Principal Diversified Real Asset

Real Assets for Real Diversification

Ups and downs on the economic road call for investors to be prepared for both the risks they know and those that are unexpected. And many experts say it's time to plan for a risk Americans haven't faced for nearly a generation — inflation.

Why is inflation risk a concern now?

Most portfolios today aren't constructed with inflation in mind, which can leave investors vulnerable to its effects — rising living expenses coupled with declining purchasing power.

When inflation does strike, it may be unexpected — such as a jump in gas prices — or a slow realization that your dollar doesn't buy as much as it used to. Retirees and others seeking a stable income stream generally can't afford to have the real value of their savings go down while their cost of living goes up.

How can you limit its impact?

Traditional stock and bond investments have not historically kept up with rising prices during periods of high inflation, and many investors today are considering diversifying with historical inflation hedges such as real assets.*

Physical, tangible assets like gold, land, equipment, and commodities (such as food) are referred to as real assets. Such investments, as well as real return securities like Treasury Inflation-Protected Securities (TIPS), can act as a hedge against inflation because their value or investment return tends to rise as the cost of living goes up.

A diverse basket of real assets can help manage the effects of both gradual and sudden inflation. If you recognize that inflation risk is always present, consider managing it by maintaining an allocation to inflation-hedging investments.

Alternative Investments May Help Manage Risks

Real assets are recognized to serve three important functions that may benefit portfolios in any inflationary environment:

- **Hedging inflation:** With values that tend to rise with consumer prices, they have helped prevent the loss of purchasing power.
- **Diversification:** As alternatives with historically low correlation to traditional stocks and bonds, they help spread risk when added to a broader portfolio.
- **Enhancing return potential:** Offering attractive historical return profiles, real assets have the potential to enhance total portfolio return in various market environments.

Gross Domestic Product (GDP) represents a country's overall economic output by measuring the total market value of all the goods and services produced during a specified period.

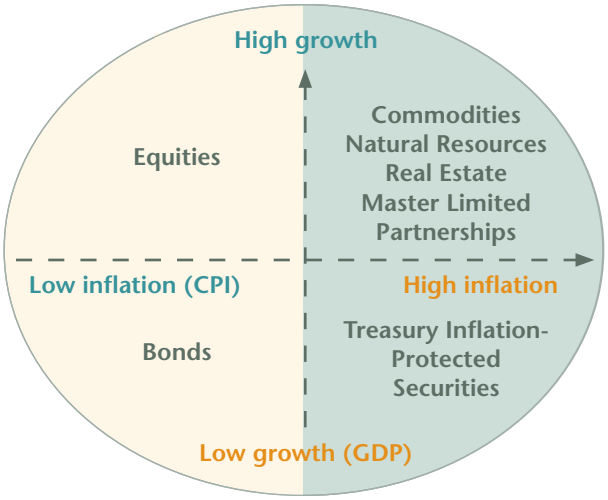
Consumer Price Index (CPI) represents increases or decreases in the prices paid by urban consumers for a representative basket of goods and services.

Master Limited Partnerships (MLPs) are publicly traded securities in partnerships engaged in the production and transportation of natural resources, such as oil and gas.

Treasury Inflation-Protected Securities (TIPS) are bonds issued by the U.S. Treasury with a fixed interest rate whose principal changes monthly by the rate of CPI.

*Past performance is no guarantee of future results.

DIVERSIFYING WITH REAL ASSETS



Diversifying a portfolio beyond traditional stocks and bonds to include alternative strategies may help manage effects of inflation, whether economic growth is booming or stagnant.

Combining Multiple Strategies in a Selective Investment Option

Asset classes perform differently in varying economic conditions, and no one strategy performs in all inflationary environments. the Principal Diversified Real Asset investment option combines multiple strategies, using a "best-in-class" manager approach[1], to target broad inflationary and market concerns.

Treasury Inflation-Protected Securities (TIPS)

- Adjustments in principal and income help maintain purchasing power
- Historically low correlation to stocks and low volatility

BLACKROCK

Nearly 200 pooled fixed-income investment professionals; $3.56 trillion assets under management[2]

U.S. Real Estate Investment Trusts

- Rents linked to inflation
- Historically low correlation to broad bond market

Principal Real Estate Investors

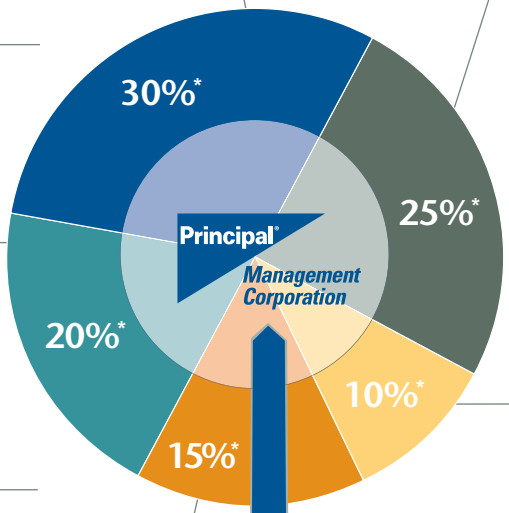
4th largest real estate manager in U.S.[3]; $35 billion in assets under management[2]

Natural Resource Stocks

- Hedge against increases in cost of natural resources
- Historically low correlation to traditional stocks and bonds

JENNISON ASSOCIATES

Investment team experience averages 15 years; $123.9 billion in assets under management[2]



Commodities

- Hedge against rising cost of raw materials
- Historically low correlation to traditional stocks and bonds

CREDIT SUISSE

Managing indexed commodities since 1994; $1.2 trillion assets under management[2]

Master Limited Partnerships (MLPs)

- Generally produce inflation-linked distributions
- Historically low correlation to traditional stocks and bonds

Tortoise Capital Advisors

Among leading investors in the energy infrastructure sector; $6.1 billion in assets under management[2]

* Allocations for TIPS and Commodities may range +/- 8%; REITs, Natural Resources, and MLPs allocations range +/- 5%.

May not reflect current allocations or sub-advisors.

OVERALL TARGET ASSET ALLOCATION

- Establish underlying asset classes and sub-advisors to manage each strategy consistent with the investment option's overall needs
- Rebalance among individual strategies based on market and economic factors
- Monitor sub-advisors to ensure each is performing well against stated benchmarks
- Evaluate and deliver additional asset class strategies that may provide added yield with market-like risk, increased diversification, and price appreciation

Investors should be aware of investment risks, including interest rate, equity, real estate, and other specific market sectors. Asset allocation/diversification does not guarantee a profit or protect against a loss.

[1] The Separate Account invests wholly in the Principal Diversified Real Asset Fund. The sub-advisors for this Fund were selected using a proprietary due diligence process that provides a rigorous and disciplined framework for identifying, hiring, and retaining premier investment managers within each asset class and investment style. It is characterized by the comprehensive and continuous review of all investment managers based on specific investment guidelines.

[2] As of December 31, 2010.

[3] Managers ranked by U.S. institutional tax-exempt real estate assets, out of 87 managers profiled, as of June 30, 2010 *Pensions & Investments*, September 10, 2010.

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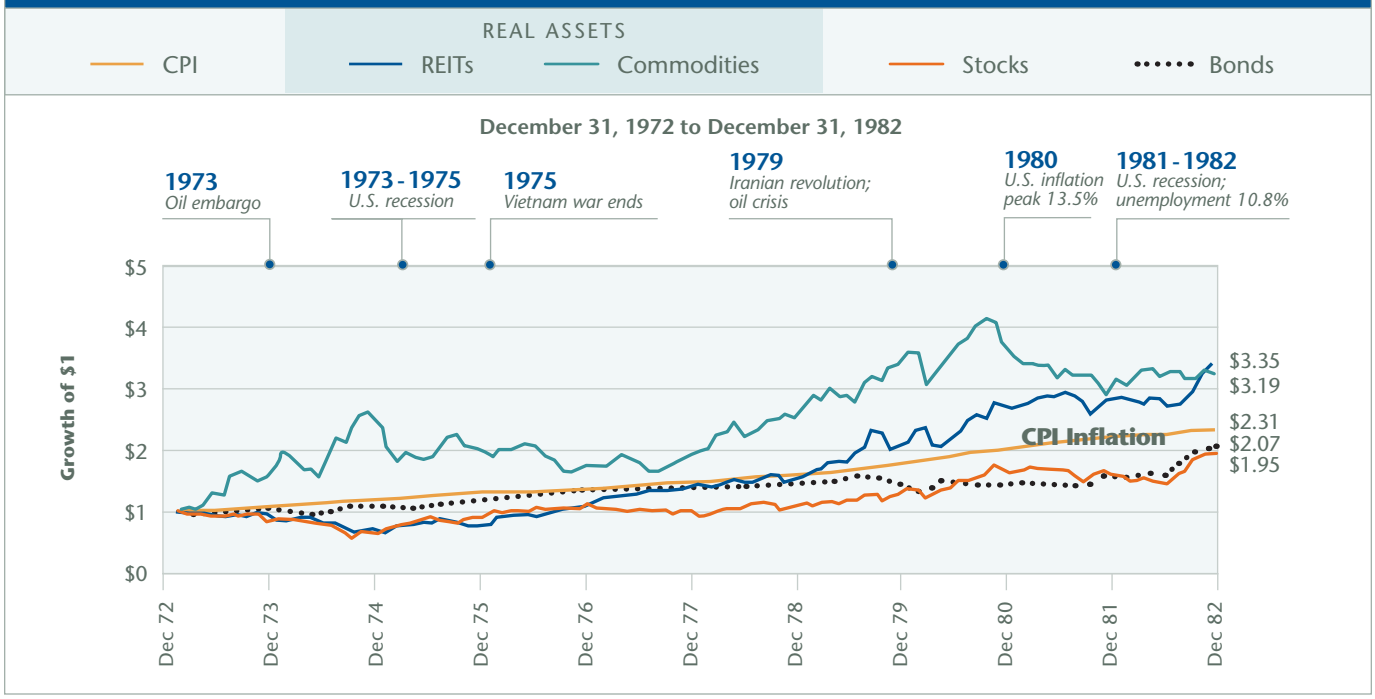
May Lose Value • Not a Deposit • No Bank or Credit Union Guarantee
Not Insured by any Federal Government Agency

Inflation is Unpredictable, but its Risks are Known

Sudden price increases can arise with unexpected inflation, while it erodes real returns over time.

During the last great period of extended inflation in the 1970s, cumulative inflation over the 10-year period spanning 1973-1982 was 131%. **This means that a dollar earned in 1972, if saved and spent in 1982, had the purchasing power of only 43 cents.** Investors today who want to preserve portfolio value, while adding diversification and return potential similar to that of traditional stocks, may want to consider an array of securities providing exposure to real assets.

HOW ASSET CLASSES PERFORMED DURING THE "GREAT INFLATION" OF THE 1970s

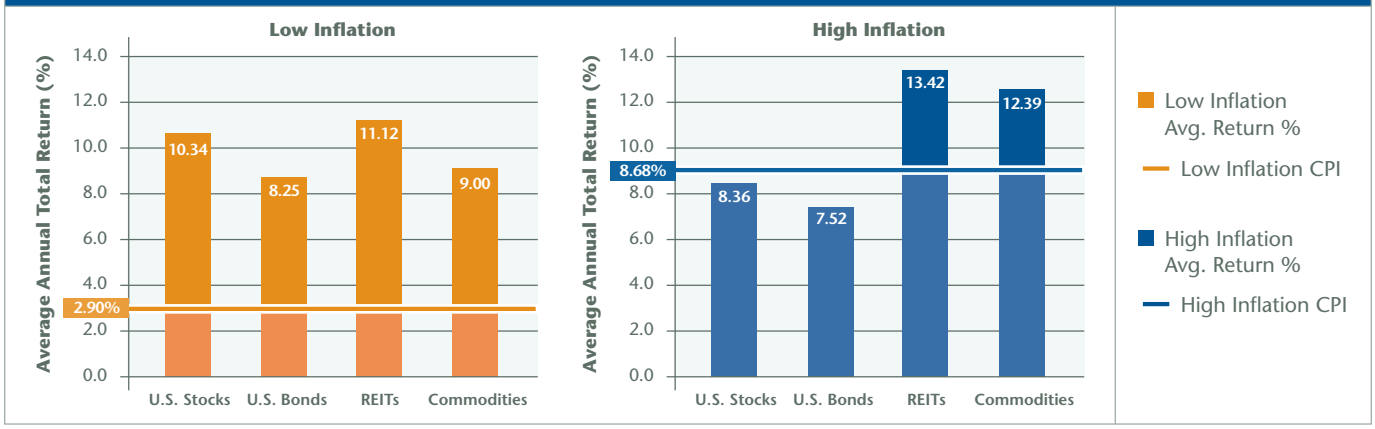


Sources: Cliffwater LLC. Goldman Sachs Commodity Index (Commodities), a broadly diversified composite index of commodity sector returns; FTSE NAREIT Equity REIT Index (REITs), a weighted index of U.S. publicly traded equity, mortgage, and hybrid REITs. S&P 500 (Stocks) is an index of 500 widely held stocks often used as a proxy for the stock market; BarCap Aggregate Bond Index (U.S. Bonds) covers the U.S. investment-grade, fixed-rate bond market; U.S. Consumer Price Index Not Seasonally Adjusted (U.S. CPI). Note: Index inception dates for TIPS, Natural Resources, and MLPs are too recent (1996 and later) to provide data for "high inflation" scenarios.

Planning for inflation can help manage its effects

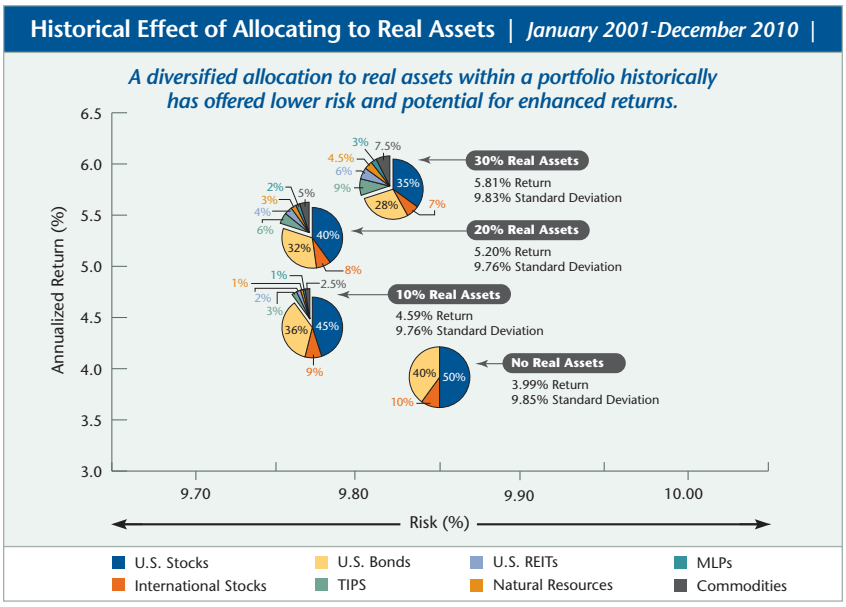
Massive fiscal and monetary responses to the recent global financial crisis are viewed by many as contributors to what could be a looming inflationary environment. A moderate allocation to real assets may help maintain a portfolio's *real* return in the event of high inflation — even if sudden or unexpected — while adding diversification and enhanced return potential.

INVESTMENT PERFORMANCE RELATIVE TO CPI IN LOW AND HIGH INFLATIONARY PERIODS



Source: Cliffwater LLC. U.S. Stocks are represented by the Wilshire 5000 Total Market Index, measuring the performance of all U.S. equity securities with readily available price data; other indices see sources above; CPI Inflation Source: U.S. Bureau of Labor Statistics. High Inflation Period, 1/31/1973 - 1/31/1983; Low Inflation Period, 12/31/1983 - 12/31/2010.

Principal Diversified Real Asset May be Right for Your Portfolio



Source: Zephyr StyleADVISOR

Portfolio performance is calculated using initial allocations of 50% U.S. stocks, 10% international stocks, and 40% U.S. bonds. As real assets were added, other asset classes were reduced proportionately. **It is not possible to invest directly in an index. Past performance does not guarantee future results.**

Asset classes are represented by: S&P 500, a market capitalization-weighted index of 500 widely held stocks often used as a proxy for the stock market (U.S. Stocks); MSCI EAFE Index, measuring stock returns in developed economies outside North America (Int'l Stocks); BarCap Aggregate Bond Index, covering the U.S. investment-grade fixed-rate bond market (U.S. Bonds); BarCap U.S. TIPS Index, which includes all eligible publicly issued U.S. Treasury inflation-protected securities (TIPS); MSCI U.S. REIT Index, representing approx. 85% of the U.S. REIT universe (U.S. REITs); S&P North American Natural Resources Sector Index, which measures the performance of U.S.-traded, natural-resource-related stocks (Natural Resources); Alerian MLP Index, a composite of the 50 most prominent energy master limited partnerships (MLPs); DJ-UBS Commodity Index, a broadly diversified composite index of commodity sector returns representing an unleveraged, long-only investment in commodity futures (Commodities). Risk is measured by standard deviation, a statistical measurement that depicts how widely returns varied over a certain time period.

Calculations are based on historical index performance and are shown for illustration purposes only. Real asset index percentages, while representative of targets of the Principal Diversified Real Asset investment option, are fixed and do not reflect past or future performance of any Principal product. Actual investment option component percentages may change without notice.

PRINCIPAL DIVERSIFIED REAL ASSET PORTFOLIO

Average Annual Total Returns as of 6/30/2011	Year to Date	1-Year	5-Year	10-Year	Since Inception (3/16/2010)
Principal Diversified Real Asset Separate Account - R6 Rate Level	3.53%	23.25%	N/A	N/A	14.91%
Principal Diversified Real Asset Separate Account - R1Rate Level	3.16%	22.36%	N/A	N/A	14.09%

Investment results shown represent historical performance and do not guarantee future results. Your investment's returns and principal values will fluctuate with changes in interest rates and other market conditions so the value, when redeemed, may be worth more or less than original costs. Current performance may be lower or higher than the performance shown.

Investment expense ratio: R6 rate level 1.06%; R1 rate level 1.78%. Returns displayed are based on net total investment expense.

Talk with your financial professional about the best strategy for your portfolio.

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 1-800-547-7754.

Investment options are subject to investment risk. Shares or unit values will fluctuate and investments, when redeemed, may be worth more or less than their original cost.

No investment strategy, such as diversification, can guarantee a profit or protect against loss in periods of declining values.

Fixed-income investment options are subject to interest rate risk, and their value will decline as interest rates rise. Neither the principal of bond investment options nor their yields are guaranteed by the U.S. or any other government entity. Concentrating investments in natural resources industries can be affected significantly by events relating to those industries, such as variations in the commodities markets, weather, disease, embargoes, international, political and economic developments, the success of exploration projects, tax and other government regulations and other factors. Investing in derivatives entails specific risks relating to liquidity, leverage and credit that may reduce returns and/or increase volatility. REIT securities are subject to risk factors associated with the real estate industry and tax factors of REIT registration. An MLP that invests in a particular industry (e.g., oil and gas) will be harmed by detrimental economic events within that industry. As partnerships, MLPs may be subject to less regulation (and less protection for investors) under state laws than corporations. In addition, MLPs may be subject to state taxation in certain jurisdictions, which may reduce the amount of income paid by an MLP to its investors.

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