



June 30, 2009

Dear Shareholder:

The State of the States:

Stories about state budget troubles, particularly in California, litter the news these days. To be sure, most states are under a significant amount of fiscal stress. Tax revenues from sales, personal income, and corporate income taxes have declined dramatically in almost all states as the economy has contracted during the recession. The five states in which we operate municipal bond funds (AL, KY, MS, NC & TN) are among the many states dealing with significant budget shortfalls. We thought it might be helpful to comment briefly on the progress states are making in balancing their budgets (which they are constitutionally obligated to do), and what we are doing on our end to oversee your investments during these trying times.

Most states have employed a combination of budget solutions that involve drawing down reserve funds, cutting services, raising taxes, and maximizing the use of federal stimulus dollars. According to the Center on Budget and Policy Priorities, so far this year twenty three states have enacted tax increases and another thirteen are considering such measures. The tax increases vary by state and include increases in personal income tax, sales taxes, business taxes, tobacco and alcohol taxes, and motor vehicle taxes and fees. Most of the tax increases have been structured so that they will bring in recurring streams of revenue. Raising taxes in a recession is not a new idea. In response to the recession of 1990-91, forty four states increased taxes significantly; thirty states raised taxes in response to the recession of 2001. It is the ability of a municipal bond issuer to raise taxes that makes a municipal bond a stronger credit, rating for rating, than a corporate bond.

In February, Congress enacted the American Recovery and Reinvestment Act of 2009 (ARRA) to provide fiscal relief to state and local governments. The ARRA includes a variety of measures that are nominally worth \$787 billion. Approximately \$250 billion of this has been set aside for state and local governments to assist with state budgets and for investments in infrastructure. The federal stimulus aid is arriving at a crucial time and is allowing states to close budget shortfalls. Early reports suggest that the federal aid is enough to close roughly 30-40 percent of state budgets. Most states expect budget problems to continue at least through 2011, so many states are planning to time the use of federal stimulus dollars so that the funds will be available over a three year period which the federal law allows.

States are also balancing their budgets by cutting services and general fund spending. The National Governors Association and the National Association of State Budget Officers conducts a *Fiscal Survey of States* and for the first time in the 32-year history of the survey state spending is expected to decline two years in a row: FY 2009 general fund spending is

P.O. Box 1149
Lexington, KY 40588-1149
Tel: 859-254-7741
800-866-0614
Fax: 859-254-1399
www.dupree-funds.com

estimated to decrease 2.2 percent, while governors' proposed budgets for FY 2010 show a 2.5 percent decline in spending.

The bottom line is that states are successfully addressing budget shortfalls through a variety of tried-and-true measures. Make no mistake about it, balancing state budgets is a painful process--but it is working. As the economy recovers, tax collections should rebound which will make balancing state budgets less painful.

In the meantime, the credit quality within our municipal bond portfolios remains high and every bond in our funds continues to pay principal and interest on schedule. Buying and selling bonds is just a small part of what we do every day. Keeping a close eye on what we own is equally important. Our portfolio managers spend a considerable amount of time each day monitoring bonds held in the various fund portfolios.

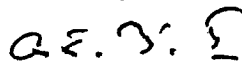
The goal of our portfolio monitoring activities is to quickly and proactively identify any potential problems that may develop with a bond, so that we can react before a bond actually becomes distressed. Reviewing financial statements of issuers, monitoring debt service coverage levels, and tracking ratings and price changes are just a few of the things we look at on a regular basis. If we identify a bond that we believe may develop problems, invariably we will sell it. With unprecedented volatility in financial markets, we're keenly aware that portfolio monitoring has never been more important.

Celebrating 30 Years:

The Kentucky Tax-Free Income Series was started thirty years ago on July 3, 1979 with less than half a million in net assets. The fund has grown steadily over the years and as of June 30, 2009, had total net assets just shy of \$800 million. Although they haven't been around as long, our eight other funds have also experienced tremendous growth. During the past thirty years we've survived a number of challenges, ranging from the near collapse of the bond market shortly after the fund was opened to the more recent tax challenge that resulted in the U.S. Supreme Court upholding the tax exemption for municipal bonds. I'm confident that with hard work and a little luck we'll survive whatever challenges come our way during the next thirty years.

Having said that, we also realize that without you, our shareholders, we wouldn't be where we are today. On behalf of everybody here at Dupree Mutual Funds, thank you for your ongoing support. We look forward to serving your investment needs in the future.

Sincerely,



Allen E. Grimes, III
Executive Vice President