Dupree
Mutual Funds

December 31, 2022

Dear Shareholder:

An aggressive interest rate tightening campaign by the Federal Reserve ("Fed") and persistent inflation led to a challenging fixed-income market in 2022. Investment grade municipal bonds posted a loss of -8.53% for the 12-month period according to Bloomberg index data, the worst annual performance since the early 1980s. The year was unsettling to investors who value municipal bonds for their safety and stability.

As bad as this year's performance might seem, it is worth noting that municipal bonds outperformed most other fixed-income asset classes including U.S. Treasuries, investment grade corporate bonds, and even high yield corporate bonds. There is no denying that 2022 was a tough year for the municipal bond market; however, on a comparative basis, municipal bonds held up relatively well in what was a punishing market.

The Fed raised the fed funds target rate a total of 425 basis points during the year. The Fed last met on December 14 and raised the fed funds target rate by 50 basis points to its current level of 4.25-4.50%. The December meeting was notable because the Fed trimmed its rate hike to 50 basis points from previous rate hikes of 75 basis points. The Fed also reiterated its commitment to lowering inflation to 2% and tightening further. Most economists are forecasting at least another 100 basis points in rate hikes before the Fed pauses.

For the municipal bond market, 2022 was all about "normalization" which meant higher yields and lower bond prices. Due to the inverse relationship between bond yields and prices, municipal bond valuations declined significantly in response to a surge in municipal bond yields.

With 2022 now in the rearview mirror, the focus naturally turns to the question of what next year might have in store for the municipal bond market. We have always doubted the wisdom of so-called financial "experts" trying to make annual market predictions. We instead subscribe to the view that following a consistent, disciplined investing process will invariably lead to better outcomes than trusting the predictions of financial experts. As portfolio managers, we plan on adhering to that process in the coming year and thought it might be useful to briefly mention a couple of factors that we think may have the greatest impact on the municipal bond market next year.

Municipal bond returns during the past ten years have been negative just twice—the first time was in 2013 which coincided with the Fed's "taper tantrum," and the second time was in 2022. This steady history of delivering mostly positive returns (even in a decade long low-yield environment) is a testament to the power of the "income" component of bonds. The income component of fixed-income returns accounts for close to 90% of returns for periods as short as five years. With current yields resetting at higher and more attractive levels, the case for owning high quality municipal bonds as part of an overall investment portfolio has become even

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stronger. While the “normalization” process currently underway has been painful in the short-run, ***long-term fixed-income investors should view higher yields as a gift***. Historically, fixed-income investors who have stayed the course through the ups and downs in the market have almost always been rewarded for their patience with higher absolute returns.

Municipal bonds have demonstrated a tremendous amount of resiliency both after periods of market declines and after the Fed finishes an interest rate tightening cycle. Municipal bonds have posted positive total returns in the 12 months immediately following market declines for the past 30 years. Additionally, following the last interest rate hikes of the previous seven Fed tightening cycles (going back to 1984), municipal bonds have provided consistent positive performance in the subsequent six-month, one-, three-, and five-year time periods. While past performance doesn’t necessarily guarantee future performance, this strong track record suggests that municipal bonds may rebound in the coming year.

The possibility of the economy tipping into a recession looks increasingly likely. Fortunately, the fiscal health of state and local governments continues to be very strong. Overall, a combination of factors including, but not limited to, the approaching end to the Fed’s tightening cycle, moderating inflation, higher yields, strong credit fundamentals, and improved investor sentiment should serve as catalysts for the municipal bond market next year. We are cautiously optimistic about the prospects for municipal bonds in 2023.

Capital Gains Distributions

Capital gains distributions were made in two of our Funds this year: (i) the Alabama Tax-Free Income Series and (ii) the Mississippi Tax-Free Income Series. Capital gains distributions were made on December 15, 2022—separate from and prior to end-of-year dividends. These capital gains distributions, along with all transactions made in your accounts in 2022, will be reflected on your end-of-year statements.

Thank you for investing with us. Happy New Year!

Sincerely,

Allen E. Grimes, III

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President

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