Fourth Quarter Outlook

As of January 6, 2020

Economy In Review

Hudson Valley Investment Advisors ("HVIA") celebrated its 25th anniversary in 2020. We can certainly say that, especially based on the year's events, "nothing can substitute for experience!" 2020 was a year that witnessed a record drop and record recovery in Gross Domestic Product ("GDP") and the financial market indexes.

During our client conference call held in March, we indicated that the drop in markets would be a potential opportunity. Our view was based on underlying factors that were occurring in the economy and markets. These factors were not reflected in prices and did not equate to how interest rates had reacted. Our confidence was also based on unprecedented fiscal and monetary support being contemplated at the time. This stimulus would help bridge the economy to reach a point where the coronavirus was less of a factor.

As 2020 progressed, we saw the economic ingenuity of business in effect. Necessity is the mother of invention! Businesses, large and small, in all areas of the economy "pulled forward" technology to allow for virtual meetings, greater use of online interaction, communication and productivity. Some, not all, of these advances were expected over a period of years but were "pulled forward" in a much earlier period allowing for organizations to support profitability and enable employees to work from home. However, there were victims in this environment as close to 25% of the US workforce is involved in labor intensive hospitality services, such as restaurants and hotels, which are still experiencing a recession. These areas are needed to rebound, as they provide a large percentage of U.S. employment, which during normal times also has a multiplier effect throughout the economy.

Other risks to the economy seen in 2020 were mass demonstrations and a contentious political environment. Many cities saw a significant increase in protests, adding to negative economic impacts. The higher level of unrest, coupled with the ability to work, in many instances, from anywhere allowed for a large migration out of major metropolitan areas. This environment factored into elections as the Presidential office was won by President elect Joe Biden. It looks as though the Democratic Party did not get a clean sweep, as the House of Representatives lost ten Democratic seats and it appears that Republicans will hold onto at least a tie in the Senate. This outcome will set up a divided government, which will cause Democrats and Republicans to work together in order to pass legislation. This outcome was positively received by Wall Street as markets saw an upswing following the election.

As of this writing, pressure is mounting for Congress to provide additional fiscal stimulus in order to maintain current economic levels and act as a bridge until the COVID-19 vaccines are widely distributed. The level of Covid cases, hospitalizations and deaths appear to be resurging. This could prolong the hesitation of consumers and businesses to return to pre-pandemic activity. These factors lead to President Trump's decision to sign a stimulus legislation prior to leaving office. The likelihood of more stimulus is high once President Elect Biden takes office.

Markets saw a record rebound that discounted a return to "normalcy" and a push up of valuations. This was, in part, a response to the government's push to lower interest rates to record lows. Manufacturing looks primed for a rebound as inventories from housing, autos and goods of all types were at record lows as 2020 ended. Risks that have are attention include the interconnected global economy, the geopolitical friction with China, the Brexit situation and the large amounts of U.S. debt. We will continue to monitor all these items closely.

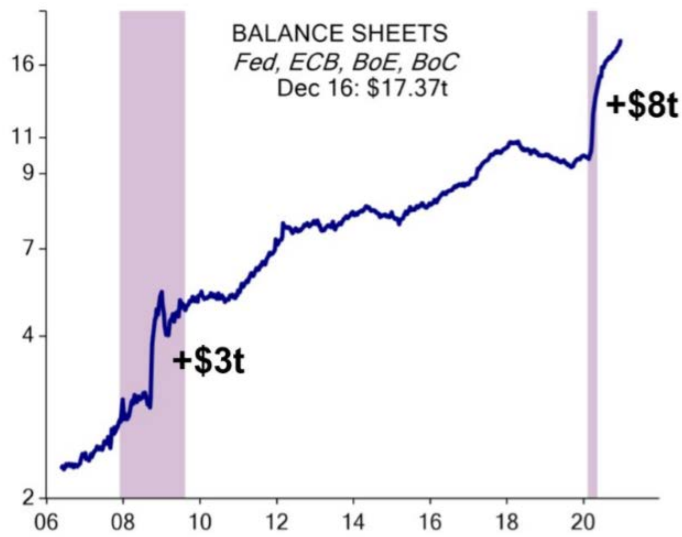
The S&P 500 recorded a gain of 12.15% for the fourth quarter. In terms of sectors, all 11 sectors reported positive returns for the quarter as many areas saw a reversion to the mean from prior quarters. Energy which had been negative for the year posted a positive quarterly returns was the top sector performer Energy (27.77%), Financials (23.22%), Industrials (15.68%, Material (14.47%), Comm Services (1.82%), Technology (11.81%), Consumer Discretionary (8.04%), Healthcare (8.03%), Utilities (6.54%), Staples (6.35%), and Real Estate (4.94%). This quarter was strong by historical standards and it shows discounting by investors of strong improvement moving in 2021.

As we look to 2021, we expect greater volatility. The transition from a period of vaccine distribution and the unwinding of lockdowns will have logistical delays and an impact on the economy. In addition, as "normalcy" returns we expect that various demographics will act differently to the way social and work settings open up. Political issues, both domestically and internationally, will continue to occur. We expect the re-engaging of U.S. led coalitions and the continuation of pressure on the Chinese for a global leadership position will cause friction. Lastly, we are watching longer term interest rates and inflation. The process of interest rates moving off their historical lows that occurred during the pandemic could be in its beginning stages.

Outlook

As we look toward 2021, we are expecting continued growth in the economy and ultimately equity market advancement. The underlying support comes from the largest amount of worldwide monetary and fiscal stimulus ever deployed. To provide perspective, the total U.S. economy represents 25% of worldwide GDP (approximately $21 Trillion for 2019). The additional global stimulus dollars stood at $18 Trillion added to economies so far during 2020. We have seen the equivalent of another U.S. economy added to the equation! Financial stimulus historically has taken 6 to 9 months to work through an economy. This impact will be seen most likely during the first half 2021 and will be significant in terms of economic influence. The quarter's strength is economic data looks to have bottomed and showing signs of improvement across a number of sectors.

The impact of the stimulus, coupled with low interest rates, a declining U.S. dollar (which helps exports), rising commodity prices and a low level of inventories that require replenishing, position the U.S. and the global economy for a solid rebound. However, it does not come without risk. We are closely monitoring the rollout of the Covid vaccines which will see hundreds of millions of doses administered worldwide by the end of the first quarter. Conversations with industry experts indicate that we can expect improvement in the COVID-19 situation by sometime around midyear. This means that the U.S. will have enough people who have been administered the vaccine or who have already been exposed to COVID-19 to start the return to "normal". This scenario would position the economy for "fun". What does that mean? We anticipate that based on the lockdowns and limited exposure to events, gatherings, travel and going to restaurants will see a strong pent up demand for these type of offerings as we move into the back half of 2021. We have monitored travel to Miami (singles), Orlando (families) and Hawaii (higher level of cost and older travelers). Our findings point to singles being more forward with plans followed by families and a slight uptick by older travelers. We believe that this scenario will continue to play out over the coming months.



Source: ISI Research

On the political front, the Biden Administration's is positioning itself as moderate compared to the liberal label advanced during the election. A split government (with expectations of a split of the Georgia Senate seats) should provide a less contentious political backdrop. We expect there to be an effort to reintroduce coalition governments among various countries to work together to take on China and other contentious political issues. This should help to provide a greater level of consensus and remove some of the divisive discussions that were part of the policy efforts seen over the past few years.

We expect that earnings growth is what drives financial markets and the 2021 earnings expectations have come back and will move higher over the coming quarters. This number is important as institutional investors use this as a point reference for valuation. Currently, the 2022 earnings expectation sits at $215 dollars which would point to an S&P 500 that could be valued at 4,300 over the next 18 to 24 months. Interest rates will continue to be held down by the Federal Reserve's initiatives which are currently running as negative real rates (the stated rate less inflation). This will continue to push up asset prices. The Fed has indicted that this will allow the economy to maintain a higher level of inflation than in the past. While we have seen the Federal Reserve looking to run at a level that includes more inflation, indications are pointing to rates that are expected to continue to remain at historically low levels. Because of the risk of a cyclical increase in yields, Hudson Valley Investment Advisors, Inc., continues to favor equities over fixed income in the near term.

Finally, we want to make you aware of a few items:

- We have updated our website and you will see a new homepage that has insights and educational material including appearances on Fox Business News and quotes from various national media publications www.hviaonline.com .

- This has been a volatile period and would expect that that we'll have another firm update as we move into 2021 which will provide our outlook.

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