Dupree Mutual Funds

June 30, 2024

Dear Shareholder:

The municipal bond market turned in a mostly flat performance during the first half of this year with the Bloomberg Municipal Bond Index providing a total return of -0.40%. Higher rates led to a decline in bond prices; however, the price declines were offset by the "carry" or income stream generated by tax-free municipal bonds.

Bond issuance in the first half of 2024 is close to 35% above the five-year average. The surge in supply coincided with relatively subdued demand as many investors seem content to hold cash until there is further clarity on the timing of the Fed's future interest rate cuts. Bond issuance is expected to stay elevated for the foreseeable future.

In addition to supply and demand, two other issues are likely to have an outsized impact on the municipal bond market in the second half of this year: (1) potential interest rate cuts by the Fed and (2) the 2024 presidential election.

The Fed last met on June 12 and opted to keep the fed funds target rate range unchanged at 5.25% to 5.50%. The Fed reiterated its "higher for longer" message and modified its forecast, signaling that there will likely be only one rate cut in 2024. The Fed's updated forecast now predicts that there will be as many as four rate cuts in 2025.

When the Fed finally pivots and begins its easing cycle, we expect that the yield curve will transition from its current inverted shape to a more upward-sloping trajectory as short term yields decline faster than long term yields. Historically, tax-exempt bonds have outperformed similar-duration taxable bonds (i.e., Treasuries) in declining rate environments. With inflation gradually receding and rate cuts around the corner, the stage is set for municipal bonds to outperform.

U.S. presidential elections typically have little impact on municipal bond returns. According to data compiled by *Bloomberg Intelligence*, going back to 1980, municipal bonds posted losses for the fourth quarter in only 2 of 11 election years (1980 and 2008). But, as we all know, elections have consequences. The main consequence for the municipal bond market this election cycle will be the effect on individual income tax rates, as select provisions of the Tax Cuts & Jobs Act (TCJA) will sunset at the end of 2025.

The Congressional Budget Office (CBO) just released its latest fiscal update, and it contains some sobering numbers and projections. For example, the CBO's projected deficit for this fiscal year will hit 7% of Gross Domestic Product. By late 2034, the federal debt will top $50 trillion, and the federal government is then projected to spend more than 40% of all individual income tax revenue on debt service.

Given the current state of this country's fiscal affairs and the projected trajectory of the federal deficit, the political party that prevails in the upcoming election will be faced with making some tough decisions with respect to future tax policy. Regardless of who wins, one thing seems pretty clear: there is almost <u>no</u> chance that individual tax rates will be <u>lowered</u>. Especially for investors in the highest tax brackets, the value of the municipal bond tax-exemption has never been more important.

The U.S. Securities & Exchange Commission recently adopted rule and form amendments that require mutual funds to transmit "concise and visually engaging" annual and semi-annual reports to shareholders that highlight key information about their fund investments. As such, our new "tailored shareholder reports" will have a fresh look. The rule requires that tailored shareholder reports be sent directly to investors, but this material will also be posted on our website.

As always, we appreciate the confidence that you have placed in us.

Sincerely,

Allen E. Grimes, III

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