Fourth Quarter Outlook

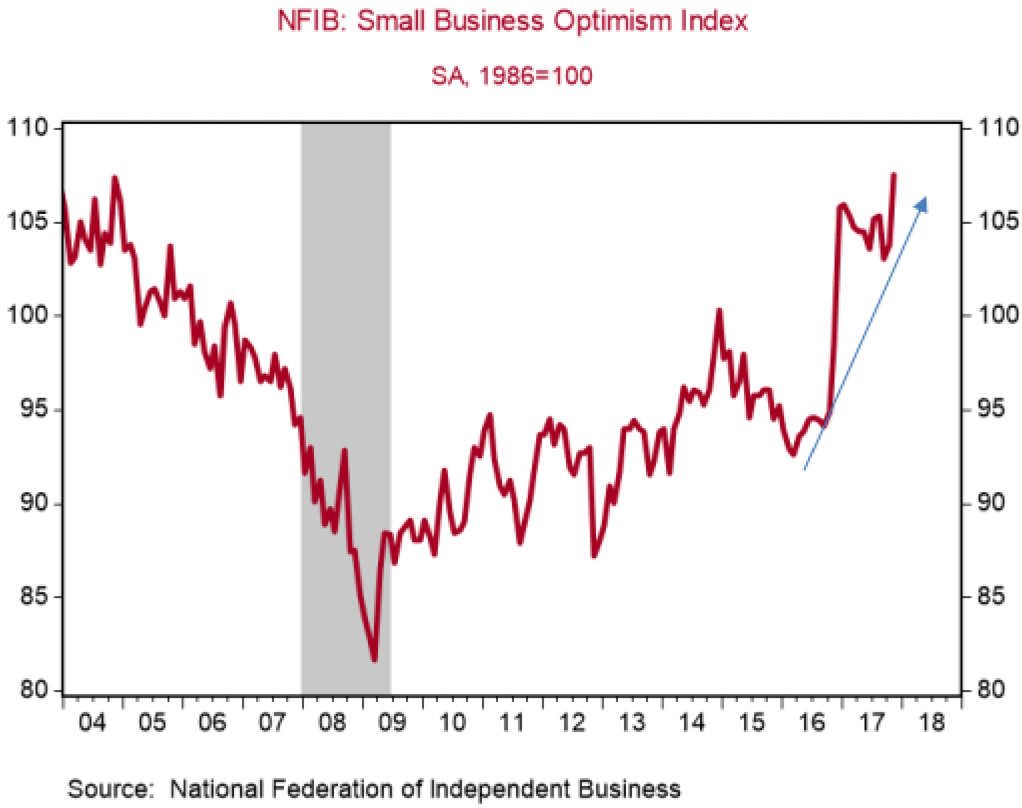
As of January 3, 2018

As we look back at 2017, expectations for the S&P 500 were optimistic. It was expected that earnings would see high single to low double digit returns. At year end, equity results passed all expectations while interest rates saw a flattening yield curve with the spread between the 1 year and 10 year treasuries tightening. Economic results showed improvement throughout the year and continue to point to a solid economic backdrop as we move into 2018. Inflation is moving slightly higher but remains contained while labor markets have pushed unemployment to near record lows. We expect additional stimulus from U.S. tax reform and the anticipated repatriation of overseas profits by U.S. corporations. Risks were muted and the stock market saw one of the smallest corrections (at 3%) in over 20 years. Geopolitical risk was extreme with North Korea saber rattling, Middle East proxy wars and Populism spreading across developed markets. The impact of the various geopolitical issues was almost non-existent as the heightened level of political risk was met with a muted response by the markets.

The current economy is moving to a normalization period. The Federal Reserve is transitioning to a new Federal Reserve Chairman as Janet Yellen is replaced by Jerome Powell. A continuation of current policy is expected in regards to major changes to interest rate increases and policy accommodation that was in place since the financial crisis is removed. This normalization process will take a number of years to unwind. Expectations are for the markets to see increased volatility as the unwinding of Quantitative Easing progresses, rates are increased, and the Federal Reserve's balance sheet is reduced. To provide perspective, approximately 30% of all stocks in the Russell 2000 index do not have positive earnings. The lower interest rates have allowed these firms in some cases to stay solvent. As rates are increased, it may force consolidation or the potential of bankruptcy in some cases.

The year began with an upward bias. The prior few years saw many public companies dependent upon cost cuts and stock buybacks to maintain earnings. In 2017 revenue growth was above expectations with growth of 5.2%. This translated to 9.6% earnings growth. The strong earnings allowed the S&P 500 to report a 21.8% total return. Our outlook for 2018 is pointing to the potential of high single to low double digit earnings growth.

Our confidence in the continuation of earnings growth is due to the economic signals. Consumer spending continues to be robust, housing is near record levels and investment by corporations is improving. When we add the stimulative effects of the changes to U.S. tax code, we could see a continuation of +3% GDP growth for 2018. Small businesses, which have historically been the driver for employment growth, are looking to hire and expand operations. An added benefit that is being overlooked is that we are in the middle of the first coordinated global period of economic growth that hasn't been seen in over 25 years. This will elongate the current strength of the environment.



While the economy and markets appear to be on track for a continuation of the current trend we are constantly looking at the current and potential risks for both stocks and bonds. The potential for increased risk may cause volatility of returns in an improving economic environment. Keep in mind we are coming off one of the lowest volatility periods in recent memory so any pickup will be noticed. The Federal Reserve has maintained a low interest rate environment for an extended period. Interest rates appear to be moving higher over the next few years but still remain low relative to historical levels. Bonds may see higher yields as government intervention is removed and we see the resumption of the "term premium", or the additional compensation needed to hold longer dated debt. The term premium will increase as markets normalize.

We continue to remain constructive on U.S. stocks. Earnings will advance while economic stimulus improves employment, adds to capital investment and keeps the consumer buoyant. Regulatory risks have subsided under the Trump administration and the pro-business policies will help to add to future growth.

Since our founding in 1995, our returns have been driven by a formulated investment process that starts with our top down analysis of economic inputs. Our equity investment focus is Growth at a Reasonable Price (GARP) while concentrating our fixed income on quality income producing investments. Of the S&P 500 groups, ten of eleven groups reported positive returns for the quarter. Quarterly returns included Consumer Discretionary (9.46%), Technology (8.65%), Financials (8.12%), Energy (6.12%), Materials (6.40%), Consumer Staples (5.76%), Industrials (5.53%), REIT's (2.33%), Telecom (2.28%), Healthcare (1.06%) and on the negative side were Utilities (-0.59%). Yearly returns also ended with ten sectors in positive territory including

Technology (36.91%), Materials (21.39%), Consumer Discretionary (21.23%), Financials (20.03%), Healthcare (20.00%), Energy (19.42%), Industrials (18.54%), Consumer Staples (10.46%), Utilities (8.32%), REIT's (7.16%) with the only negative return from Telecom (5.97%). At year end the economic data pointed to continued vibrancy and may make the Federal Reserve be more aggressive to normalization policy.

Outlook

At year end the economy appears to be close to recording +3% GDP growth rate for three consecutive quarters. This was beyond most economists' expectations at the start of the year. A combination of factors including an improvement in consumer demand, industrial investment, housing and international growth all contributed to the step up in economic growth. U.S. tax reform, repatriation of overseas funds and the rebuilding of parts of Houston, Florida and California should help contribute to the continuation of strong growth into 2018. The other area that hasn't gotten as much attention is the regulatory environment that has been reduced, opening up greater investment and less friction to growth. We also are anticipating a major investment in infrastructure to help rebuild and position the economy for the future.

Consumer confidence has risen since the Trump victory and is one of the biggest movers of the economy. In spite of the positives being discounted we are seeing a market that is becoming fairly valued with forward earnings at close to the highest level in almost ten years. As the U.S. economy continues to expand, the consensus 2018 earnings growth is 11.8% for the S&P 500, which is currently trading at 18.4 P/E with expected earnings per share of $146.59. The markets may be in a position that sees an economy that outpaces the stock market with both having an upward bias. On the fixed income side, economic strength and the Federal Reserve raising of interest rates may put bonds in a trading range for the foreseeable future. To summarize, expectations are for a continuation of earnings growth with the prospects for higher interest rates into 2018.

Hudson Valley Investment Advisors, Inc. continues to favor equities over fixed income. The Federal Reserve is in the middle of normalizing rates, the economy is now working in a more traditional manner and differentiation among investments has begun. The term "correlation" refers to how stocks or bonds move relative to one another with the higher the correlation, it is more likely that assets trade together. Since the Federal Reserve started to lower interest rates starting in 2008 correlations increased to near record levels. Today, as the Federal Reserve unwinds Quantitative Easing, correlations have declined and differences among assets have started to widen. We expect that to increase in the coming year and continue the increased need for active management. Interest rates have been declining for close to 30 years and that will be changing in the future. Keep in mind changes to rates happen slowly and this may be the start of a multiyear process. Overall, we feel that equities are positioned to have future appreciation.

We welcome you to take a look at our website http://www.hviaonline.com which now has videos and updates on the markets as well as thought pieces on investing. We welcome your feedback and thank you for your support as clients.

The information and opinions in this report were prepared by Hudson Valley Investment Advisors, Inc.("HVIA"). Information, opinions and estimates contained in this report reflect a judgment at its original date and are subject to change. HVIA and its employees shall have no obligation to update or amend any information contained herein The contents of this report do not constitute an offer or solicitation of any transaction in any securities referred to herein or investment advice to any person and HVIA will not treat recipients as its customers by virtue of their receiving this report. HVIA or its employees have or may have a position in securities or other related investments mentioned herein.

This publication is being furnished to you for informational purposes and only on condition that it will not form a primary basis for any investment decision. These materials are based upon information generally available to the public from sources believed to be reliable. No representation is given with respect to accuracy or completeness, and they may change without notice. HVIA on its own behalf disclaims any and all liability relating to these materials, including, without limitation, any express or implied recommendations or warranties for statements or errors contained in, or omission from, these materials. The information and analyses contained herein are not intended as tax, legal or investment advice and may not be suitable for your specific circumstances.