December 30, 2016

Dear Shareholder:

Bond yields have risen suddenly and dramatically (prices falling) since the election on November 8. The spike in yields was completely unexpected and caught financial markets and most investment advisers (including yours truly) off guard. Yields on 10 year AAA-rated municipal securities have increased by over 75 basis points in a little over six weeks. That's a big move in a short period of time! On December 14, the Fed also raised the target range for the fed funds rate to ½ to ¾ percent. Many of you are probably wondering what the heck is going on and what to expect in the New Year.

Expectations for higher interest rates have climbed following Donald Trump's election win. The market is betting that a new Trump administration will add a significant fiscal boost to the economy that will lead to higher growth rates, higher inflation, and higher budget deficits. This "reflationary" thesis has led to a pronounced selloff in bonds with yields rising and prices plummeting. The prospect of lower corporate and individual tax rates under a new Republican administration also helped fuel the selloff, particularly in municipal bonds.

Make no mistake; if all of this comes to pass, it is not bond-friendly. Some in the financial press are saying bond prices will decline for an indefinite period of time. In my sixty one years in the municipal bond business, I have witnessed a number of bond market declines (big and small) and, just like clockwork, eager stock brokers and some in the financial press have started warning that "now might be the time for investors to abandon fixed-income portfolios." I may be wrong, but my advice to you is "don't believe the hype." I'm a cautious optimist who believes good things happen just when you think they won't.

In the case of the bond market, I am confident it will find its equilibrium. From our perspective, higher yields present an opportunity for fixed-income investors, who have been starved for yield for the past eight years, to invest cash at a higher yield and help build long-term growth. When interest rates rise, new bonds pay a higher coupon, increasing the income investors receive. Interest income is the primary driver of bond returns.

Bond prices may well continue to be volatile for the next few months and perhaps even longer. While markets have reacted sharply to the election results, the truth is, it will take a significant amount of time for what has now been dubbed "Trumponomics" to unfold. Even if higher growth rates, higher inflation, and higher budget deficits are in our future, it will take time for all of this to occur. There is a good chance that proposed tax law changes may not take effect until 2018. It typically takes lots of time and effort to

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pass and implement infrastructure spending plans. In the meantime, what we have now is an economy that is sputtering along at a moderate pace, low inflation levels, and tons of money sitting in banks, unused.

If you are one of those investors thinking about cashing out and getting back in the bond market someday, I think you might be making a mistake. Experience has taught me that bond investors should be in their investments for the long haul. We have voluminous records of our monthly fund prices and dividend histories dating back as long as thirty seven years in the case of the Kentucky Tax-Free Income Series. If you put these figures together you get a number which is known in the industry as "total return." Looking at these numbers one is immediately struck by how stable the total returns are over longer periods of time. Past performance doesn't necessarily guarantee future results, but I can tell you the numbers definitely support taking a long term approach to fixed-income investing.

Buying high quality bonds and holding them for the long term is almost always a winning strategy. You need to think in ten year segments or maybe even twenty. The irony of a panicked bond investor who sells when bond prices are falling is that he or she typically doesn't realize that their dividend hasn't gone down at all. Even when prices decline, the coupon value of a high quality bond portfolio is still providing meaningful cash flow to an investor.

I have worn out some of our long term shareholders with my milk-cow story, but this is the time and place to remind you of it again:

Bond investing is like buying a milk-cow;

You go to the livestock market in town and buy the best milk-cow you can find;

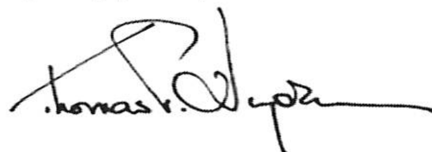
You choose the one that looks healthy and gives the most and best milk, and pay;

You take her home and enjoy the milk she gives.

You do not go back to the market to find her price every day. You have already paid the price for her and were satisfied it was fair. You are wasting your time at the livestock market because you were buying the milk, not the cow.

We appreciate the trust you have placed in us. I hope you have a Happy New Year!

Very truly yours,



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