

Principal Small-MidCap Dividend Income Portfolio

Sub-advised by Edge Asset Management



Edge Asset Management (EDGE) offers broad expertise in equity, fixed income and global asset allocation capabilities and specializes in income oriented strategies. The firm is headquartered in Seattle, Washington and has been managing assets for clients for more than 75 years.

EDGE remains at the forefront of innovation with a heritage dating back to 1939, when it launched one of the first 50 mutual funds in the U.S. The firm also introduced one of the first target risk series of funds in the industry. Acquired by the Principal Management Corporation (a member of the Principal Financial Group) on December 31, 2006, EDGE enjoys the focus of a boutique firm while leveraging the resources of a leading global organization.

Investment Philosophy and Process

The Principal Small-MidCap Dividend Income portfolio is available as a mutual fund and as a separate account that invests wholly in Institutional class shares of the mutual fund.

Philosophy

The Small-MidCap Dividend Income portfolio primarily seeks to provide current income and long-term growth of income and capital while investing primarily in small- to mid-capitalization companies. The EDGE team believes in purchasing companies that:

- Have the commitment and capacity to pay dividends
- Can consistently grow dividends over time and
- Demonstrate a commitment to shareholders

The investment advisor's investment philosophy and strategy may not perform as intended and could result in a loss or gain.

Process

In its investment process (Figure 1 on page 2), the equity team (comprised of portfolio managers, analysts and a dedicated trader) uses quantitative screens to identify attractively priced dividend-paying companies and exclude overvalued companies.

Figure 1: EDGE's Equity Investment Process

Investment Process Overview

I. Investment Universe

- Screen companies using strategy-specific metrics such as market capitalization, dividend yield, return on capital and sales growth

II. Fundamental Research

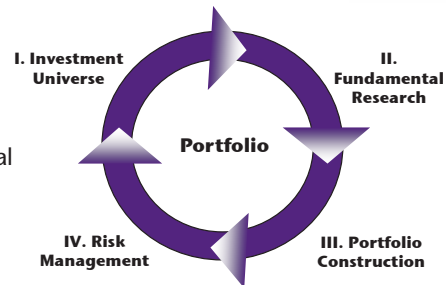
- Perform industry and company analysis to identify industry trends and outstanding businesses with strong long-term prospects

III. Stock Selection and Portfolio Construction

- Strive to purchase quality franchises that are out of favor while maintaining sector neutral approach

IV. Risk Management

- Utilize BarrOne® for portfolio risk analysis, stress testing and attribution feedback.
Use Charles River Trading System for portfolio guideline compliance



After these screens are completed, robust fundamental research is performed on an industry and company level:

- Analysts perform comprehensive industry reviews, where each supply/demand component for an industry is examined.
- After examining the industry as a whole, analysts assign a qualitative rank of companies within each industry.
- Finally, analysts assign buy/sell/hold ratings for each company in the industry based on its business model, profitability, dividend growth and competitive advantage.

These assigned ratings are used as signals to the portfolio management team and discussed in the equity team's weekly meeting. Although it is the responsibility of analysts to update and keep portfolio management apprised of company rating changes or additions to buy/sell lists, portfolio managers have ultimate responsibility for stock selection.

Small-to-mid-size companies — the focus of the Small-MidCap Dividend Income portfolio — can be less liquid at times than larger-cap companies. As a result, the portfolio management team is cognizant of liquidity, and the portfolio is generally limited to holding less than 5% of any one company's outstanding stock, with no one company making up more than 5% of the portfolio's holdings. (In practice, most positions are limited to less than 3% of the portfolio.) Typically, 60-90 stocks are held in the portfolio, with market capitalizations generally ranging between \$200 million and \$7 billion.

Not FDIC or NCUA insured

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

Portfolio management team

David W. Simpson, CFA, has been a Portfolio Manager at Edge Asset Management since 2003 and has been in the investment industry since 1986. Previously, he was Chief Investment Officer and Managing Director at Summit Capital Management and from 1993 to 2001, he was a Portfolio Manager for WM Advisors, Inc., the predecessor to Edge Asset Management. He received an M.B.A. in finance from the University of Wisconsin and a bachelor's degree in agricultural sciences from the University of Illinois.

Daniel R. Coleman is the Head of Equities at Edge Asset Management and also serves as a Portfolio Manager. He joined EDGE in 2001 and has been in the investment industry since 1979. Previously, he was Vice President and Senior Business Manager for Info Space, Inc./Go2Net, Inc. His background also includes positions with Brookhaven Capital Management, LLC/Clyde Hill Research and Ragen MacKenzie. Mr. Coleman received an M.B.A. from New York University and a bachelor's degree in finance from the University of Washington.

Additional Information

Carefully consider the Fund's objectives, risks, charges, and expenses. Contact your financial professional or visit principal.com for a prospectus, or summary prospectus if available, containing this and other information. Please read it carefully before investing.

Before directing retirement funds to a separate account, investors should carefully consider the investment objectives, risks, charges and expenses of the separate account as well as their individual risk tolerance, time horizon and goals. For additional information contact us at 800-547-7754 or by visiting principal.com.

Investing involves risk, including possible loss of principal.

Small-cap and mid-cap stocks may have additional risks, including greater price volatility.



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