DUPREE MUTUAL FUNDS

September 30, 2020

Dear Shareholder:

Compared to the first half of this year, the third quarter of 2020 was relatively uneventful for the municipal bond market. Bond market volatility was muted, and yields continued to grind slightly lower (i.e., prices moved higher). Despite ongoing worries about the fallout from COVID-19, credit conditions in the investment grade municipal bond sector have continued to hold up remarkably well with only a small number of issues receiving credit downgrades. Favorable supply-and-demand dynamics have continued to act as a tailwind for the municipal market. The Bloomberg Barclays Municipal Bond Index provided a total return of 1.23% for the third quarter and 3.33% on a year-to-date basis.

One slightly unexpected recent development in the municipal market is worth noting. On the supply side, state and local governments are issuing *taxable* municipal bonds at a record pace due to falling interest rates and the 2017 tax-cut law that restricted issuers' ability to advance refund tax-exempt issues. The low interest rate environment has allowed state and local governments to refinance debt with *taxable* securities that cost less than what they are paying on outstanding tax-exempt bonds. So far this year, state and local governments have issued close to $100 billion in debt subject to federal income taxes. If the current pace continues for the remainder of this year, the supply of *taxable* municipal bonds may come close to or even surpass the $154 billion in taxable bonds issued in 2010 when the Build America Bond program expired. This refinancing activity should help ease budgetary fiscal pressures.

The credit quality of all of our investment portfolios remains very strong. We have taken proactive steps in a few of our funds to eliminate or reduce our positions in certain credits where we felt those holdings had a higher-than-average risk of a potential credit downgrade. Most of the bonds that we have sold (which represent only a small fraction of our overall investment portfolios) were in sectors that have been disproportionately impacted by COVID-19. Examples of such sectors include, but are not limited to, convention centers, airports, small colleges, and small rural hospitals.

From a portfolio strategy perspective, we have a current bias towards essential service revenue bonds that finance critical services such as water, wastewater, and electricity. Essential service bonds offer stable and sustainable revenue streams that are better protected in an economic downturn. We also currently favor bonds issued by school districts, flagship universities, and high quality national and regional health systems. Our portfolio managers are being extra careful when it comes to security selection, and they are spending a considerable amount of their time and efforts watching over all of the holdings in each of our investment portfolios.

The issue of providing additional financial assistance to states and localities is still under consideration by Congress. It looks increasingly unlikely that this matter will be resolved before the election. Regardless of whether additional federal aid is forthcoming, we think it is worth

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bearing in mind that state and local governments have a wide variety of tools at their disposal to recover lost revenues and manage their finances. Fortunately, most states entered the current economic downturn in relatively strong financial positions, many with sizeable rainy day reserve funds. Additionally, property tax revenue, which supports local debt issued by cities, towns, and counties, has increased as a result of a housing-sales boom stimulated by low mortgage rates.

Federal Reserve Update

As expected, the Federal Reserve Open Market Committee ("FOMC") left the federal funds target rate unchanged at 0 to 1/4% at its September meeting. However, in a surprise policy change, the FOMC adopted explicit forward guidance and indicated that any future interest rate hikes would be on hold until "inflation has risen to 2 percent *and is on track to moderately exceed 2 percent for some time*." (Emphasis added).

In short, the FOMC has adopted what economists call an "inflation overshoot" into its forward policy guidance. This shift in strategy will permit the FOMC to worry less about fighting inflation and to focus more on achieving maximum employment and improving living standards. This represents a significant departure from past FOMC policy which has always been heavily tilted towards fighting inflation. Many of you probably remember Paul Volcker's brute-force campaign in the late 1970s and early '80s to tame inflation. It appears that, after all of these years, the thinking at the FOMC has evolved.

As a practical matter, the new policy guidance means that interest rates will likely remain anchored at their current low levels for an even longer period of time since the FOMC has indicated that it will not start tightening monetary policy as early in the cycle, even if inflation reaches 2%. The FOMC's updated economic projections which were released at the September meeting indicate that the majority of FOMC members don't expect interest rates to rise before 2023. A stable interest rate environment should help municipal bonds continue to perform well.

New Online Access Shareholder Portal

We are pleased to announce the recent launch of Dupree's upgraded online access portal. The new portal offers a more user-friendly interface, easier navigation, and enhanced security features. Please note that all shareholders who wish to access the online portal must register with a new user id, even if they were previously registered under the old system. Shareholders may register by following the "Online Access" tab at www.dupree-funds.com. Please call us if you need any assistance with the registration process.

Thank you for the continued confidence that you have placed in us.

Sincerely,

Allen E. Grimes, III

Allen E. Grimes, III
President