Hudson Valley Investment Advisors, Inc.
A subsidiary of Orange County Bancorp, Inc.

Second Quarter Outlook

As of July 2, 2021

Economy In Review

As we look back on the first six months of 2021, we saw changes not only in our economic environment, but our social and financial environments as well. For the time being, COVID appears to have subsided in the U.S. This is allowing individuals to move past concerns which once limited overall interaction, causing many parts of the economy to be held back. Every eligible person who would like the COVID vaccine now has the ability to receive one. Those individuals most susceptible to COVID and in the demographic category of 65 and older are now close to 80% vaccinated. This has allowed many parts of the economy to begin functioning again in a more traditional sense. The economic environment went from a period of too much supply and limited demand, to one in which demand has far outstripped supply. As supply chains try to work in a more fluid manner, it is expected to take a number of quarters until the bottleneck in production is alleviated.

The imbalance in supply chains has caused a number of problems. The most apparent is in the markets of housing related commodities, electronics as well as autos, which saw increased demand and limited supply. This imbalance inflated prices for a number of goods, including homes, autos, washers, dryers and basic commodities. A good example of this is the increase in lumber pricing of over 275% from the prior year. However, we have seen a reversal in those lumber prices dropping 40% since the end of June. There was a pullback in housing as higher prices slowed demand. Based on our due diligence, we believe many of these factors are temporary and we should see some sort of rebalancing of supply and demand as the year progresses.

At the end of the quarter, we saw Congress debate an infrastructure bill which appears to be close to passing. This would include monies that have been appropriated but not spent. By this measure, taxes are not expected to be raised to the proposed 28% from the current 21%. This was part of the prior administrations agenda which helped advance one of the most dynamic economic growth periods in the nation's history.

As we look back at the quarter, the demand shock we have seen has been hampered by government initiatives. States that have refused monies from the Federal government, which limited unemployment benefits, have seen a greater number of laid off workers return to work. States that have followed this behavior have lower unemployment rates, relative to states that are still offering the enhanced benefits. This experiment will end in September when benefits end in over 10 states. We will also see teachers and students returning to the classrooms, which will allow for more adults to return to work. The impact of the past 12 months will be felt for years to come. However, as of now, we expect the economy to be moving into a more normalized period.

Currently many states are lifting restrictions and labor intensive services are being added back at a record pace. During May's unemployment reporting, hospitality positions increased by 500k, which point towards an increase in demand for hotel and restaurant offerings. As previously stated, the strain on supply chains has caused prices to increase. We believe the economy is on pace to show a strong foundation for growth over the next several years. With the need for housing and auto supply to return and come back into balance, along with pent up demand for services and the high level of cash balances held by individuals, guides our confidence in future growth. However we are not without risks, as we continue to monitor the economy worldwide, geopolitical friction with China, the Brexit situation along with the large amount of U.S. debt.

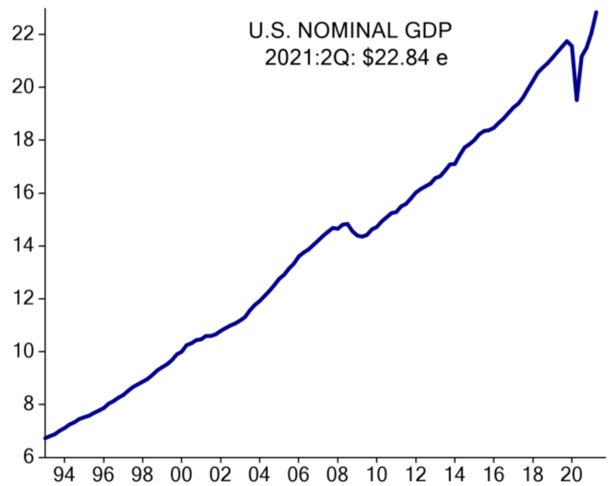
The S&P 500 recorded a gain of 8.55% for the second quarter. In terms of sectors, 10 groups reported positive returns for the quarter. Positive quarterly returns included; Real Estate (13.09%), Information Technology (11.56%), Energy (11.30%), Telecomm (10.72%), Healthcare (8.40%), and Financials (8.36%), Consumer Discretionary (6.95%), Materials (4.97%), Industrials (4.48%) and Staples (3.83%). On the negative side of the ledger were Utilities (-0.41%). The quarter's economic data looks to have started to accelerate across a number of sectors.

As we move into the second half of 2021, we expect greater volatility as the transition to an open economy and unwinding of lockdowns will continue to have logistical delays. In addition, we expect that the ability to do things will occur. We expect the reengaging of U.S. led coalitions and the continued Chinese pressures for a leadership position will cause friction. Lastly, we are watching longer term interest rates and inflation which could be starting the process of interest rate moving off their historical lows that occurred during the pandemic.

Outlook

We expect continued growth in GDP to benefit from the U.S. coming out of restrictions from COVID. Lagging industries are expected to be more synchronized with global growth. We are expecting higher nominal interest rates over time with fears of higher long term inflation underpinning the higher yields. We are also expecting higher levels of productivity which should help mitigate inflationary levels and enhance U.S. GDP growth. As the U.S. economy moves forward, the self-sustaining nature of the economy should remove the need for support from the U.S. government.

The stimulus is having a dramatic impact on prices. This is coupled with a number of events, such as winter storms in Texas that impacted chemical production along with a fire at a major computer chip plant in Japan, significantly impacted production levels worldwide. HVIA expects surging demand and restricted supply should come into balance during the latter half of the year. This process will elongate the economic cycle as inventories are rebuilt and pent up demand takes longer to satisfy. As of this report U.S. GDP is running at a +10% level which is well above the 2% average seen during the past economic cycle. We believe that a 3% to 4% GDP level is possible over the next 24 months.



The rebound from last year's recession has seen a major move by consumers and businesses to purchase computers, cars and other durable products enabling work from home and remote learning. We see the transition of consumers shifting to services continuing. The hospitality industry has seen a strong rebound which may be limited due to the ability to gain enough personnel to meet increased demand. Expanding on this thought we believe a step up in employment will alleviate the ability of companies to meet the demand. September 1, 2021 will limit the Federal unemployment benefits. This should also help to alleviate some of the inflationary pressures that have been building over the past year.

The Biden Administration's efforts to move forward with additional stimulus for many of his constituents societal goals has been met with pushback. Markets are discounting a high likelihood that of passage in its current form will be limited. Keep in mind that the U.S. engagement after COVID will be important as the world has in part been closed down. COVID has had less influence on the U.S. compared to almost all other regions. You can compare of the current environment as if we were coming out of a world war but to a smaller extent. This means the U.S. will need to take on a larger role in helping and supporting areas of the world that we have pull back from in order to reduce COVID and to allow lower levels of poverty, disease and potentially war. This support would reestablish the U.S. into a favorable light and support the economic growth on a worldwide basis.

Earnings growth is the main influence on financial markets. Growth expectations from the start of the year for the 2021 and 2022 calendar years continues to move higher over the coming quarters. This number is important as institutional investors use this as a point of reference for valuation. The earnings for 2022 has risen from $190 for the S&P 500 to its current level of $215 dollars. We anticipate that this number will migrate higher and help to support higher values for the index.

Interest rates are also expected to move higher over the longer term. Over the next few quarters we anticipate that interest rates will trade in a range until longer term inflation and economic growth are more evident. Our thoughts on rates continue to point to the Federal Reserve's initiatives to maintain negative real rates (the stated rate less inflation) which will continue to push up asset prices. The Fed continues to communicate that it will allow the economy to maintain a higher level of inflation in order to gain a greater level of employment. This action will push up price and make bonds less attractive. For investors, there still is a need for fixed income investments to mitigate risks in terms of diversification.

We continue to expect an upward bias to equities with bonds remaining in a trading range over the coming quarters.

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