

November 9, 2009

Dear Shareholder:

I am well into my 55th year in the investment business, having completed 54 years this summer. During every minute of that time I have specialized in municipal bonds. In the early years I sought to be the fiscal agent of municipal clients. A fiscal agent advises the State, a City, County, School District or other political subdivision in every facet of marketing their municipal bonds. These are bonds that they may need to issue in order to finance a public project. This could include roads, bridges, a school building, floodwall, airport, football stadium, basketball arena, hospital or City Hall and publicly owned water, sewer and electric facilities, to name only a few.

At the same time we competed for the fiscal agency business we also attempted to sell municipal bonds to banks and trust companies. So that was my primary training.

I left the U. S. Navy after three years of service and joined my father in Harlan, Kentucky to "learn the business". The plan was, that I would later go on to a large New York institutional firm, Blyth & Co., and that I would have some grassroots experience that would give me a leg up. My father made me work the telephone until noon selling municipal bonds to country banks; then in the afternoon he would make me read, digest and organize files of small municipal bond deals he had done. When I thought I was ready, I would have to sit down in front of him and reiterate in chronological order every step from beginning to end that was required to get those bonds marketed. Then at least one or two days of every week I traveled in order to visit those banks I had been calling, to establish a more personal connection. While I was in town I also called on school superintendents, mayors and County Judges to see if they were in need of a fiscal agent to advise them on the issuance of bonds for an upcoming project.

I began by serving banks and municipal clients in the mountains of eastern Kentucky and am still "partial" to that part of the state. I put over 50,000 miles on a car each year and later, when we wanted to expand our clientele to Louisville and Lexington I bought a partnership in a Cessna 182 with Vernon Cole, a Harlan banker who was an ex-SAC pilot, and then I flew myself to those cities to call on the banks and large trust companies. I was a bit of a "curiosity" with my "Bus Terminal Bldg., Harlan, KY" address. One Trust officer claims I sent in my business card, and when he did not appear to welcome me, I asked for the card back so I could use it in the offices of one of his competitors. That made him come out to see what kind of creature was waiting there.

In 1963 the Ashland KY School District had enough confidence in me to allow me to try to "advance refund" an outstanding bond issue of theirs. When you advance refund a bond issue you pay it off by issuing new bonds and escrowing the money until the old outstanding bond issue can be recalled, usually several years later. While the money is waiting in escrow it could (at that time) be invested at a profit. We got the approval of the Kentucky Court of Appeals to do this and it was such a well written opinion that the case was referred to in most of the advance refunding bond deals done in

other states as well. It was successful in saving the Ashland School District something in excess of \$300,000 and was instrumental in relocating Dupree & Company to Lexington. The school board chairman indicated he was afraid to let somebody with a Bus Terminal Bldg., Harlan, KY address work with Ashland's school money. We moved!

Then later, in 1979 we started the Kentucky Tax-Free Income Fund to manage an investment portfolio of Kentucky Municipal Bonds for shareholders. In spite of a case of bad timing (July 1979 we started the fund; October of 1979 Paul Volcker raised interest rates, depressing the bond market) the fund ultimately became a howling success.

What have I learned?

**That:** through all the economic ups and downs; all the market fluctuations, there is nothing quite as rewarding as owning a security which promises to pay interest every six months and principal at a stated maturity date in the future. Regardless of where the price goes, which is a function of changing interest rates and other factors, ultimately you will get the principal and interest promised so long as there is no default. Selecting shorter term bonds serves to stabilize the price of a portfolio because the repayment date is much shorter, holding the price near its maturity value.

**That:** we must work constantly to monitor our various portfolios (9 in all), and to proactively identify and sell any bond that might conceivably default at some point in the future. The result has been a stable performance all through the 2008 market selloff.

**That:** in the entire 54 years of my career, there has ALWAYS been a threat from Washington to do away with tax-free municipal bonds. These threats come from IRS people who think bond holders are "rich", or from professional staff people in the Treasury Department who are committed federalists. They haven't succeeded yet.

**That:** liquidity is not important until you need it, then it is indispensable.

**That:** there will be other bubbles as time goes by. People will never stop gambling, will never stop getting excited, or greedy, or both. That reminds me of a story about a habitual gambler who played the horses constantly. One day he lost a very large amount of money. "I'll never bet again!" he declared to a friend. "I'll bet you \$100 you will." The friend replied. "I'll take that bet" the gambler replied, reaching for his wallet.

**That:** In bad times, good things are happening too; we just don't notice!

Sincerely,

Thomas P. Dupree, President