Principal[SM]

Quarterly commentary

Blue Chip Equity

2017 fourth quarter

Performance overview

There was no slowing down equity markets in 2017, as share prices continued climbing to new highs in the fourth quarter. Faster growing companies extended their lead over "value" peers. The Russell 1000 Growth outperformed the Russell 1000 Value Index by 17% for the year. Stocks outside the US finished the year on a high note as well, with both developed and emerging market indices positive for the quarter. Larger companies again outperformed smaller peers during the period, finishing the year nearly 8% better.

The Principal Blue Chip strategy underperformed the Russell 1000 Growth Index in the fourth quarter. Top contributors included our top weights Amazon and Alphabet, two businesses with wide competitive moats and owner-operator leadership. Detractors included CarMax and Aon, companies we've held since the inception of Blue Chip. Their quarterly sales were a bit lower than market expectations, but both companies remain positioned well. More information about these companies and the other contributors and detractors 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 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 can outperform over a full market cycle, delivering the superior long-term risk-adjusted results that our process strives to consistently produce.

Risk warning: Past performance is not a reliable indicator of future performance. The financial market outlook is based on current market conditions. There is no assurance that such events or projections will occur and actual conditions may be significantly different than that shown here. The potential for profit is accompanied with the by the possibility of loss.

Index scorecard fourth quarter 2017 (in U.S. dollars)

Blue Chip Equity	6.83%
Russell 1000 Growth	7.86%
Russell 1000 Value	5.33%
Russell 1000	6.59%
S&P 500	6.64%
Russell Top 200	6.79%
Russell Midcap	6.07%
Russell 2000	3.34%

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 2017

	Three months	One years	Two years	Three years	Four years	Five years	Since Inception[1]
Blue Chip Equity *(gross)*	7.01%	29.72%	19.21%	14.70%	13.90%	16.99%	16.87%
Blue Chip Equity *(net)*	6.88%	29.12%	18.66%	14.17%	13.36%	16.43%	16.31%
Russell 1000 Growth Index	7.86%	30.21%	18.05%	13.77%	13.59%	17.32%	16.58%
Excess return *(based on gross returns)*	-0.86%	-0.50%	1.16%	0.93%	0.29%	-0.32%	0.29%

[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

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 offer lower prices and a better experience to customers. Amazon continues to invest to increase long-term intrinsic value, including 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 growing intrinsic value. He has a long-term mindset and doesn't emphasize quarterly earnings reports. Amazon shares performed well during the fourth quarter, as the company continues to invest and focus on deepening its relationship with customers.

Alphabet's core Google business has tremendous advantages and will continue to benefit as advertising budgets move from traditional media to where people increasingly spend their time. Additionally, businesses such as YouTube are at the beginning of a path to greater monetization. The long-term perspective of Alphabet's owner-operator leaders continues to be an underappreciated asset. Alphabet recently reported solid results driven by growth in advertising and mobile search.

Microsoft's strength continues to be its enterprise business, where over 80% of its profits are derived. 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. Microsoft performed well during the last three months.

Berkshire Hathaway is a diversified company with businesses ranging from insurance to railroads. 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 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 last three months. We continue to view Berkshire's businesses favorably.

Visa is a dominant company in the global electronic payments market, accounting for roughly half of all credit card transactions and nearly three-fourths of debit card transactions in recent years. With 85% of payment transactions globally still conducted via either cash or check, Visa has a tremendous runway of growth ahead. The scale of Visa's global infrastructure is very difficult to replicate, and is a firm barrier to entry while also benefiting the company through continual network effects. New payment systems rely on - rather than replace - the incumbents' networks, showing the strength of the competitive advantage. Visa performed well last quarter.

Top five detractors

CarMax is the largest used car retailer in the U.S. with more than 170 locations. CarMax purchases, reconditions, and sells used vehicles, operates wholesale auctions on their store lots, and provides financing to their used vehicle customers through CarMax Auto Finance. The company offers low, no-haggle prices across a broad selection of high-quality vehicles. Due to its disciplined inventory management, CarMax is positioned to perform well throughout the auto cycle. CarMax shares underperformed last quarter on reported sales that were lighter than expected, but the business remains positioned well.

Aon is the world's largest insurance broker and a leading human resources consulting firm. In the brokerage segment, Aon matches businesses with insurers, as well as insurers with reinsurers. In human resources, Aon provides benefits consulting as well as retirement services. Insurance brokerage and human resources consulting are attractive businesses that complement one another. The barriers to entry are high as the businesses rely on built-up expertise and relationships. Both industries are consolidated, with Aon being one of the three large competitors in each. Aon's share declined last quarter due to slower than expected revenue growth.

The Priceline Group operates in the online travel sector, which is growing around the world. Priceline, along with Expedia, have dominant positions in what is still a very fragmented market. Due to the scale of Priceline, they can offer better prices through acquired platforms while still achieving a higher operating margin than competitors. The network Priceline has built over the years is hard to replicate. The company has recently grown significantly outside of the United States, most prominently in Europe with Booking.com. Priceline's stock price declined last quarter on softer than expected booking volume.

Liberty Broadband was spun out of Liberty Media in November 2014 as a way to highlight Liberty's investment in domestic cable assets, notably Charter Communications (~20% stake). Charter Communications comprises nearly all of Liberty Broadband's asset value, so the performance of Liberty Broadband is closely tied to Charter. With the acquisition of Time Warner Cable and Bright House Networks, Charter will have more than 20 million customers and be a top-2 competitor in an industry where significant benefits can be achieved by scale. Liberty Broadband shares declined last quarter after Charter reported subscription growth that was slightly below market expectations.

Kinder Morgan owns and manages a diversified portfolio of energy transportation and storage assets. The company effectively controls over 70,000 miles of pipeline and over 180 energy terminals. These pipelines transport natural gas, refined petroleum products, crude oil, carbon dioxide and other products, and its terminals store petroleum products and chemicals and handle such products as ethanol, coal, petroleum coke and steel. All together this makes Kinder Morgan one of the largest energy infrastructure companies in North America. Kinder Morgan founder and executive chairman Richard Kinder is a disciplined capital allocator, an important attribute, especially for an energy company. The company's shares slightly declined last quarter.