

December 31, 2009

Dear Shareholder:

The Value of Staying the Course:

The theme of the year-end letter to shareholders last year was one of turbulence and adversity. Financial markets in 2008, including the municipal bond market, suffered a dramatic meltdown. Our funds did not escape unscathed. The share prices of many of our funds reached lows not seen in many years. Throughout all of this, we experienced almost no market-related redemptions as our shareholders wisely decided to stay the course. We thanked you at the time for not pulling money out of our funds because it kept us from having to sell bonds in a distressed market and permitted us to buy bonds at bargain prices.

This year, instead of thanking you, we want to congratulate you. Beginning in early 2009, the municipal bond market began what turned out to be a year-long rally. Avoiding the knee-jerk reaction of panicking and selling shares at the worst possible time has paid off for you as the share prices of our funds have bounced back nicely from their 2008 lows. Additionally, you have continued to collect a steady stream of tax-free income. A variety of forces acted to push the prices of municipal bonds higher over the past twelve months. We have discussed most of these factors in previous shareholder letters, but I'll mention a few of the more important ones again.

The economic stimulus package was good news for state and local governments as it provided timely relief to governments struggling with substantial budget deficits. The introduction of taxable Build America Bonds as part of the stimulus package has reduced the supply of new tax-exempt bonds thereby increasing prices of bonds already issued. A tremendous amount of money sitting in cash or cash-equivalents earning near-zero yields flowed into the municipal bond sector keeping demand for tax-exempt bonds at high levels. Strong demand from retail and institutional investors coupled with a limited supply of bonds led to strong prices. Very low levels of inflation and expectations of higher tax rates also added to the attractiveness of municipal bonds.

Looking forward to 2010, we anticipate that many of these same forces will continue to act as support for the municipal bond market. The Build America Bond Program is authorized through the end of 2010 and may be extended which would continue to support prices of tax-exempt bonds. Moreover, there is still a tremendous amount of money sitting on the sidelines in low-yielding cash or cash-equivalents that

may be redeployed to the municipal bond sector in search of higher yields. Finally, inflation expectations seem to be well anchored which is bond-friendly news.

The Lost Decade (For Equities):

I was reading the *Wall Street Journal* the other day and an article caught my attention. The article which was published on December 21, 2009, was titled "Investors Hope the '10s Beat the '00s". The article highlighted the perils of investing solely in stocks as the primary way of saving for retirement. The article pointed out that the U.S. stock market is wrapping up what is likely to be the worst decade ever in recorded stock market returns. That dates all the way back to the 1820s according to data compiled by Yale University finance professor William Goetzmann. Since the end of 1999, stocks traded on the New York Stock Exchange have lost an average of approximately 0.5% a year thanks to the two bear markets of the decade.

It is interesting to compare that performance with an investment in our Kentucky Tax-Free Income Series during the same 10-year time period. The Kentucky Tax-Free Income Series had a total return of approximately 5.0% a year during that same time frame. We think that looks pretty good compared to an investment in stocks. Also, remember, you didn't pay state and federal income taxes on the income you received during the 10-year period. Additionally, the money you invested in our municipal bond funds has been used to build schools, bridges, roads, hospitals, airports and other vital infrastructure in your communities. An investment in municipal bonds has a "civic" component unlike any other investment. Please keep in mind that past performance is no guarantee of future performance.

I point out this disparity in performance over the last decade simply as a reminder of the importance of maintaining a well diversified portfolio. With the top two marginal tax brackets likely to increase next year and with Congress looking for ways to pay for healthcare reform, we think it will be more important than ever in the coming years to have some exposure to municipal bonds.

In Memoriam:

We are sad to report that Terry Schlernitzauer, one of our longtime employees and colleagues, passed away on December 29. Terry worked with us for twenty-seven years, most recently in our transfer agent department. She was a person who always put others before herself and she had a remarkable work ethic. We will miss her dearly. We feel privileged to have worked with her.

Sincerely,



Allen E. Grimes, III
Executive Vice President