Dupree Mutual Funds

March 31, 2021

Dear Shareholder:

Municipal bonds turned in a mixed performance during the first quarter. In January, the municipal bond market got off to a solid start and posted positive total returns. However, things quickly changed in February when an unexpected surge in Treasury yields led to a broad-based selloff in all fixed-income markets. Yields on 10-year Treasuries increased 83 basis points during the first quarter. Yields on 10-year benchmark AAA-rated municipal bonds moved higher in tandem with Treasuries, but to a lesser degree (41 basis points) during the first quarter. As yields rise, bond prices decline.

A number of factors contributed to the sudden spike in yields. Increased optimism about the progress of the COVID-19 vaccine rollout and the re-opening of the economy led many, including the Federal Reserve, to raise their economic growth forecasts. The Federal Reserve is now projecting that real GDP will increase at a 6.5% rate in 2021. The recent passage of an additional $1.9 trillion economic stimulus package (the "American Rescue Plan") and the prospect of a $2.25 trillion infrastructure bill also contributed to the surge in yields. All of these developments caused the market to increasingly focus on, and price-in, upside risks to inflation.

Yields on Treasuries and municipal bonds decoupled somewhat in March with municipal yields moving lower (prices higher). An improving credit outlook, favorable supply and demand patterns, and the prospect of higher taxes under a new administration all contributed to a slight rebound in municipal bond prices during the month of March. Despite the ups and downs of the market, municipal bonds ended the first quarter almost flat with the Bloomberg Barclays Municipal Bond Index providing a total return of -0.35%.

State & Local Assistance:

The American Rescue Plan is the sixth stimulus bill passed since the onset of the pandemic and the largest to date. In the aggregate, enacted COVID-19 relief funding now stands at $5.2 trillion. The American Rescue Plan provides $350 billion to state and local governments to make up for the financial toll caused by the pandemic. The financial aid will be apportioned based on the share of unemployed workers in each state, meaning larger states will receive the most aid. Approximately $195 billion of the aid package is being allocated directly to states. Local governments across the country will receive approximately $130 billion, split evenly between municipalities and counties. The aid is expected to be released in two tranches, with the first funds required to be delivered by mid-May.

Under the funding formula estimates, Kentucky will receive $2.4 billion in state assistance; Tennessee will receive $3.8 billion; Alabama will receive $2.1 billion; Mississippi will receive $1.8 billion; and North Carolina will receive $5.2 billion.

The stimulus funds come with certain restrictions and must be spent by December 31, 2024. In short, the funds can be used to respond to the COVID-19 public health emergency or its negative economic impacts; support essential workers; provide public services in an amount up to the decrease in revenue versus the prior fiscal year; and finance water, sewer, and broadband infrastructure projects. There are two restrictions: (i) funds cannot be deposited into pension funds and (ii) funds cannot be used to "either directly or indirectly offset a reduction in the net tax revenue." The tax cut restriction clause does not apply to localities, but the pension clause language remains intact. In the coming months, the Treasury Department will be issuing formal guidance that provides further clarification about permissible uses for the aid money.

Earlier this year, Moody's Analytics estimated that state and local governments needed about $61 billion in additional aid to cover budgetary shortfalls through 2022 (after taking into consideration federal aid already received before the American Rescue Plan). Pretty much everyone is in agreement that the amount of financial aid provided is very generous. The stimulus should be more than enough to make up for any lost tax revenues and will allow most state and local governments to close any budget shortfalls. Many jurisdictions will likely use the funds to replace depleted reserve funds, and some may even be able to deposit funds in their rainy day funds.

Moody's, Standard & Poor's, and Fitch Ratings have all raised their outlook on the credit ratings of state and local governments to stable from negative noting that the aid will help stabilize finances and make up for revenue lost during the pandemic. Sectors that were hit especially hard by COVID-19 such as mass transit, airports, convention centers, toll roads, and higher education will receive an immediate boost from the new round of financial assistance.

Overall, the passage of the American Rescue Plan is a big win for the municipal bond market. Now, as one commenter aptly noted, the hard part will begin--giving away all of the money! An improving credit outlook, strong supply and demand technical factors, and anticipated tax reform should all help to support municipal bond prices in the coming months.

Federal Reserve Update:

The Federal Reserve Open Market Committee ("FOMC") met on March 16-17 and decided to keep the target range for the federal funds rate unchanged at 0 to ¼ percent. The FOMC reaffirmed its current interest rate stance and also announced that it will continue its asset purchases. Chair Powell's post-meeting press conference comments and his subsequent testimony to Congress suggest that he does not expect that the fed funds rate will be increased before late 2023. He also made it clear that he believes that any stimulus-induced inflationary pressures will likely be "transitory" in nature.

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

Sincerely,

Allen E. Grimes, III

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