

Quarterly commentary

Blue Chip Equity

2016 Fourth Quarter

Performance overview

U.S. equity markets finished the year with a strong fourth quarter. The gains came after the November elections with smaller companies benefitting the most. The Russell 2000 Index returned more than 13% from Election Day to the end of the year. Value expanded its lead over growth during the quarter. The Russell 1000 Value Index outperformed the Russell 1000 Growth Index by more than 10% in 2016, the widest spread since 2006. The sector with the best fourth quarter performance was financials. Within the S&P 500 Index this group returned more than 21% during the period as investors anticipated the potential benefits of higher interest rates and asset values as well as lower taxes and a less burdensome regulatory environment.

The Blue Chip Equity strategy underperformed the Russell 1000 Growth Index in the fourth quarter. Wells Fargo and Berkshire Hathaway were the portfolio's two largest contributors. Both of these companies benefit from a higher rate environment. The portfolio's largest detractors included Anheuser-Busch InBev and Liberty Global, two companies that have faced some temporary headwinds in non-U.S. markets. More details about these companies and the other contributors and detractors in the fourth quarter can be found in the sections below. We remain confident in the companies we own as they possess competitive advantages that enable them to increase intrinsic value over time.

Our process remains the same. We are bottom-up, long-term investors, seeking to own high-quality companies with sustainable competitive advantages that are managed by owner-operators. We purchase these companies at a discount to their intrinsic value in order to have a margin of safety. We continually focus on reducing risk from the beginning of our process all the way through to monitoring the companies in the portfolio. While quarterly results may fluctuate and lower-quality companies may outperform for periods of time, we are confident that our strategy will outperform over a full market cycle, delivering superior long-term risk-adjusted results.

Index scorecard Fourth Quarter 2016 (in U.S. dollars)

Blue Chip Equity	-0.41%
Russell 1000 Growth	1.01%
Russell 1000 Value	6.68%
Russell 1000	3.83%
S&P 500	3.82%
Russell Top 200	4.08%
Russell Midcap	3.21%
Russell 2000	8.83%

Source: Russell Investment Group is the source and owner of the trademarks, service marks, & copyrights related to the Russell Indexes. Russell® is a trademark of Russell Investment Group. Standard & Poor's Ratings Services.

Composite performance as of 31 December 2016

	Three Months	One Year	Three Years	Since Inception ¹
Blue Chip Equity (gross)	-0.41%	9.61%	9.07%	14.20%
Blue Chip Equity (net)	-0.52%	9.10%	8.56%	13.65%
Russell 1000 Growth Index	1.01%	7.08%	8.54%	13.76%
Excess return (based on gross returns)	-1.42%	2.53%	0.53%	0.44%

¹ Inception date: 1 July 2012. Returns are expressed in U.S. dollars. Periods over one year are annualized. Outperforming the benchmarks is not specifically included within the strategy's objectives. They are shown for comparative purposes only. The two methods of calculation of performance may not be identical and it is not possible to invest in an index. Past performance is not a reliable indicator of future performance and should not be relied upon as a significant basis for an investment decision. Due to rounding, figures and percentages shown may not add to the totals or equal 100%. You should consider whether an investment fits your investment objectives, particular needs and financial situation before making any investment decision. See end of document for additional disclosure information.

Top five contributors

Wells Fargo is a nationwide bank that offers traditional bank/lending services as well as securities brokerage, wealth management, and insurance services. The competitive advantage Wells Fargo has over other large banks is their source of funding as a greater share of their funding base comes from low-cost deposits due to their dominance in key markets. The company has also demonstrated a better lending culture than its large bank peers. Along with other banks, Wells Fargo has performed well since the November election in anticipation of potentially higher interest rates and less regulatory burden.

Berkshire Hathaway is a diversified company with businesses ranging from insurance to railroads, as well as partial ownership of companies such as Coca-Cola and American Express. The company has been built over decades by owner-operators Warren Buffett and Charlie Munger. Over the company's 51-year history, its average annual return has more than doubled that of the S&P 500. Berkshire has a very long time horizon, never intending to sell its businesses. This long-term perspective has enabled Berkshire to be aggressive during times of market fear, building an impressive track record of value-adding capital allocation. The company is decentralized and remains committed to giving its businesses autonomy. The stock price increased during the fourth quarter. We continue to view Berkshire's businesses favorably and have confidence in the leadership of the company.

CarMax is the largest used car retailer in the United States with more than 150 stores in operation. CarMax purchases, reconditions, and sells used vehicles (one-to-six years old), operates wholesale auctions on their store lots, and provides financing to their used vehicle customers through CarMax Auto Finance. It strives to provide low, no-haggle prices across a broad selection of high-quality vehicles. Within the markets it serves, the company has been able to capture an impressive estimated 8-10% of the market. CarMax shares increased over the last quarter as third quarter results showed healthy sales growth.

Charles Schwab is an asset gatherer that earns fees and commissions by providing securities brokerage, banking, and related financial services to individuals and institutional clients.

The company has a strong brand name, the largest market share in its industry, and a long history of successfully growing its assets under management. The company continues to benefit from the influence of founder and chairman Chuck Schwab. The company's shares increased in the fourth quarter on expectations of rising interest rates, market appreciation, and elevated client trading activities.

Microsoft has been a contributor over the last three months. The company's strength continues to be its enterprise business, where over 80% of its profits derive. The attractiveness of the enterprise customer stems from both higher switching costs and profitability. CEO Satya Nadella has positioned Microsoft well for the future, with key investments in its fast-growing commercial cloud business and the transition of its Office suite to a subscription service delivered over the cloud.

Top five detractors

Amazon is an e-commerce company started by Jeff Bezos in 1994. Originally developed as an internet site to sell books, today the company sells a wide variety of products to people around the world. Amazon benefits from the virtuous cycle of using its scale and existing network to provide lower prices and a better experience to customers. Amazon continues to invest in its growth, which has included building a leading position in the fast-growing market for cloud services, where Amazon Web Services is now the dominant competitor. Bezos still owns 17% of the company and is focused on profitability, but he has a long-term mindset and doesn't emphasize quarterly earnings reports. Amazon shares were down during the fourth quarter due to concerns about the size of the company's investment spending and the potential for regulatory changes post-election.

Liberty Global is a large cable company with operations primarily in Europe. The company provides video, internet, and telephone services to its more than 25 million customers and increasingly also provides mobile services. Liberty Global has successfully consolidated significant assets across Europe over the last decade and now benefits from its scale. Its largest market is the United Kingdom, but its operations span 11 other European countries, as well as smaller operations in Latin America. During the last three months, Liberty Global shares

were weighed down by continued uncertainty related to the Brexit referendum.

Facebook is the world's dominant social network, with over one billion users that visit the network daily. Using Facebook's extensive data, advertisers can target their marketing campaigns on Facebook with much more specific criteria than is possible using traditional media. As marketers around the world have recognized this immense benefit, Facebook's share of advertising budgets has grown swiftly. Furthermore, Facebook is positioned to benefit from the increasing reliance on mobile devices. In fact, 80% of Facebook's advertising revenue already comes from mobile. The company has significant potential to monetize its Instagram, WhatsApp, and Messenger platforms as those apps continue to grow. There are many reasons we appreciate having owner-operator Mark Zuckerberg at the helm, including his willingness to be patient and focused on long-term potential with these budding platforms. Facebook shares decreased during the fourth quarter on concerns about decelerating ad revenue growth and rising costs.

Anheuser-Busch InBev (ABI) is by far the largest brewer in the world with operations in 50 markets. The company completed its acquisition of SABMiller in October 2016, making it the global leader in beer brewing and distribution. M&A is a core competency for ABI, and the company has a strong track record when it comes to integrating businesses. ABI's shares fell in the fourth quarter after reporting third quarter earnings that were weaker than expected, primarily due to the difficult environment in Brazil. We continue to have confidence in ABI's ability to generate superior growth through best-in-class management ability.

Moody's is one of the three major credit rating agencies and benefits from oligopolistic industry fundamentals such as high margins, returns on capital, and pricing power. Margins have rebounded from depressed financial crisis levels and have been expanding. Moody's shares decreased during the fourth quarter due to concerns that the rising interest rate environment will depress bond issuance. We believe Moody's is positioned to

perform well over the long term even if they face the headwind of higher interest rates. countries, as well as smaller operations in Latin America. During the last three months, Liberty Global shares were weighed down by continued uncertainty related to the Brexit referendum.

Unless otherwise noted, the information in this document has been derived from sources believed to be accurate as of January 2017. Information derived from sources other than Principal Global Investors or its affiliates is believed to be reliable; however, we do not independently verify or guarantee its accuracy or validity. Past performance is not necessarily indicative or a guarantee of future performance and should not be relied upon to make an investment decision.

The information in this document contains general information only on investment matters. It does not take account of any investor's investment objectives, particular needs or financial situation and should not be construed as specific investment advice, an opinion or recommendation or be relied on in any way as a guarantee, promise, forecast or prediction of future events regarding a particular investment or the markets in general. All expressions of opinion and predictions in this document are subject to change without notice. Any reference to a specific investment or security does not constitute a recommendation to buy, sell, or hold such investment or security, nor an indication that Principal Global Investors or its affiliates has recommended a specific security for any client account.

Principal Financial Group, Inc., its affiliates, nor its officers, directors, employees, agents, disclaim any express or implied warranty of reliability or accuracy (including by reason of negligence) arising out of any for error or omission in this document or in the information or data provided in this document.

Contributors and detractors do not represent all of the securities purchased, sold or recommended for advisory clients during the quarter. A list of recommendations made, and every holding's contribution to the representative account for the strategy during the past twelve months is available upon request. It should not be assumed that recommendations made in the future will be profitable or equal the performance of the securities listed. Past performance does not guarantee future results.

All figures shown in this document are in U.S. dollars unless otherwise noted.

This document is issued in:

- The United States by Principal Global Investors, LLC, which is regulated by the U.S. Securities and Exchange Commission.
- Europe by Principal Global Investors (Europe) Limited, Level 1, 1 Wood Street, London EC2V 7JB, registered in England, No. 03819986, which has approved its contents, and which is authorised and regulated by the Financial Conduct Authority.
- Singapore by Principal Global Investors (Singapore) Limited (ACRA Reg. No. 199603735H), which is regulated by the Monetary Authority of Singapore and is directed exclusively at institutional investors as defined by the Securities and Futures Act (Chapter 289).
- Australia by Principal Global Investors (Australia) Limited (ABN 45 102 488 068, AFS Licence No. 225385), which is regulated by the Australian Securities and Investments Commission.
- This document is issued by Principal Global Investors LLC, a branch registered in the Dubai International Financial Centre and authorized by the Dubai Financial Services Authority as a representative office and is delivered on an individual basis to the recipient and should not be passed on or otherwise distributed by the recipient to any other person or organization. This document is intended for sophisticated institutional and professional investors only.

In the United Kingdom this presentation is directed exclusively at persons who are Eligible Counterparties or Professional Clients (as defined by the rules of the Financial Conduct Authority). In connection with its management of client portfolios, Principal Global Investors (Europe) Limited may delegate management authority to affiliates who are not authorized and regulated by the FCA. In any such case, the client may not benefit from all the protections afforded by the rules and regulations enacted under the Financial Services and Markets Act 2000.

This material is not intended for distribution to, or use by any person or entity in any jurisdiction or country where such distribution or use would be contrary to local law or regulation.

©2017 Principal Financial Services, Inc.

Principal, Principal and the symbol design and Principal Financial Group are trademarks and service marks of Principal Financial Services, Inc., a member of the Principal Financial Group.

Principal Global Investors is the asset management arm of the Principal Financial Group.

Aligned Investors is a specialized investment management group within Principal Global Investors.