

Principal Global Strategic Income Fund

Investment Philosophy and Process

Principal Global Investors global strategic income capability is designed to provide investors access to a diversified fixed income strategy that seeks to deliver a high total return while managing downside risk. The capability emphasises high yield (non-investment grade) bonds, preferred securities and other high income generating sectors of the fixed income universe, including investment grade corporate bonds, commercial mortgage-backed securities (CMBS), emerging markets debt and asset-backed securities (ABS).

The strategy emphasises a “multi-sector” investment approach. This means we evaluate market inefficiencies across a broad array of fixed income global market sectors seeking the most attractive issues within the most attractive sectors. The objective of the process is to access the high yields available in these sectors. The duration (interest rate sensitivity) of the portfolio will be managed at a modest level (in a range of zero to three years). The purpose of this is to defend investors’ capital value from fluctuating with interest rate changes.

Each sector of the fixed income universe is impacted by a variety of micro and macro factors that influence price movements in that particular sector. For example, mortgage pricing is influenced by option volatility, as the U.S. homeowners’ right to prepay their mortgages creates a significant option element to the bonds. In corporate and high yield markets, default levels and trends are important influences tending to depress prices as defaults rise and vice versa. The influence of interest rates is common across all fixed income markets, but the extent of the impact will differ due to a variety of factors such as duration, cash flow patterns (e.g. mortgage-backed securities (MBS) or ABS), and maturity.

It is this variety of influences that leads to less-than-perfect correlation of performance across sectors, which, in turn, provides opportunities for a more “efficient” portfolio. Exhibit 1 highlights the correlation of various fixed income sectors.

Investment Range

The objective of our investment strategy is to maintain a highly diversified portfolio by investing across some of the highest yielding sectors of the fixed income universe. Establishing parameters around the investment range ensures that the capability remains diverse, yet provides for significant opportunities to exploit market inefficiencies across market sectors. The investment ranges for the strategy are highlighted in Exhibit 2:

Exhibit 2

| Asset Class/Sectors | Investment Range | |
|-----------------------|------------------|-------|
| | Min % | Max % |
| High Yield | 10 | 50 |
| Preferred Securities | 10 | 40 |
| Global Opportunistic* | 10 | 70 |
| Cash | 0 | 30 |

*The global opportunistic sector consists of all other securities available globally, including, but not limited to, investment grade corporate bonds, structured debt, CMBS, ABS, emerging markets debt, bank loans and convertible bonds.

Exhibit 1—Principal Global Investors Five Year Correlation Analysis to 30 June 2009

| | Barclays Capital ABS Index | Barclays Capital CMBS High Yield Index | Barclays Capital Credit A Index | Barclays Capital U.S High Yield Index | Merrill Lynch Preferred Stock Index | Barclays Capital Emerging Markets Index | Barclays Capital Intrmd. BBB Credit Index |
|---|----------------------------|--|---------------------------------|---------------------------------------|-------------------------------------|---|---|
| Barclays Capital ABS Index | 1.00 | | | | | | |
| Barclays Capital CMBS High Yield Index | 0.39 | 1.00 | | | | | |
| Barclays Capital Credit A Index | 0.49 | 0.10 | 1.00 | | | | |
| Barclays Capital U.S. High Yield Index | 0.66 | 0.65 | 0.56 | 1.00 | | | |
| Merrill Lynch Preferred Stock Index | 0.14 | 0.11 | 0.51 | 0.34 | 1.00 | | |
| Barclays Capital Emerging Markets Index | 0.66 | 0.36 | 0.76 | 0.78 | 0.22 | 1.00 | |
| Barclays Capital Intrmd. BBB Credit Index | 0.78 | 0.36 | 0.80 | 0.79 | 0.22 | 0.90 | 1.00 |



Principal Global Strategic Income Fund

Investment Philosophy and Process

Investment Process

Our investment style reflects a substantial commitment to fundamental research. The process is team-oriented and draws upon the cumulative input of multiple research teams and specialised analytical resources. Internal research serves as the foundation of the decision-making process. Our experienced staff of credit analysts and industry specialists provides in-depth, real-time coverage of over 1,000 major domestic and international bond issuers. We employ an independent credit rating and monitoring process, providing the opportunity to identify disparities between our assessments and those of the public credit rating agencies. We also draw from dedicated specialists and sophisticated valuation tools for structured debt instruments including a broad range of mortgage- and asset-backed securities. The process is global in focus, incorporating the analysis of economic trends and credit market conditions in over 50 countries worldwide. We believe this provides an effective framework for the early recognition of economic events and capital market imbalances in both developed and emerging markets.

Focus Filter

We emphasise relative value within the context of a consistent, firm-wide economic outlook. Particular attention is placed on identifying market dislocations and return enhancement opportunities across a broad universe of market sectors, industries and individual securities. Those dislocations that are already fully implied into the market price of the securities are screened out.

The global strategic income capability, by its nature, has investment criteria that allows for further filtering of the universe before the full research and investment process is applied to potential candidates. We seek to achieve a high yield while emphasising a modest to low overall duration. As new issues and secondary market inventory is offered to us, we undertake an initial screening to determine whether the investment opportunity is available for further analysis.

Securities are screened out where the following key factors for the potential investment are judged to be inconsistent with the strategy's overall risk and return objectives:

- Yield
- Duration
- Country of origin risk
- Sector

Research and Idea Generation

We obtain the majority of key process inputs and investment ideas from internally derived fundamental and quantitative research. Three distinct, yet integrated, areas of research drive portfolio decisions.

Credit Analysis/Security Selection

Our culture and history are characterised by a long-standing commitment to independent credit research. Our proprietary credit rating and monitoring process is supported by a core group of over 25 credit analysts, organised by industry specialisation. These analysts provide in-depth coverage of over 1,000 major bond issuers. Traditional balance sheet, income statement, capital structure and cash flow analysis are integral to the process. Our research also places significant emphasis on direct company contact and active participation in industry associations and trade conferences. Outputs of the process include detailed credit profiles, event risk considerations, proprietary quality ratings and projected rating changes over a 12 to 18 month horizon.

Structured Debt Research

Our staff includes dedicated sector specialists, focused on the intricacies of MBS, ABS and private market debt instruments. This research is both fundamental and quantitative in nature, incorporating the analysis of variable cash flows, amortisation features, liquidity characteristics and credit quality. With access to the substantial resources of the firm's dedicated real estate investment group, we also offer expertise in managing CMBS and private mortgages. Our research depth provides access to opportunities across the broad fixed income market, including segments overlooked or underrepresented by the standard indexes.

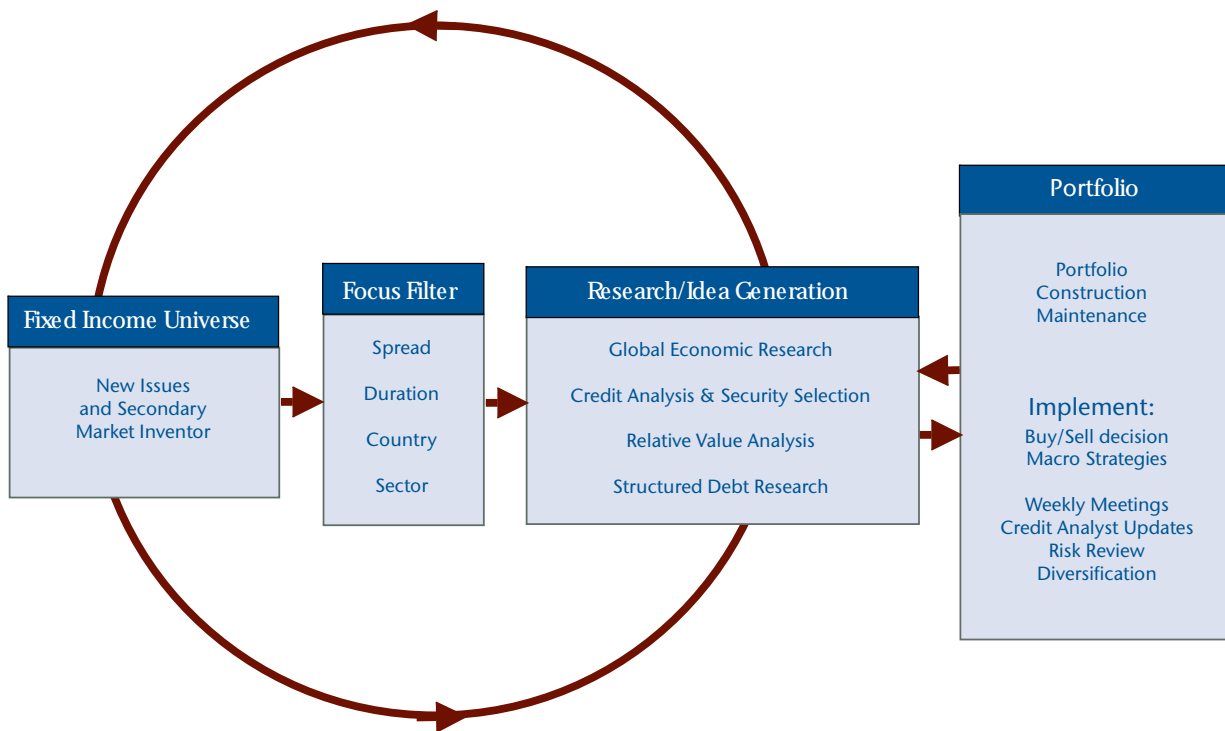
Global Research

Our dedicated international fixed income team and our Economic Resource Group provide global economic research, including sovereign credit analysis and the ongoing evaluation of global and regional economic trends. The process culminates with a documented quarterly economic outlook. The central purpose of this outlook is to generate baseline economic scenarios and forecast assumptions, providing a consistent framework for bottom-up research at the security, industry and sector-level. The outlook is monitored and refined as conditions warrant and scrutinised through weekly reviews with our portfolio management teams.

Principal Global Strategic Income Fund

Investment Philosophy and Process

Principal Global Strategic Income Fund Investment Process



Relative Value Analysis

A key aspect of the management of the product is our relative value analysis. All relative value decisions directly reflect our underlying research recommendations and economic outlook. Portfolio management teams collaborate directly with our research professionals to formulate specific buy/sell decisions. We employ multiple comparisons to align analyst recommendations with portfolio objectives, including:

Sector and Industry Spread Analysis—Historical and prospective evaluation of yield differentials across major market sectors (government, corporate, MBS, etc.), adjusted for differences in credit quality and cash flow volatility.

Credit Curve Analysis—Compares securities of similar credit quality across different maturities, as well as bonds of similar maturity with different quality characteristics. Also provides a gauge of market credit risk premiums.

Liquidity Premium Analysis—Various measures of comparative market

breadth and dislocations, such as comparisons of newly issued U.S. Treasuries vs. outstanding government bonds, agencies, futures, swaps, etc.

Yield Curve Analysis—Compares the dynamics between long-term and short-term interest rates, independent of credit and liquidity risks. Incorporates a significant focus on global inflation trends, monetary policy and fiscal policy.

Risk Management

Security selection, credit quality positioning and industry/sector allocation represent the dominant sources of excess returns. Our economic research process and market intelligence provides the basis for duration management.

This “total portfolio” comparative framework provides a consistent basis for the reinvestment of portfolio cash flows and active relative value-based trading. Purchase decisions are made concurrently based on the relative attractiveness of existing holdings versus proposed additions.

Principal Global Strategic Income Fund

Investment Philosophy and Process

Fixed Income Specialists



Principal Global Investors is responsible for managing US\$118.7 billion in fixed income assets as of 30 June 2009. The group draws on the strength of over 130 fixed income professionals. Our capabilities span multiple economic and credit market cycles, with expertise in all major fixed income sectors and security types.

Principal Global Investors disciplined investment process employs both bottom-up and top-down portfolio construction techniques while maintaining a strong focus on relative value opportunities and broad diversification.

The cornerstone of this process is proprietary research at macroeconomic, sector and security levels.

It is our belief that while markets are not perpetually efficient, over time, prices do reflect fundamental values. By generating high quality internal research, we are well placed to exploit those instances when prices do not reflect value. In addition, our internal research capability allows us to benchmark the best third party research we receive, be that rating agency, or broker research.

The portfolio construction process is highly interactive, with research and decision-making within each sector benefiting from the combined insights of the portfolio managers for the Fund, the sector heads and the research teams.

Principal Global Investors offers specialised expertise in the management of the preferred securities and high yield components of the product through our affiliates, Spectrum Asset Management and Post Advisory Group.

SPECTRUM

Spectrum Asset Management (Spectrum) is one of the largest managers of preferred securities portfolios in the United States. Spectrum maintains a presence on the floor of the New York Stock Exchange that enables the firm to add value via trading as an agent in preferred securities.

Spectrum's investment philosophy is based on the belief that institutional investors can receive high current income and enhanced diversification without having to sacrifice quality. Spectrum's style reflects a commitment to fundamental research and a team-oriented approach.

Spectrum emphasises a rigorous fundamental, bottom-up process to identify superior investment alternatives. Spectrum places primary emphasis on investment-grade hybrid preferred securities offering superior risk-adjusted yield premiums. Spectrum's methods emphasise traditional financial analysis within the context of broad industry and economic trends. The objective of the analysis is to assess the relative value among various preferred securities based on the following key features: call protection, subordination, option-adjusted spread and credit quality. This information is then shared across all of the asset management groups in order to form a common framework for making investment decisions.



Another major component of the product is high yield (non-investment grade) securities that are accessed through Post Advisory Group (Post). With the goal of consistently outperforming client expectations while maintaining below average volatility, Post is a leading manager of high yield fixed income investments.

Post believes the high yield market is a continuum and, accordingly, that opportunities exist through all market environments and cycles. From this belief, Post derives the philosophy that superior performance is achieved through consistent identification of three specific attributes: (1) value identification, (2) downside protection and (3) risk diversification. In value identification, Post concentrates on complex, under-followed and misunderstood credits, which have the highest probability of being mispriced in the consensus view. Another cornerstone is downside protection based on qualitative analysis. The third cornerstone is portfolio diversification by issue, issuer, security type, duration, maturity and credit rating.

Post's investment process includes the following steps: (1) idea generation, (2) proprietary Value Scoring Model, (3) detailed analysis, (4) relative-decision making and (5) constant monitoring. Post believes this rigorous individualised analysis produces a well-diversified investment portfolio. Post's bottom-up investment process revolves around reviewing, evaluating and selecting individual securities.

This material contains general information only on investment matters; it should not be considered as a comprehensive statement on any matter and should not be relied upon as such. The information it contains does not take account of any investor's investment objectives, particular needs or financial situation. This material is given in good faith and has been derived from sources believed to be accurate as at July 2009. Subject to any contrary provisions of applicable law, no company in the Principal Financial Group nor any of their employees or directors gives any warranty of reliability or accuracy nor accepts any responsibility arising in any other way (including by reason of negligence) for errors or omissions herein. Issued in Australia by Principal Global Investors (Australia) Limited (Licence number 225385), which is regulated by the Australian Securities and Investments Commission.

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