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

First Quarter Outlook

As of April 5, 2021

Economy In Review

At Hudson Valley Investment Advisors ("HVIA") we maintain a view that we will see an unprecedented rebound in the economy in 2021. We are coming out of an economy in lock down moving to reopening. We have weathered this period due to the infusion of fiscal and monetary stimulus. We want our clients to realize that when the U.S. economy comes out of a downturn it is historically due to the reaction to an oversupply of things such as inventories which needs to be worked off which is not currently evident. At this point in time we have consumers that are well positioned in terms of savings, personal balance sheets and job growth. We realize that not everything is back to normal, but we believe the unemployment levels will continue to come down as more vaccines are distributed and states will open up their economies.

Covid has been front and center in the economy and markets. As vaccines have been administered, the U.S. economy has started to open up to a greater degree. This has also been at the same time that interest rates have moved higher. This has not been in isolation. We have seen the U.S. dollar strengthening which will cause a cap on higher rates and commodity prices over the intermediate term. We believe that rates over the longer term will move higher due to the strength of the U.S. economy compared to others such as the Eurozone and the developing world, which will take longer to come out of this pandemic.

The economy is recording record growth and we anticipate this to continue as we move into the second quarter. Our thoughts are a result of data points like housing inventories having been near all-time lows, inventories for cars being limited and pent up demand meeting shrinking supply. Miles driven has increased and passenger traffic at TSA check points are up to 75% of pre-Covid levels. Again, as we look at vaccine distribution increasing, the economic vitality in the U.S. will continue. Risks to the economy were the hospitality industry which was severely impacted by Covid, due to the face to face nature of the business.

The growth we have seen has increased inflation and we expect this to continue over the coming quarters. If no inflation is generated from the stimulus package, over the longer term, politicians will focus on Modern Monetary Theory. This theory postulates that you can borrow increasing amounts without the worry of inflation. This may provide cover for elected officials to borrow and spend without any political ramifications. We believe bond holders will push back on this forcing higher rates and slowing the overall economy.

The S&P 500 recorded a gain of 6.17% for the first quarter. In terms of sectors, all groups reported positive returns as there was a rebound in many areas that underperformed over the prior year. Positive quarterly returns included Energy (30.85%), Financials (15.99%), Industrials (11.41%), Materials (9.08%), REIT's (9.02%), Comm Services (8.08%), Health Care (3.18%), Discretionary (3.11%), Utilities (2.80%), Technology (1.97%) and Staples (1.15%). The quarter's economic data looks to have started to accelerate across a broad range of sectors providing a future tailwind.

<u>Outlook</u>

HVIA held a conference call for clients during March (the replay link https://hviaonline.com/insight/economic-market-conference-call-03-18-2021/) where we laid out our thoughts on the direction of Covid-19 and the economy. At HVIA, we expect both growth and value to be greatly influenced by interest rates. We believe rate changes will move nominally higher over the coming 12 to 18 months. Our belief is that rates may move back to pre Covid levels. Also, the markets are anticipating interest spreads to widen. Our expectation for GDP will be strong into 2022 influencing rates.

Higher interest rates will be offset by the growth in earnings over the coming quarters. We are keeping an eye on various potential risks such as higher input costs. Businesses appear to be absorbing higher cost in the short term as they do not want to raise and then lower prices to clients. This may cause a potential shortfall in select companies estimated earnings per share. This would point to the fact that businesses believe that higher costs are transitory, as increasing prices would most likely be made by companies if they believed that this will be ongoing.

As 2021 proceeds, a move from a period of vaccine distribution and the unwinding of lockdowns will transition to a labor and economic normalization. In addition, as “normalcy” returns, we expect that various age demographics will act differently to the way social and work settings open up. In spite of opening up the economy, we will still see continued political issues both domestically and internationally. 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.

The reopening of the U.S. economy continues to support equity markets as the light at the end of the coronavirus tunnel draws near. While concerns have surfaced regarding another outbreak, the rate of inoculation is exponentially outpacing new cases. The opening of the economy and the rebuilding of inventories. The reemergence of services will help move the economy from one supported by stimulus to a more traditional one that is interdependent on economic vitality. This transition is expected to occur and we will see the opening of businesses and the normal flow of logistics, opening of schools and the expansion of capital investment. We also will focus on new “normal”, as we see the continued use of technologies that were implemented during this past year becoming part of our permanent lives. Since this has positively impacted productivity, we believe it will be part of future business dealings.

The recovery will resume with more fiscal support being deployed. Vaccinations to the elderly have reduced the number of deaths and admittance to hospital ICU beds, which is the most significant step. HVIA expects herd immunity to be reached sometime this summer. However, a mutated strain of the Covid-19 virus is still a risk to this timing.

Gains have been seen in income, net worth, and $2 trillion in excess savings should lead to strong consumption growth which can be seen in the below chart. The $900 billion COVID relief bill passed in December boosted incomes and spending to start the year. Another $1.9b trillion in relief adds more stimulus checks, extended unemployment benefits, and state and local government aid.

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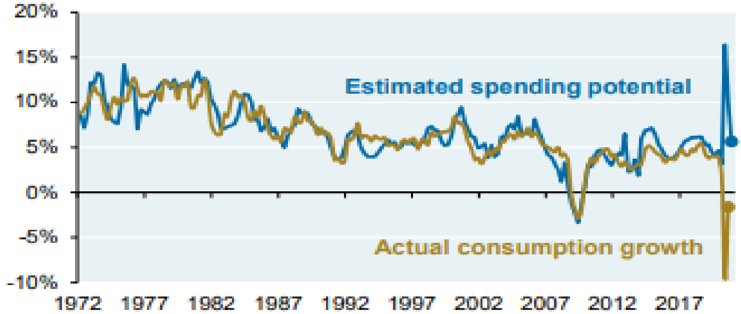
Pent-up spending will be unleashed sometime in 2021

y/y % change



Source: Federal Reserve, BEA, JPMAM. Q4 2020. Spending potential: 65% of taxable income, 100% of transfer payments, 10% of housing wealth and 1.5% of financial wealth.

Real Gross Domestic Product (GDP) is expected to remain strong. In addition, the labor market has slowed slightly. We believe accelerating economic growth, a large share of unemployment being termed "temporary", and job openings at high levels mean we should see unemployment fall significantly this year further lifting incomes.

HVIA expects another sizable fiscal package focused on infrastructure, climate, and possibly healthcare. This spending will be paired with tax increases. This package will need to get buy-in from both Democrats and Republicans in order to get this approved. We expect tax changes will include raising the top marginal individual income tax rate, raising the corporate tax rate a few percentage points, and a change to the capital gains tax.

We expect that earnings growth is what drives financial markets and the 2021 earnings expectations have been extremely strong. Earnings expectations are expected to remain at double digit levels for the full year. This is important as institutional investors use this as a point of reference for valuation. Currently, the 2022 earnings expectation sits at $203 dollars which could push up significantly over the coming quarters. Some strategists have alluded to earnings close to $225 for their S&P 500 expectations. This is one of the main reasons for our positive view on equity markets over the next year.

The Fed has indicted that it 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 rise modestly but remain near 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 .

Disclosures:

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