Global Real Estate Securities Fund (A)

Fourth Quarter 2011

Quarterly Commentary

Ticker	Inv Manager or Sub-Advisor	Benchmark	Morningstar Category	Investment Objective
POSAX	Principal Real Estate Inv	FTSE EPRA/NAREIT Developed Index	Global Real Estate	Speciality - Real Estate

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:

An underweight to Japanese developers and stock selection among Japanese real estate investment trusts (REITs) were the chief positive contributors. Underweights to Nippon Building Fund and Sumitomo Realty & Development benefited relative performance, as both companies strongly underperformed during the quarter. Decisions to overweight owners of data centers and technology-related office space in the U.S. added value; specifically, overweights to Digital Realty Trust and Dupont Fabros Technology outperformed as demand-drivers appeared to be less correlated with overall economic conditions. The portfolio's overweight to the self-storage sector in the U.S. contributed strongly to performance; Extra Space Storage, Public Storage and CubeSmart posted returns in excess of 20%.

During last 12 months:

Similar to the quarter, an underweight to Japanese developers and stock selection among Japanese REITs were the chief positive contributors. Underweights to Nippon Building Fund and Sumitomo Realty & Development aided relative performance, as both companies strongly underperformed in the fourth quarter. Decisions to overweight owners of data centers and technology-related office space in the U.S. added value; specifically, overweights to Digital Realty Trust and Dupont Fabros Technology outperformed. Stock selection in Singapore contributed positively as strategic underweights to Singapore developers came under pressure from government policies aimed at reducing growth in the residential market. Overweighting Allgreen Properties contributed due to a take-over offer in the second quarter of 2011.

Negative Contributors

During last quarter:

The portfolio's positioning of Canadian holdings dragged on results. Specifically, an overweight to Canadian REIT (the portfolio's largest Canadian position) detracted due to weak performance, and underweights to Canadian-based H&R REIT and Canmark REIT detracted because both companies posted strong returns during the quarter. Underweighting the U.S. health care sector detracted, despite strong stock selection within the high-performing segment. (The health care segment has remained highly volatile as investors speculate on the future of U.S. government spending on programs such as Medicare and Medicaid.) The portfolio's strategic underweight of the U.S. industrial sector detracted as the sector rallied during the period, led by strong performance from DCT Industrial Trust and First Industrial Realty Trust (both of which gained more than 20%).

During last 12 months:

Underweighting the U.S. health care sector detracted despite strong stock selection within the high-performing segment. Stock selection in Australia was a source of underperformance, due in large part to an overweight position in FKP Property Group (a deeply discounted, highly geared developer and owner of primarily retirement and residential properties). Also, the portfolio's positioning in realty servicers CB Richard Ellis and Jones Lang LaSalle detracted. These companies' revenue streams were supported primarily by sales and leasing commissions; as commissions and rentals are variable, their stock prices tend to be volatile during periods of market uncertainty.

Changes to the investment option's structure or portfolio:

No material changes occurred in the portfolio structure.

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
Global Real Estate Securities Fund (A) (excl. sales charge)	9.30	-5.93	-5.93	15.84	-	-	-6.58
Global Real Estate Securities Fund (A) (incl. sales charge)	3.22	-11.15	-11.15	13.67	-	-	-7.81
FTSE EPRA/NAREIT Developed Index	7.36	-5.82	-5.82	16.17	-5.27	9.59	-
Global Real Estate Category	5.88	-10.10	-10.10	12.57	-6.77	8.72	-
Morningstar Percentile Ranking	-	-	25	13	-	-	-
Total Funds in Category	182	169	169	144	93	21	-

Inception Date	10/01/2007
Ext. Perf. Inc. Date	10/01/2007
Total Inv. Exp Gross	2.28
Total Inv Exp Net	1.45
Waiver Date	02/29/2012
Contractual Cap Date	02/29/2012
Contingent Deferred Sales Charge	-
Maximum Up-front Sales Charge	5.50

Global Real Estate Securities 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					
Global Real Estate Securities Fund (A)	0.18	0.97	98.00	0.69	-0.08	25.86	21	15	6.05	-5.63	98.95	99.67
FTSE EPRA/NAREIT Developed Index	N/A	N/A	N/A	N/A	N/A	N/A	22	14	6.11	-5.65	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 (%)
Simon Property Group Inc	5.80
Westfield Group	3.81
Sun Hung Kai Properties, Ltd.	3.76
Mitsubishi Estate	3.14
Public Storage	3.05
Boston Properties Inc	2.75
Mitsui Fudosan Co., Ltd.	2.75
Unibail-Rodamco SE	2.71
Equity Residential	2.65
Vornado Realty Trust	2.42
Total % in Top 10	**32.84**

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

Global Real Estate Securities Fund (A)

Manager(s)	Start Date	Degree	Alma Mater
Kelly D. Rush	10/01/2007	M.B.A.	University of Iowa
Chris Lepherd	10/01/2007	M.S.	Securities Institute of Australia
Simon Hedger	10/01/2007	M.B.A.	University of New England
Anthony Kenkel	09/16/2010	M.B.A.	University of Chicago
Alastair Gillespie	09/16/2010	M.S.	Securities Institute of Australia

Fund Strategy

The investment seeks to generate a total return. The fund invests at least 80% of net assets in equity securities of U.S. and non-U.S. companies principally engaged in the real estate industry. It has no limitation on the percentage of assets that are invested in any one country or denominated in any one currency. The fund is non-diversified.

About Principal Real Estate Inv

Principal Real Estate Investors, which is the dedicated real estate group for Principal Global Investors, managed $34.7 billion in commercial real estate assets 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. Principal Real Estate Investors is the fourth largest institutional real estate manager in the United States, based on tax-exempt assets under management (Pensions & Investments, September 10, 2010 issue; Out of 87 managers profiled, as of June 30, 2010).

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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

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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.

International and global investment options are subject to additional risk due to fluctuating exchange rates, foreign accounting and financial policies, and other economic and political environments.

Real estate investment options are subject to some risks inherent in real estate and Real Estate Investment Trusts, such as risks associated with general and local economic conditions.

On January 2, 2008, the Principal Funds, Inc. Global Real Estate Securities Fund experienced a one-time gain of $0.05/share from an as of shareholder transaction which resulted in a positive impact on its performance and if the gain had been excluded, the return would be lower.

FTSE EPRA/NAREIT Developed Index is designed to represent general trends in eligible real estate equities worldwide.

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.

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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.

[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

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Important Notes

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