

# Investment strength and flexibility

Principal LifeTime Hybrid CITs • Principal LifeTime Hybrid Funds

Seeking well-diversified and primarily passively managed investment options for target date investors? Are our Principal LifeTime Hybrid portfolios right for your organization’s plan?<sup>1</sup>

Designed to include distinct investment options staged in five-year increments, each is managed toward a target retirement date. And, portfolios automatically shift allocations to generally more conservative underlying investment options as the target date approaches. Our Principal LifeTime Hybrid portfolios reflect what the managers believe to be an optimal asset class mix — a combination of actively and passively managed equity, fixed income and real assets — for the respective target date portfolio.

**With more than \$54.2 billion** under management in target date funds, we know how to help people save for retirement.\*

\*Source: Principal, Dec 31, 2016

## Investment philosophy and process

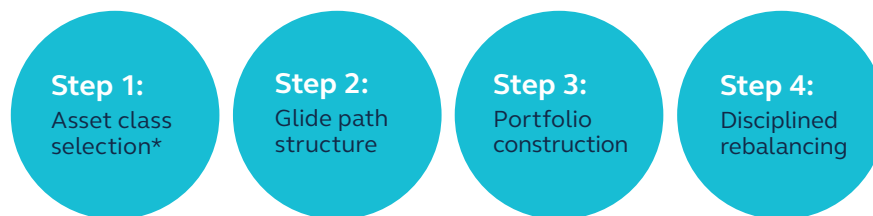
Our Principal LifeTime Hybrid portfolios embrace a multi-manager, multi-asset class and multi-style strategy. They provide an institutional-quality investment approach, offering:

- Extensive diversification across core and specialty asset classes;
- A structured investment strategy with disciplined risk management at each stage of the investment process; and
- Multiple underlying investment managers representing a range of asset classes, investment styles and money management firms.

Strategic in nature, our investment philosophies are based on the long-term equilibrium relationships between investment return and risk. They’re instrumental to the success of the portfolios, and guide the asset allocation, rebalancing and underlying asset selection processes.

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

**Our investment process:**



<sup>1</sup>Principal LifeTime Hybrid Collective Investment Funds (CITs) and Principal LifeTime Hybrid Funds have the same attributes and construction process, but deliver this to investors through different types of underlying investments. They are referenced here collectively as “portfolio/portfolios”.

\*For list and allocations for underlying investments, see holdings information on principal.com.

## Step 1: Asset Class Selection

The first step is selecting asset classes and corresponding benchmarks. Every asset class we use must provide:

- Risk premiums that are in line with the asset class risk profile;

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- Incremental diversification benefits;

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- Suitable investment options that permit efficient access to the asset class (e.g. open-ended mutual funds, insurance company separate accounts); and

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- A clearly defined role in our asset allocation strategy, such as:
  - Capital appreciation
  - Income generation
  - Diversification
  - Inflation hedge
  - Capital preservation
  - Liquidity



Asset allocation and diversification do not ensure a profit or protect against a loss.

## Step 2: Glide Path Structure

Next, we design the glide path, or formula, that defines the asset allocation mix of each Principal LifeTime Hybrid portfolio. It's the "path" the portfolio follows to become more conservative as the target date approaches. To determine the glide path, we analyze investing and spending scenarios using proprietary capital market assumptions and a variety of optimization and stochastic modeling tools (Monte Carlo simulations, mean/variance optimization and downside risk analysis).

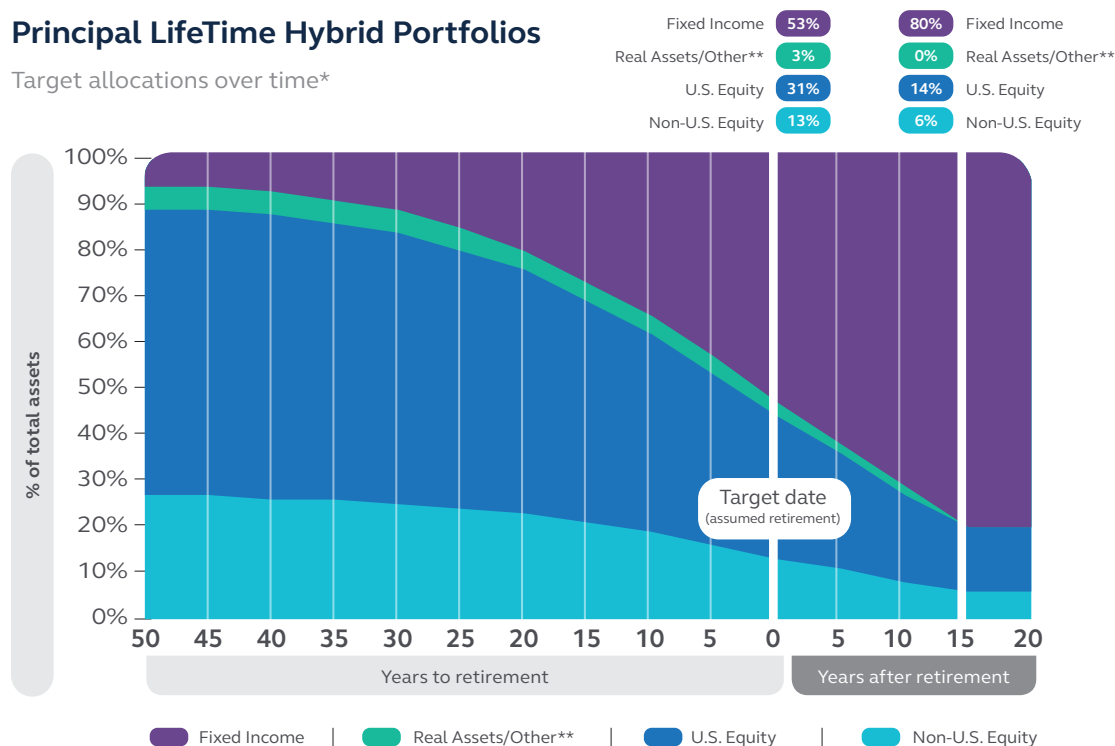
The glide path reflects what we believe to be an optimal asset allocation mix that balances key risks including savings shortfall risk, market risk, inflation risk and longevity risk.

Each risk is managed differently, depending on the time horizon of the Principal LifeTime Hybrid portfolio. The resulting framework represents a total investment time horizon of roughly 80 years, including up to a 50-year working career and more than 25 years in retirement.

This chart depicts the asset class targets and overall glide path for our Principal LifeTime Hybrid portfolios.

### Principal LifeTime Hybrid Portfolios

Target allocations over time\*



Neither the principal nor the underlying assets of the Principal LifeTime Hybrid portfolios are guaranteed at any time, including the target date. Investment risk remains at all times.

\*As of October 31, 2016

\*\*Shareholders receive exposure to real assets and alternative investment strategies through certain underlying funds.

Looking at the chart, you'll notice that the glide path isn't linear during the accumulation or spending phases because the rate of risk reduction is not constant through time. In the early accumulation years, the glide path slope is gradual, representing a modest risk reduction intended to maximize portfolio growth. During the later accumulation years, the glide path slope becomes much steeper, which suggests the rate of shifting the allocation to investment options, which are typically more conservative, is accelerating.

The acceleration reflects the belief that equity allocations should fall more rapidly as mid-life savers become increasingly more sensitive to market risk due to higher asset balances and approaching retirement dates. In later post-retirement years, the capital preservation attributes of cash and fixed income strategies generally become more desirable. Accordingly, the rate of risk reduction declines again and the equity glide path becomes flat.



## Accumulation Phases — Early Career and Prime Career

The most important investment risk for Early Career savers (usually those in their 20s and 30s) is shortfall risk, defined as the risk of failing to save and invest aggressively enough to adequately fund retirement spending. Despite a long investment horizon, Early Career savers are also subject to market risk. To properly balance shortfall and market risk, the asset allocation mix is diversified across equity, fixed-income and real estate portfolios. A small, yet strategic, allocation to high yield and real estate securities allows for proper diversification to help minimize large losses, with the goal of adding incremental yield.

Prime Career savers (typically early 40s through early 60s) are subject to the same risks as Early Career savers. However, we believe their true level of market risk aversion is higher than that of Early Career savers because, by this time, most Prime Career savers may have accumulated substantial assets and their retirement date is rapidly approaching. Therefore, we believe Prime Career savers seek balance between continued wealth accumulation and a desire to avoid significant capital losses in the years remaining until retirement. To address shortfall and market risk during these years, the slope of the Principal LifeTime Hybrid portfolios' glide path becomes steeper, which suggests a greater level of change within the equity and fixed-income asset classes. Inflation protection securities are also introduced at this stage to help minimize losses and to help preserve real purchasing power.

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## Spending Phases — New Retiree and Senior Retiree

Transitioning into their early retirement years (typically mid-60s to late 70s), New Retirees face the delicate task of balancing market risk with longevity and inflation risk. Longevity risk is the chance of outliving assets, while inflation risk can cause the loss of real purchasing power to inflation over time. New Retirees are most vulnerable to longevity risk at retirement because it's when their potential spending horizon is the longest. Therefore, we analyzed various annual spending rates (4 percent, 5 percent and 6 percent) when creating the glide path.

The dominant risk for Senior Retirees (typically, age 80+) is market risk because much of their savings has usually been depleted and what remains is needed to fund their continued spending. Thus, the equity portion of the glide path flattens and the asset class mix favors capital preservation.

Using this framework along with a dynamic asset allocation model, we're able to evaluate each of the key risks simultaneously within each of a participant's four life stages. Then, we further refine the asset allocation targets to help ensure our Principal LifeTime Hybrid portfolios land on the efficient frontier.<sup>2</sup>

### Step 3: Portfolio Construction

Our third step is to select and monitor the underlying investment options and investment managers.

Our Principal LifeTime Hybrid portfolios are invested in underlying investment options having a combination of different investment managers. As a result, they are classified within the industry as “multi-manager” target date funds. The majority of the underlying investment options used within the portfolios are passively managed. We use passively managed underlying investment options in the generally more efficient asset classes and investment styles (such as U.S. equities and core fixed income) and actively managed underlying investment options in less efficient market segments (developed non-U.S. equities, global emerging markets, real estate and high-yield bonds).

**Note:** The asset allocation of the portfolios will change over time and there is no guarantee that future risk/return performance will be consistent, especially over shorter time periods. No portfolio has zero risk, and none guarantees any specific reward.

<sup>2</sup> The efficient frontier is a curved line plotted on a risk/return graph that represents the optimal portfolios as determined from a risk/reward analysis. The optimal portfolios plotted along the curve are expected to potentially deliver the highest return possible for the given level of risk. The efficient frontier for the portfolios is generally representative of their potential long-term risk/return relationships with their current asset allocation.

## Step 4: Disciplined Rebalancing

The final step in our investment process is rebalancing. It's a risk management service with a primary focus on controlling and managing systematic risks, not forecasting short-term market trends.

We monitor each Principal LifeTime Hybrid portfolio and make adjustments to ensure it remains within the guidelines.

Our rebalancing process is rules-based and strategic since it maintains target ranges for each asset class and investment manager. The rebalancing ranges for each target aim to achieve optimal balance between excess transaction costs (which can occur when ranges are too narrow) and policy drift (which can occur when ranges are too wide).

The minimum and maximum ranges for total equity exposure are static limits we rarely exceed. If any asset class or underlying asset exceeds its minimum/maximum limits, we'll rebalance the allocation back to its target.

### Summary

The goal of our four-step investment process is a well-diversified, institutional-quality target date portfolios constructed to help investors over their entire lives. Our experience and skills provide the Principal LifeTime Hybrid portfolios with a competitive edge in terms of strategic asset allocation, investment manager selection and monitoring and systematic rebalancing.

## About Target Date investment options:

Target date portfolios are managed toward a particular target date, or the approximate date the investor is expected to start withdrawing money from the portfolio. As each target date portfolio approaches its target date, the investment mix becomes more conservative by increasing exposure to generally more conservative investments and reducing exposure to typically more aggressive investments. Neither the principal nor the underlying assets of target date portfolios are guaranteed at any time, including the target date. Investment risk remains at all times. Asset allocation and diversification do not ensure a profit or protect against a loss. Be sure to see the relevant prospectus or offering document for full discussion of a target date investment option including determination of when the portfolio achieves its most conservative allocation.

## Important Information

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

The Principal LifeTime Hybrid Collective Investment Funds (CITs) are collective investment trusts maintained by Principal Global Investors Trust Company, (the Trust Company). The Trust Company has retained Principal Global Investors, LLC, doing business as Principal Portfolio Strategies (the Adviser), to serve as investment adviser with respect to the CITs, subject to the Trust Company's supervision and review. The Adviser is an indirect wholly owned subsidiary of Principal Financial Group, Inc., and is under common control with the Trust Company. The Adviser also manages portfolios which may be included as underlying investments in the CITs. The Adviser receives management fees from these portfolios. The Adviser or other affiliates of the Trust Company may provide services to the CITs and may receive fees for such services. The CITs are available only to certain qualified retirement plans and governmental 457(b) plans.

The CITs are not mutual funds and are not registered with the Securities and Exchange Commission, the State of Oregon, or any other regulatory body. Units of the CITs are not deposits or obligations of, guaranteed by, or insured by the Trust Company or any affiliate, and are not insured by the FDIC or any other federal or state government agency. The value of the CITs will fluctuate so that when redeemed, units may be worth more or less than the original cost. The declaration of trust, participation agreement, and disclosure documents contain important information about investment objectives, risks, fees and expenses associated with investment in the CITs and should be read carefully before investing. The declaration of trust is available at [principal.com](http://principal.com). A copy of the participation agreement can be obtained from your plan administrator.

**Asset allocation and diversification does not ensure a profit or protect against a loss.** Equity investment options involve greater risk, including heightened volatility, than fixed-income investment options. Fixed-income investments are subject to interest rate risk; as interest rates rise their value will decline. International and global investing involves greater risks such as currency fluctuations, political/social instability and differing accounting standards. These risks are magnified in emerging markets. Fixed-income and asset allocation investment options that invest in mortgage securities are subject to increased risk due to real estate exposure.

**Investing involves risk, including possible loss of principal.**

**Asset allocation and diversification do not ensure a profit or protect against a loss.** Additionally there is no guarantee this investment option will provide adequate income at or through retirement.

This document is not a recommendation and is not intended to be taken as a recommendation. This material was prepared for general distribution and is not directed to a specific individual.

Investment manager/sub-advisor means either the Investment Adviser or Sub-Advisor to the investment option or the underlying asset(s). The trustee of any Collective Investment Trust is the Investment Manager as defined by ERISA, with regard to the assets of the CIT.

Insurance products and plan administrative services provided through Principal Life Insurance Co. Principal Funds, Inc. is distributed by Principal Funds Distributor, Inc. Securities offered through Principal Securities, Inc., 800.547.7754, member SIPC and/or independent broker-dealers. Principal Life, Principal Funds Distributor, Inc. and Principal Securities® are members of the Principal Financial Group®, Des Moines, IA 50392. Certain investment options may not be available in all states or U.S. commonwealths.

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