of Barclays Capital Aggregate Bond Index

<sup>14</sup> Source: As measured by components of Barclays Capital High Yield Index

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

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