HUDSON VALLEY
INVESTMENT ADVISORS, INC.
A subsidiary of Orange County Bancorp, Inc.

First Quarter 2017 Outlook

As of April 1, 2017

The first quarter the U.S. markets continued to move higher based on the expectation of President Trump's election promises of lower taxes, less regulation, infrastructure and changes to healthcare reform. Promises aside, Hudson Valley Investment Advisors, Inc. (HVIA) continues to expect a positive economic backdrop. On January 17, 2017, HVIA held its second annual investment outlook meeting which provided insight on the current economic environment and impact from the recent presidential election. Our conversations with economists and company managements provided a mosaic of positive information as we moved into the New Year. The Trump Administration's anticipated changes helped to support stock prices as investors moved from stocks with stable earnings to those that have more cyclical businesses. The view is that the market "re risked stocks" in which returns should see greater improvement from investment and revenue growth while moving away from companies that benefitted from cost cuts and efficiencies. This change has helped cyclical stocks outperform since Election Day, while more stable earnings stocks underperform. The more cyclical growth signaled economic improvement is more robust for stocks while it served as a headwind to fixed income investments.

The expected pace of growth for the remainder of 2017 will most likely be slower than presented by President Trump and what was shown in the post-election surge in optimism. For example, President Trump's healthcare proposal did not gain widespread support. This was his first proposed bill and presented investors with the risk that other pieces of legislation would face potential failure. The story here is more about Washington D.C. than about Wall St. President Trump must manage the political reality in order to get his agenda through Congress. The President has indicated that he is going to be more bi-partisan on his next piece of legislation, the tax bill, trying to limit the influence of both the Freedom caucus and the far left.

The current investing environment has an accommodative monetary policy. The yield curve is positively sloped which is an indication of a positive economic backdrop. Earnings expectations for the S&P 500 are for continued improvement. The outlook is pointing to solid future growth based on readings from economic barometers like consumer confidence which surged since October and coincides with improvement in other consumer and manufacturing surveys. Small business, homebuilders and corporate CFO's confidence levels are all showing significant strength. The gains in consumer confidence far exceed what occurred in previous elections and reflect a much more encouraging expectation of both current and future economic conditions.

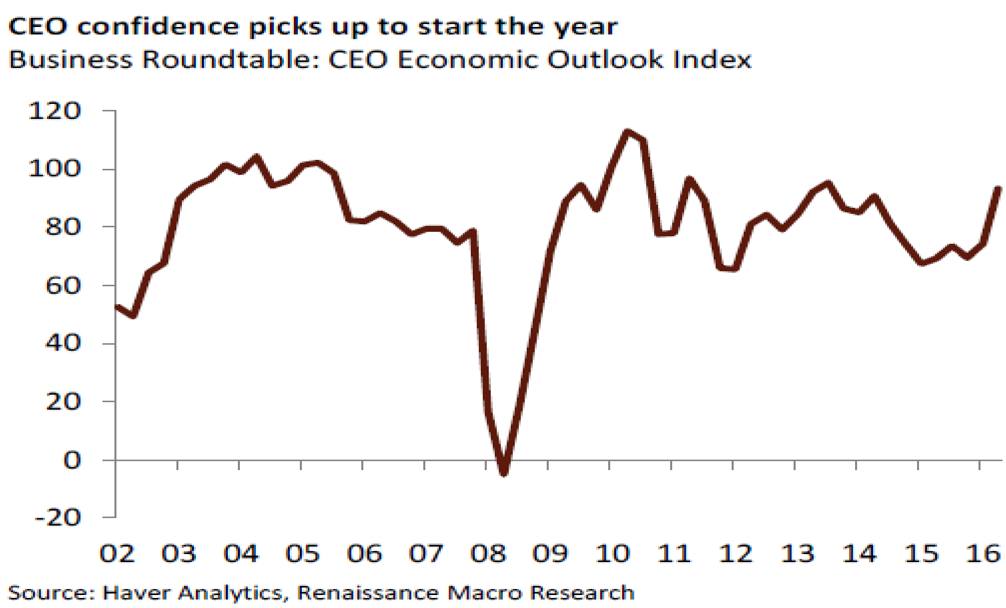
Overseas markets, both emerging and developed, have seen economic improvement which is providing a coordinated worldwide recovery. This may lengthen the US economic expansion. China, in particular, has shown growth that is north of 6.5%. That is ahead of expectations. It is important because China is the second most important economy in the world. This should help support other developing economies future growth.

The S&P 500 recorded a gain of 5.53% for the first quarter. In terms of sectors, nine groups reported positive returns for the quarter as many of the top performers at the end of the year continued to show positive performance but at a slower rate than during the first few months post the election. Positive quarterly returns included Information Technology (12.2%), Consumer Discretionary (8.1%), Health Care (7.9%), Staples (5.6%), Utilities (5.4%), Materials (5.3%), Industrials (4.0%), Real Estate (2.7%) and Financials (2.1%). On the negative side of the ledger Energy (-7.3%) and Telecomm (-5.1%) were the areas that lagged. Expectations are for continued economic growth but it is not without risk as anticipated policies in the U.S. are possibly delayed.

Outlook

As we end the first quarter, we are in an economy that has continued to show improvement and is providing the Federal Reserve an environment in which it can move to normalize rates. Economic data has seen continued improvement in mortgage applications in spite of higher rates. ISM which points to future growth had a solid start recording a 54.9% reading with new orders surging to 21.3% the highest levels since 2012. CEO confidence continues to rebound recording a 93.3 reading which also is the highest level seen since Q2 2014. This confidence is helping to support the willingness of managements' to hire, expand and invest. These economic indicators should move GDP higher as the year progresses while the first quarter may show GDP below expectations due to weather conditions in the northeast U.S. We believe the addition of fiscal stimulus, repatriation of funds from overseas and lower regulation will help GDP expand as we progress into 2017.

The Federal Reserve's expectation of moving rates higher would normally choke off economic growth. As the U.S. economy comes off artificially low rates we anticipate that the economy can continue to expand and show growth over the next year at a minimum. We are keeping a close eye on the U.S. political environment. The speed of implementation of fiscal policy will be monitored to gauge the potential positive impact to the economy. Offsetting this growth will be potential rising costs for labor and in inflation. The potential increase in inflation should be examined closely as the economy will continue to be exposed to excess capacity potentially making any inflationary pressures short lived.



The above chart indicates CEO confidence which usually shows up outside of surveys and in the real data over a short period of time. The normal increases should move into higher levels of capital expenditures, pointing to greater output for the US economy. Keep in mind that labor markets are tightening and finding suitable candidates is becoming tougher which may increase capital investment as companies increase productivity and lessen the need for human capital.

S&P 500 operating margins have rebounded on a year over year basis and are at the higher end of their historical range. In addition, P/E's are also at the higher end of historical levels and are most likely limited to see expansion. This sets up a market environment in which earnings must show improvement in order for stock prices to advance. Based on current earnings we would expect an upward bias to the S&P 500 index as each earnings quarter progresses.

The U.S. economy has consensus 2017 earnings growth of 9.8% for the S&P 500. The index is currently trading at 17.2x forward earnings with expected earnings per share of approximately $131.11. As we previously noted we anticipate a limited P/E expansion over the foreseeable future with earning gains being the primary factor in S&P 500 appreciation. The consensus earnings have improved from the flat earnings growth seen over the past three years as energy rebounds, capital increases and businesses invest. Revenue is also expected to show growth and reverse the flat results seen over the past 12 months. The earnings growth provides support to the equity markets. We expect subdued P/E's moving forward with a range of 16x to 19x. Based on earnings expectations of $131.11, the S&P 500 has a potential range of 2,100 to 2,500 over the coming year.

Hudson Valley Investment Advisors, Inc. continues to favor equities over fixed income. The Federal Reserve started the interest rate raising process which should continue over an extended period. We believe they are looking to normalize rates and may accelerate interest rate increases as the US economy appears set to absorb the hikes. Overall, we feel that equities are positioned to have future appreciation.