March 29, 2019

Dear Shareholder:

Municipal Market & Federal Reserve Update:

The municipal bond market is off to its strongest start since 2014. The strong performance has been driven by a number of factors including, but not limited to: the Federal Reserve's decision this month to pause its interest rate hikes; the new cap on the deduction for state and local income taxes commonly known as the "SALT" deduction; and favorable supply and demand patterns.

The Fed's March meeting was a game changer for financial markets. As expected, the Fed left the fed funds target rate range unchanged at 2.25 to 2.50 percent. However, several other actions taken by the Federal Open Market Committee (FOMC) took financial markets by surprise. The FOMC made it clear in its statement that it would be "patient" as it determines whether additional rate hikes are appropriate. The switch to an "on hold" rate policy stance is a substantial departure from the FOMC's previous rate policy guidance which suggested additional tightening would likely be appropriate. In the press conference following the meeting, Chairman Powell reiterated his belief that the fed funds rate is currently at or near the long-run neutral rate. We may now be at the end of this rate tightening cycle. For the first time, some interest rate forecasters are predicting that the next move by the FOMC will be a rate cut.

The FOMC also made significant changes to its balance sheet normalization plan. Beginning in May, the re-investment cap for Treasuries will be reduced from $30 billion to $15 billion and then further reduced to zero at the end of September. In September, the FOMC will also start reinvesting runoff from its holdings of mortgage backed securities in Treasuries bought in the open market. The end result is the Fed will be purchasing approximately $200 billion more in Treasuries this year than financial markets originally anticipated and continuing to hold significantly more assets on its balance sheet going forward than it has historically carried.

The 2017 tax code overhaul capped at $10,000 the amount of state and local tax payments a household can deduct from its federal income taxes. Previously, a taxpayer could deduct the entire amount they paid in state and local property taxes, and either the state individual income tax or state sales tax. The cap on the SALT deduction has led to a spike in demand for tax-exempt municipal bonds as investors look for new tax shelters. The demand for tax-exempt municipal bonds has been particularly robust in high-tax states such as New York, Connecticut, California, and New Jersey. The increase in demand from retail investors has occurred at a particularly opportune time, as banks have continued to reduce their municipal bond holdings due to lower corporate tax rates which make tax-exempt debt less attractive for them.

During the first quarter, the pace of new bond issuance did not keep up with demand creating a supply and demand imbalance that resulted in higher bond prices. Although issuance volumes are expected to increase

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slightly in the coming months, a record amount of tax-exempt debt is scheduled to mature in the second and third quarters of this year. This runoff will generate a significant amount of cash that likely will be reinvested in tax-exempt bonds. Favorable supply and demand dynamics should continue to act as a support for municipal bond prices.

Bond markets have repriced dramatically in response to these developments with bond prices increasing and yields declining. At the end of the first quarter, the 10-year benchmark municipal bond yield as measured by the MMD AAA Municipal Yield Curve was 1.86%, the lowest it's been since September 2017. The 30-year benchmark municipal bond yield dropped to 2.60%, the lowest it's been since January 2018.

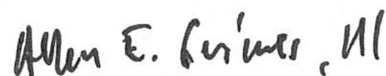
There are signs that the economy is slowing down. Real GDP growth in the fourth quarter of last year came in at 2.2 percent which was down significantly from the 3.4 percent growth rate experienced during the third quarter of 2018. Personal spending dropped substantially in December and was flat in January. The slowdown in economic growth does not appear to be confined to the United States, as Europe and China are also showing signs of weakening economic conditions. Importantly, key measures of inflation have continued to run below the Fed's 2% inflation target rate. The Fed's preferred inflation measure, the core PCE, increased at an annual rate of 1.8% rate in January.

The good news is that the combination of slower economic growth and subdued inflation is a benign environment for bonds. We think that conditions are ripe for municipal bonds to deliver positive returns for the remainder of this year. Particularly with the recent changes to the federal tax code, investors are increasingly discovering that tax-exempt municipal bonds are one of the last tax havens left. Also, with stock market indexes approaching last year's record levels, we think it is important to keep in mind that, in addition to providing a steady stream of tax-free income, municipal bonds offer important diversification benefits for an overall investment portfolio.

On behalf of all members of the Dupree Mutual Funds family, I would also like to recognize the enormous contributions made to Dupree by C. Timothy Cone, who passed away on February 8, 2019. Tim served as a trustee of Dupree Mutual Funds for 16 years and was chairman at the time of his death. An accomplished and respected lawyer by trade and a steady leader in his profession and community, Tim shared his intellect, acumen, and loyalty with Dupree Mutual Funds to the benefit of all of us. He is and will be missed.

Thank you for investing with us.

Sincerely,



Allen E. Grimes, III
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