Principal Asset Management℠

PRINCIPAL EQUITY INCOME FUND

Quarterly commentary

THIRD QUARTER 2024

The Principal Equity Income Fund outperformed the Russell 1000® Value index on a net basis in the third quarter driven by positive stock selection in 5 out of 11 sectors. Over the trailing one-year, 97% of companies held have raised their dividend by a median of 7.1%.

TICKER:

Class I: PEIIX
Class A: PQIAX
Class C: PEUCX

What helped

The financial sector was the top contributor to performance, led by KKR & Co Inc (KKR) and Fidelity National Financial (FNF). Both companies continue to execute well as KKR raised $34 billion in the quarter, which included the initial close of their Global Infrastructure V Fund, which raised $11 billion. Over the trailing one-year, KKR has raised $108 billion. FNF is the largest title insurance company in the U.S. and saw revenues increase 5% year-over-year with margins coming in above expectations within their title segment. Stock selection was also strong within the consumer discretionary sector. D.R. Horton (DHI) provides homebuyers with a wide product breadth and an affordable price point. The company topped EPS expectations aided by homebuilding gross margins as the company continues to improve cash flows and capital returns. DHI has also rewarded shareholders with a 20% dividend increase over the past year.

What hurt

Stock selection within the health care sector detracted the most from performance during the quarter. After hitting fresh all-time highs in late June, Merck & Co. (MRK) moved lower as negative attention regarding Gardasil weighed on the stock despite a modest beat and raise quarter. Becton, Dickinson and Company (BDX) detracted from relative performance as investors focused on short-term guidance in 2023 which was below current estimates, however the company remains on track to exceed 2025 operating margin targets and stepped-up its outlook for its Alaris pumps. The real estate sector also hurt performance as a small underweight and holding Alexandria Real Estate Equities, Inc. (ARE) detracted from results. Alexandria has carved out a niche within the office sector as the leading life science REIT specifically focused on lab office space. ARE leases primarily to pharma, life science and not-for-profit research institutions in key research clusters of San Franisco, Boston, New York City, Seattle, San Diego, and the Research Triangle. ARE detracted from relative performance as investors grew concerned over increased supply and upcoming lease expirations. Within consumer discretionary we sold out of Magna International (MGA) as we continued to build our position in Hilton within the consumer discretionary sector

What we did

In the quarter we added one new name and eliminated four holdings. Within the information technology sector, we sold out of TE Connectivity (TEL) and purchased Broadcom Inc. (AVGO). AVGO designs, develops, and supplies semiconductor and infrastructure software solutions and has a portfolio of diverse franchises that sell into multiple end markets including wired, wireless, video, enterprise storage, and industrial. AVGO is the number 1 or 2 player in 22 separate divisions. The company has grown over time through acquisitions and now has 76% of total revenue in semi and 24% in infrastructure software. The company was added to the portfolio during the quarter as management has been extremely shareholder friendly through accretive acquisitions, consistent dividend increases, and meaningful share buybacks. We also expect company margins to continue to improve as AI related revenues accelerate. BCE Inc. (BCE), the largest Canadian broadband provider, was eliminated from the portfolio as we believe T-Mobile (TMUS) is the best positioned wireless provider in North America. Lastly, PPG Industries (PPG) was eliminated from the strategy has we have higher conviction in our other materials names.

PRINCIPAL EQUITY INCOME FUND

The Equity Income Fund invests predominantly in dividend-paying companies and seeks to provide a relatively high level of current income and long-term growth of income and capital. In pursuing its goal, we invest primarily in the common stocks of large-capitalization U.S. companies.

Top five contributors

D.R. Horton (DHI) is the largest home builder by volume in the U.S. with an extensive geographic footprint and leading market share in 4 of its top 5 markets. DHI provides homebuyers with a wide product breadth and an affordable price point. The company topped EPS expectations aided by homebuilding gross margins as the company continues to improve cash flows and capital returns. Shares contributed to relative performance as the stock hit new all-time highs as mortgage rates fell in the quarter.

Parker-Hannifin (PH) operates across six business segments and is a global leader in motion and control technologies. PH's relentless focus on margin improvement and profitable growth helped the company generate robust cash generation. PH has used its strong cash position to increase its dividend 10% over the past year and deleverage their balance sheet post-Meggitt acquisition. Parker hit fresh all-time highs in the quarter as the company's aerospace segment saw robust sales and record margins. Shares of PH contributed to relative performance.

KKR & Co Inc (KKR) is an alternative asset manager specializing in private equity, credit, and real estate. KKR's capital markets business and the use of their balance sheet to invest into their funds separates them from other managers in the industry. KKR raised $34 billion in the quarter which included the initial close of their Global Infrastructure V fund, which raised $11 billion. Over the trailing one-year KKR has raised $108 billion.

Fidelity National Financial (FNF) is a title insurance and transaction service provider to the real estate and mortgage industries. FNF is the largest title insurance company in the U.S. with subsidiaries such as Fidelity National Title, Chicago Title, and Alamo Title. Shares contributed to relative performance as their title segment saw revenues increase 5% year-over-year with margins coming in above expectations. In anticipation of the decline in interest rates, FNF saw August refinance orders increase 43% year-over-year with management expecting that there may be further upside with refinance activity.

PNC Financial (PNC) has grown to be a top 10 bank in the U.S. based on assets as the company has spent much of the past decade investing in and modernizing their technology backbone. The company has expanded its geographic footprint as well with the acquisition of BBVA's U.S. operations which had more than 600 branches; many that were in Texas, California, and Florida. PNC posted solid net interest income and fee income results with expense control coming in better than expected.

Top five detractors

Merck & Co. (MRK) is a biopharma company and the global leader in oncology with additional focus in vaccines, cardiometabolic health, and animal health products. MRK detracted from results despite a modest beat and raise quarter, as negative attention regarding Gardasil weighed on the stock.

Microchip Technology (MCHP) is a leading provider of microcontrollers, mixed signal, analog, and integrated circuits with a diverse set of end markets ranging from industrials and auto to datacenters and computing. MCHP detracted from relative performance as the company is facing a continued inventory correction as multiple end markets remain weak.

Marathon Petroleum Corporation (MPC) is the largest U.S. refiner with 16 refineries in the Midcontinent, West Coast, and Gulf Coast. The company's complex refining facilities located in key regions create high barriers to entry and gives them a cost advantage. The company continued to return cash to shareholders as buybacks totaled $2.9 billion, up from $2.2 billion in Q1. MPC detracted from relative performance as crack spreads remain weak due to excess supply.

PACCAR Inc (PCAR), manufacturer of trucks under the Peterbilt, Kenworth, and DAF brands, has a highly profitable parts segment. PCAR benefits from a strong dealership network and has paid shareholders a dividend every year since 1941. PCAR lowered its forecast for U.S. and Canada Class 8 industry retail sales for the second quarter in a row, which weighed on the stock.

Microsoft (MSFT) is a technology juggernaut which develops consumer and enterprise software. Services include cloud-based solutions that provide customers with software, services, platforms, and content. Products include operating systems, business solution applications, desktop and server management tools, and devices like PCs, tablets, and gaming consoles. We expect most companies will go through a digital AI transformation with Microsoft positioned as the most mission critical and long-term partner for enterprises. MSFT shares moved lower in the quarter as cloud revenues disappointed investors.

Outlook

U.S. equity market performance was once again strong in the third quarter of 2024 with the S&P 500 near all-time highs. Strength was broad-based but was led by yield oriented sectors like Utilities and Real Estate as market optimism around lower interest rates grew. The breadth of performance was in stark contrast to the Magnificent Seven dominated first half with only three of the Magnificent Seven higher on the quarter. Energy was the only S&P 500 sector in the red.

Despite continued geopolitical turmoil and election uncertainty, the third quarter marked the S&P 500's fourth consecutive quarterly gain. The Federal Reserve's decision to cut interest rates by 50 basis points in September spurred expectations of further cuts this year and throughout 2025. But there is still much uncertainty. The path of inflation, the labor market, and broader economic conditions will ultimately determine the extent and speed of Fed action, and investors can't expect a free lunch. The rapid increase in interest rates didn't slow the economy as much as many expected, so a decline in rates may also be less effective at steering the economy than in the past. If that is the case, running into stocks with over-leveraged balance sheets and perceived sensitivity to lower rates could backfire. Regardless of the interest rate backdrop, we believe there are competitively advantaged businesses across sectors and the market cap spectrum that are positioned to expand margins, gain market share, and become increasingly valuable investments.

With an uncertain backdrop and markets at all-time highs, volatility is likely to increase, and selectivity will be key. We believe investors will be well served to focus on quality businesses with strong balance sheets that generate ample free cash flow. The most lucrative investments tend to be structurally advantaged compounders that can grow into increasingly valuable companies over time. Finding those compounders isn't always easy and requires deep, fundamental research. But the compounders of the future are out there. Market volatility can be unsettling, but its those periods of volatility that give long-term investors the opportunity to buy those quality compounders at discounted prices.

PRINCIPAL EQUITY INCOME FUND as of September 30, 2024

Top 10 holdings

	% of net assets
Parker-Hannifin Corp	3.2
KKR & Co Inc	2.9
Costco Wholesale Corp	2.8
Morgan Stanley	2.7
JPMorgan Chase & Co	2.7
PNC Financial Services Group Inc	2.6
Trane Technologies	2.6
Chubb Ltd	2.6
DR Horton Inc	2.4
Hilton Worldwide Holdings Inc	2.3
Total	**26.8**

The holdings listed do not constitute a recommendation to purchase or sell a particular security. Cash and/or derivative positions that are not part of the core investment strategy will not be reflected in the top holdings list.

Performance, rankings, & ratings

	Average annual total returns (%)									Yield[1] (%)	
	3-month	Year-to-date	1-year	3-year	5-year	10-year	Since inception[2]	Expense ratio (gross/net)[3]	Expense limit expiration date	30-day SEC unsubsidized/ subsidized	12-month distribution
Class I[4]	9.63	17.44	30.09	8.71	10.09	10.13	9.05	0.54/0.52	02/28/2025	1.59/1.61	1.75
Morningstar category average	9.43	16.68	27.76	9.03	10.69	9.23	—	—		—	—
Russell 1000® Value Index[5],[6]	8.04	15.90	27.14	9.58	11.24	9.30	—	—		—	—
Morningstar rankings and ratings	3-month	Year-to-date	1-year	3-year	5-year	10-year	Overall				
Category and number of funds in category: Large Value	1,192	1,184	1,173	1,085	1,031	804	1,085	—		—	—
Class I percentile rankings[7]	—	—	23	70	76	26	—	—		—	—
Class I ratings[8]8	—	—	—	★★	★★	★★★★	★★★	—		—	—

Calendar year returns (%)	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Class I[2]	12.66	-3.88	15.58	21.03	-5.06	28.95	6.54	22.33	-10.51	11.11
Russell 1000® Value Index[1,5]	13.45	-3.83	17.34	13.66	-8.27	26.54	2.80	25.16	-7.54	11.46
Morningstar category average	10.21	-4.05	14.81	15.94	-8.53	25.04	2.91	26.22	-5.90	11.63

Morningstar percentile rankings are based on total returns. Morningstar ratings are based on risk-adjusted returns.

Returns represent past performance and do not guarantee future results. Share price, principal value and return will vary and you may have a gain or loss when shares are sold. Current performance may be lower or higher than quoted. For the most recent month-end performance, visit PrincipalAM.com.

(1) 30-Day SEC yield represents net investment income earned by a fund over a 30-day period, stated as an annual percentage. Unsubsidized yield reflects the SEC yield when some fund expenses are not waived. Subsidized yield reflects a fund's yield when all expense waivers are included. 12-month yield is based on actual distributions paid over a trailing 12-month period, stated as an annual percentage.

(2) Class I shares were first sold on 08/01/2000. Returns for Class I shares prior to 08/01/2000, including since-inception performance, are based on performance of the Class A shares adjusted to reflect the fees and expenses of Class I shares. Class A shares were first sold on 05/31/1939.

(3) The net expense ratio reflects contractual expense limits, if any, which may lower net expenses and cause the gross and net expense ratios to differ. In such cases a date is listed through which expense limits are expected to apply; however, Principal Funds and the investment adviser may mutually agree to terminate the expense limits prior to the end of the period. Returns displayed are based on net total investment expense.

(4) Performance assumes reinvestment of all dividends and capital gains. Returns shown for periods of less than one year are not annualized.

(5) Russell 1000® Value Index is a market-capitalization weighted index of those firms in the Russell 1000® with lower price-to-book ratios and lower forecasted growth values. Information regarding the comparison to the Russell 1000® Value Index is available upon request. Russell Investment Group is the source and owner of the trademarks, service marks and copyrights related to the Russell Indexes. Russell® is a trademark of Russell Investment Group.

(6) Index performance information reflects no deduction for fees, expenses, or taxes. Indices are unmanaged and individuals cannot invest directly in an index.

(7) Morningstar percentile rankings are based on total returns and do not reflect the inclusion of sales charges. If sales charges were reflected, rankings could be lower.

(8) The Morningstar Rating™ for funds, or "star rating," is calculated for managed products (including mutual funds, variable annuity and variable life subaccounts, exchange-traded funds, closed-end funds, and separate accounts) with at least a three-year history. Exchange traded funds and open-ended mutual funds are considered a single population for comparative purposes. It is calculated based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a managed product's monthly excess performance, placing more emphasis on downward variations and rewarding consistent performance. The top 10% of products in each product category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars, and the bottom 10% receive 1 star. The Overall Morningstar Rating for a managed product is derived from a weighted average of the performance figures associated with its three-, five-, and 10-year (if applicable) Morningstar Rating metrics. The weights are: 100% three-year rating for 36–59 months of total returns, 60% five-year rating/40% three-year rating for 60–119 months of total returns, and 50% 10-year rating/30% five-year rating/20% three-year rating for 120 or more months of total returns. While the 10-year overall star rating formula seems to give the most weight to the 10-year period, the most recent three-year period actually has the greatest impact because it is included in all three rating periods. Morningstar ratings do not reflect the inclusion of sales charges. If sales charges were reflected, ratings could be lower. Part of the mutual fund data contained herein: (1) is proprietary to Morningstar and/or its content providers; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete, or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information.

MM10394-24 | 10/2024 | 3937040-022025

Principal Asset Management℠

PrincipalAM.com