



December 31, 2011

Dear Shareholder:

One of my favorite newspaper columnists is Joe Creason, now deceased, who wrote for the Louisville *Courier Journal*. His forte was traveling around the rural parts of Kentucky recording funny stories, written in the dialect found in the hills and hollows of our commonwealth. I've got a book of Creason's stories that I love, and I re-read it about every other year. I'm getting old. I forget what's in a book in about two years. So, while re-reading, I am always just as surprised and amused as I was on the first reading (Old age has its compensations.) Joe Creason was an avid tennis player; in fact, they tell me he died of a heart attack chasing down a hard passing shot. Tennis is the game that I still play at 81 years of age to help hold back the Parkinson's problems I have. The other morning I took a painful spill on the court and, thinking of Creason, I went looking for my copy of *Joe Creason's Kentucky*.

That same morning, I read in the *Wall Street Journal* about the plans of some central banks in Europe to return to printing money, anticipating the possible dissolution of the European Union and the abandonment of the Euro as currency. Think about that for a minute! If you were in the export business would you want to accept freshly printed currency, either in cash or by electronic deposit, as payment for your real and valuable goods or services? You really would have little choice if you needed to make the sale. This explains why China holds so much of our Treasury bond debt. They accepted the bonds in payment for goods exported to the U.S.A. (U.S. Treasury bonds are simply dollars with a maturity date and an interest rate.) The question generates even more anxiety when you read that the various members of the euro-area don't want to loan to each other. Are you going to want to hold their bonds while knowing they won't?

Creason tells of two women talking to each other outside a small town bank in rural Kentucky. "Well," one said to the other, "have you saw airy a sight or heered airy a wonder this week?" (After reading that *Wall Street Journal* article I knew I had. And that wonder is that the U.S. Federal Reserve Bank may step in to bail out these European banks when and as needed. The Fed will print the money to loan the Europeans, and they will print the money to pay us back.)

Around the streets of Lexington I often run into our fund shareholders who ask me "What's going to happen to the economy now?" I reply that "I can't imagine who knows." Many banks, under the strains that are currently present in Europe seem near certain to fail, and once a few fail, even well capitalized banks may follow as panic spreads. Lehman Brothers is an example of panic driven failure that took place here in the United States. Lehman was in pretty fair financial condition; nevertheless, once depositors begin to lose faith, failure often becomes self fulfilling. That there are not multiple failures taking place right now makes me think the market believes there is a lender-of-last-resort out there somewhere. Folks have been waiting on Germany to do the deed, but Frau Merkel is good at the game of "chicken". Who will come to the rescue? You guessed it, the aforementioned Ben Bernanke and the U.S. Federal Reserve.

There are seventeen sovereign countries that make up the Euro Union. Greece, one of the seventeen, is most known to be near failure. Deficit spending on the “good life” has gotten Greece in trouble. What is not so well known is that Spain, Italy and perhaps even France are almost in the same condition! The currency of the whole euro union may collapse. Anticipating this, our Federal Reserve Bank is actually moving forward with plans to bail them out by “printing” dollars. This comes after watching the central banks of Germany and France refuse to make such guarantees. Why the Fed would agree to this goes far beyond anything for which my undergraduate degree in economics has prepared me. Perhaps the Fed believes failure of the Euro will take us down as well, and that is possible. One thing is for certain, if we support the Euro, they will not pay us back for the simple reason that they will not be able to do so.

What does this say to us? It says “be careful.” Don’t spend a lot; increase your personal savings. Use only well capitalized banks. I am convinced there are many banks, perhaps most banks in the rural south (our home territory), that will remain solvent through the worst of times (should they materialize). Likewise I believe that most bond issues will pay interest and principal on time through the worst of times. But be careful.

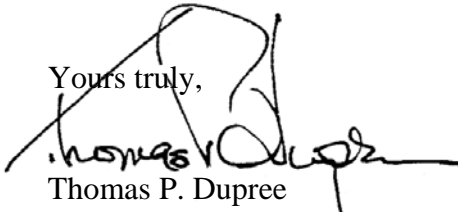
Joe Creason tells a tale about checking on your bank. “Years ago, when some people really didn’t understand banks an old mountain man in Perry County, Kentucky, finally was convinced he should take the money he kept buried in a coffee can in the back yard and put it on deposit in a Hazard bank. The very next morning he appeared at the bank to withdraw his treasure.

When the money was handed to him, he stood at the cashier’s window and slowly counted it twice.

‘Isn’t it all there?’ the cashier asked.

‘Yep’ came the grudging reply, ‘but just barely!’”

All is not “doom and gloom.” I want to say as the year ends and 2012 begins that I believe there are a few positive signs that we may slowly work our way out of this recession. The U. S. economy is still the world’s largest, our dollar is still the world’s reserve currency; investors everywhere flee to U. S. Treasuries for safety in spite of their lowered rating. We have lots of good things going for us. If we face our problems honestly, things will likely resolve over time. Be of good cheer and Happy New Year!

Yours truly,

Thomas P. Dupree
President