DUPREE MUTUAL FUNDS

June 30, 2019

Dear Shareholder:

Mid-Year Municipal Market Update:

During the first half of the year municipal bonds posted strong returns. Bond prices rose (yields declined) as investors' appetite for tax-exempt bonds increased. The boost in demand was fueled in part by recent changes to the federal tax code (i.e., the impact from capping the state and local tax (SALT) deduction for higher-income earners) and also by investors' flight to safe-haven assets during a period which witnessed increased trade tensions and heightened geopolitical risks.

On the supply side, net new issuance of tax-exempt bonds remained flat. The supply of newly issued municipal bonds has been constrained by the new federal tax law that prohibits issuers from advance refunding outstanding bonds on a tax-exempt basis. Favorable supply-and-demand dynamics created a powerful technical tailwind for municipal bonds that contributed to the strong performance. On a total return basis, the Bloomberg Barclays Municipal Bond Index posted a 5.09% gain for the six month period ended June 30.

A favorable macroeconomic environment also helped support municipal bond prices. On the domestic front, economic data (e.g., business income growth and a slowdown in consumption during the first quarter) suggest that the pace of economic activity, while still positive, is beginning to slow. Manufacturing production has also posted declines so far this year. In the meantime, key measures of inflation have continued to be muted. The Fed's preferred inflation gauge, the core PCE, increased at a 1.6% annual rate in May and continues to run well below the Fed's 2% target rate.

On the international front, there are also signs that economic conditions are weakening. Earlier this year, the World Bank cut its forecasts for global economic growth in 2019 and 2020 for the U.S., the Eurozone, and China. Escalating trade tensions have cast a dark cloud over economic growth prospects around the world. The heads of several foreign central banks have recently suggested that they are prepared to roll out additional economic stimulus if economic conditions continue to soften.

Federal Reserve Update:

Against this backdrop, the Federal Reserve Open Market Committee (FOMC) met on June 19th and decided to leave the fed funds target rate range unchanged at 2.25-2.50%. From our perspective, we think the outcome of the Fed's June meeting was notable for a couple of reasons.

To the surprise of many, the FOMC abandoned its use of the term "patient" to describe its approach to future policy changes. The "patient" language had just recently been adopted by the FOMC but was nowhere to be found in the FOMC's June statement. Instead, the FOMC revealed that it plans to "closely monitor the implications of incoming information for the economic outlook and will act as appropriate to sustain the expansion..." (Emphasis added). The FOMC's pivot to a "ready to act" policy stance was a significant monetary policy development. We believe it pretty much confirms that the interest rate tightening cycle has officially come to an end. One voting FOMC member, James

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Bullard, voted against leaving the fed funds target rate unchanged, as he preferred to lower the target rate range by 25 basis points at the June meeting.

The FOMC's change in its policy stance was sudden and fairly dramatic. The revised "dot plot" that is released along with the FOMC's statement showed that eight of 17 Fed officials now expect a rate cut by the end of the year, with seven suggesting 50 basis points (bps) of rate cuts by year-end. Bond traders are feeling somewhat vindicated by the FOMC's revised policy stance as they have been pricing in the possibility of a rate cut for some time. While market conditions can change rapidly, it looks like the next move by the FOMC will be a rate cut. Fed funds futures are currently pricing in a 100% probability of a rate cut in July (78% 25bps cut, 22% 50 bps cut).

The FOMC's June meeting was also notable because Fed Chairman Powell seemed to tweak his comments about the significance of persistently low inflation. In his post-meeting press conference, Powell acknowledged that the FOMC was less confident in its previous pronouncements that low inflation readings were "transitory" in nature. He made a point to mention that wage growth was unlikely to "provide much upward impetus to inflation" and that weaker global growth could continue to hold inflation down around the world. Financial markets interpreted these dovish comments to mean that the FOMC would, if necessary, consider cutting interest rates to address stubbornly low inflation levels. The FOMC meets again on July 31, so stay tuned for more policy developments.

We think municipal bonds will continue their strong performance during the second half of this year. As a general matter, bonds perform well in a slow growth, low inflation environment. If current economic trends persist, the second half of this year looks like it will meet both of these criteria. Default rates of investment grade municipal bonds have remained at historically low levels. The credit quality of all our investment portfolios remains very strong.

The summer months are historically a period of net negative issuance (which occurs when the amount of maturing debt and refunded securities exceeds the supply of new issuance) for the municipal bond market. This tends to support bond prices. Citigroup estimates that over the next three months there will be -$47.7 billion in net tax-exempt issuance. At the same time, retail and institutional demand for municipal bonds continues to be very strong. Taken together, all of these factors should help support the municipal bond market in the coming months.

Thank you for investing with Dupree Mutual Funds. Please don't hesitate to contact us if we can be of any assistance. Enjoy your summer!

Sincerely,

Allen E. Grimes, III

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President