HUDSON VALLEY INVESTMENT ADVISORS, INC.

A subsidiary of Orange County Bancorp, Inc.

First Quarter Outlook

As of April 4, 2022

Summary

The first quarter of 2022 saw significant change based on supply-demand dynamics, inflation, and the Ukraine-Russia conflict. There is a strong belief that because of the confrontation we may have seen the end of Globalization. These changes are at a point in time when we've just come out of the COVID-19 pandemic which created a logistic supply shock. The Ukraine Russia war added a second supply shock as close to 20% of energy flows and a significant portion of the world's wheat, soybean, and fertilizer supply come from these two countries and will add to higher prices. One aspect of these supply shocks is the potential for worldwide inflation in food and other basic products that may cause the potential for conflicts around the world.

The first quarter of 2022 pointed to the potential end of the COVID-19 pandemic in the U.S. The number of positively tested persons within the U.S. came down to nominal levels. This has allowed for the opening of many services, businesses, schools, and healthcare offices that had been limited in their ability to operate. We saw a continued increase in employment and the return to work of many individuals lowering the unemployment rate to levels that we haven't seen in over 50 years. At the end of the quarter, we believe that an additional amount of individuals impacted by COVID-19 (either having it or taking care of someone that has it) amounted to over 5 million individuals. We believe these individuals will be reentering the workforce over the coming months. The restriction on labor has negatively influenced supply chains, company service levels, and the cost of labor in general. These headwinds have worried economists which are focused on a wage-price spiral. As a response to these fears, we have seen a significant amount of investment in productivity-enhancing capital expenditures. We are anticipating this trend to continue to replace labor and gain scale which limits inflation and helps with production. Despite these input price increases, companies have passed along these higher costs to consumers.

The main factor that played into the quarter was the Ukraine-Russia conflict. This geopolitical event is the first land war in Europe since WW II. This appears to be a major miscalculation on the part of Russia as the Ukrainian conflict appears to be at a standstill. This has caused a major geopolitical event and has isolated the Russian government and caused a reassessment of how countries look at trade partners, defense spending, and immigration. The current situation in Ukraine, coupled with how China has dealt with other nations and escalation in conflicts, will cause a reassessing of reshoring in the U.S. and other developed countries. The war impact has caused our previously discussed increase in commodity costs which is weighing on confidence and activity in Europe. This is in addition to the slowdown in China as the zero COVID-19 policy weighs on activity.

Did You Know:

You can visit hviaonline.com/insights to view our latest Client Events and Economic Updates.

****

You can also view your account online at: investor.pershing.com

If you have any questions or need assistance, please contact us at:

Hudson Valley Investment Advisors, Inc.
117 Grand St., Suite 201
PO Box 268
Goshen, NY 10924

P: (845) 294-6127
F: (845) 294-1438
e-mail:
operations@hviaonline. com

****

Appointments also available at:

4 West Red Oak Lane
White Plains, NY 10604

****

Visit us at *hviaonline.com* *for more information*

Hudson Valley Investment Advisors, Inc.

A subsidiary of Orange County Bancorp, Inc.

First Quarter Outlook

As of April 4, 2022

At HVIA we are expecting that inflation may stay higher for longer as the economy works toward supply chain normalization and the improvement in supply for commodities. We are also keeping an eye on if inflation remains anchored or do individuals look at the inflationary environment as now part of the economic fabric. If this takes hold we could potentially be looking at levels of hoarding, the substitution of goods, and higher levels of malnutrition. Based on the future expectations HVIA maintained its balanced equity portfolio approach to take advantage of this volatility and we sought bond portfolios that were shorter in duration to hedge against the risk of higher interest rates.

In the U.S. housing remains strong despite the rise in mortgage rates, as cancellations are low, inventory tight and demand remains strong. Urban markets are seeing price acceleration while suburban prices remain strong. Despite price increases at retailers there has been limited trade down. Overall, the demand in the U.S. economy continues to be strong with a limited slowdown.

These various shocks, imbalances, and higher rate expectations saw markets move into correction territory as investors anticipated an ever high level of interest rates and a slowing of demand. The yield curve, which is looked at for signaling, moved into an inverted position and lowered valuations multiples. This caused a pullback in equity markets and saw rates negatively impact bond returns. Our thoughts were that markets were overly aggressive on both the level of rate increases while earning numbers were adjusted higher during the quarter.

Economy In Review

As we ended the quarter, we saw the potential end of COVID-19 impact on the economy. There was a greater level of opening up of businesses as restrictions have been lifted in many regions. Stadiums, restaurants, concerts, and travel all saw a return to a more normalized level which was well received by consumers who have shown pent-up demand for these types of services. As this was occurring we saw the invasion of Ukraine by Russia causing another supply shock, and the slowdown was seen in GDP which then rebounded at the quarter-end.

The impact on the economy was directly seen in commodity prices which are expected to continue to move higher as the Ukraine - Russia conflict limit supplies from this important region over the coming year. This limiting in supply we believe will push up food prices and may cause friction in the developing world as food is often subsidized and we have seen past rioting when prices for basics have been increased. The outlook of this conflict doesn't look to have an end. The Russians appear to have underestimated the Ukrainian response and have continued to repel their Russian aggressors. We believe that the longer this goes on without a resolution the greater likelihood that the reversing of globalization will accelerate.

Another outcome of higher prices is the approval ratings of U.S. politicians. They are at the lowest levels in recent history. The number one concern from voters is inflation with the Russian Ukraine war being the second-highest concern. The rising inflation is the main factor in the concern of voters and the declining poll numbers for U.S. politicians. In response, the Federal Reserve's decision to be more aggressive in moving to quantitative tightening is expected to increase interest rates. This is expected to slow down demand which would theoretically lessen inflation. The only other period similar to the current environment was post-WWII when demand exceeded supply, employment was robust and the lack of supply pushed up prices. Just like in the WWII period we expect that the improvement in supply and availability of labor will improve and lower inflation rates. This will not get us back to pre-pandemic levels of inflation but will come down from current levels.

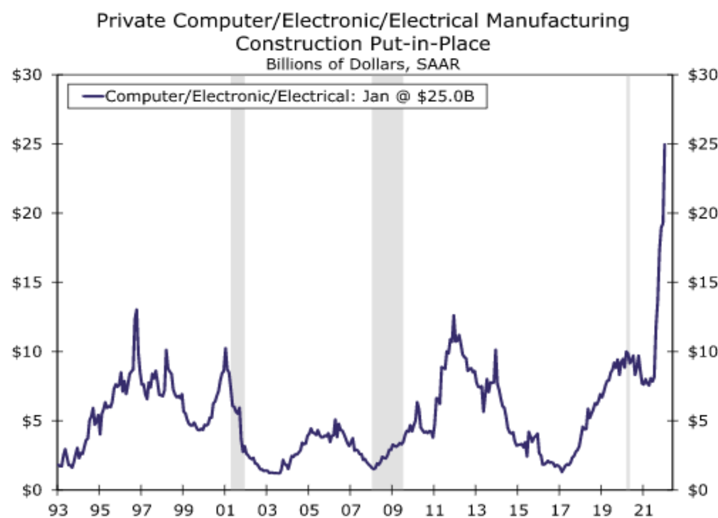
HUDSON VALLEY
INVESTMENT ADVISORS, INC.
A subsidiary of Orange County Bancorp, Inc.

First Quarter Outlook

As of April 4, 2022

The current geopolitical environment will cause several headwinds. We believe the U.S. is one of the best-positioned countries post COVID-19 and war in Europe. Our thought process is that the U.S. is mainly self-sufficient in commodities, has a significant economic base, strong employment situation, and is dominant in technology which will be needed over the coming decade to enhance productivity. This compares to other countries that have limits in several areas. In addition, the U.S. is one of the lowest exporting countries in the developed world relying predominately on domestic demand. We also expect many developed countries to significantly increase their defense spending which will slow down growth for non-U.S. competitors.

The continued labor squeeze has seen companies dedicate capital expenditures to boost productivity and offset the U.S. labor shortage. The investment in technology-based manufacturing facilities is more than double the amount invested over the past 30 years. Again, the change in how U.S. businesses are viewing supply chains is shifting from “just in time” to “just in case”. Remember that current capital investment has a lag effect that usually bears fruit 2 to 3 years into the future.



Expectations at year-end are cautiously optimistic based on Federal Reserve tightening, higher inflation, and the reopening of supply chains. Despite the headwinds, we are seeing strong demand that appears to be holding up despite higher interest rates and prices. The underlying demand we don’t believe will slow down. Why are we still positive on demand? **1)** consumers have pent up demand after two-plus years of COVID-19; **2)** inventories for cars, homes and other goods need to be replenished; **3)** employment is strong and there has been the lowest number of layoffs in the nation’s history; and, **4)** State and Local governments are sitting on budget surpluses which will be deployed over the next year. This is why it may be difficult to meaningfully slow down the economy.

Politically, the current administration’s proposed programs have been limited and the current War in Europe has taken his focus away from priorities. At the writing of this letter, the President did get his infrastructure bill passed which should help in the improvement of U.S. roads, bridges, and 5G expansion. This timing may be helpful as we move to a more domestic-focused economy. The upgrade in infrastructure will help with the domestic logistics market for U.S. commerce.

The S&P 500 recorded a loss of -4.6% for the first quarter. In terms of sectors, 2 of 11 groups reported positive returns for the quarter as the continued demand surge was felt across the overall economy. Positive quarterly returns included Energy (39.03%) and Utilities (4.77%).

On the negative side of the ledger was Communication Services (-11.92%), Discretionary (-9.03%), Information Technology (-8.36%), Real Estate (-6.22%), Healthcare (-2.58%), Materials (-2.37%), Industrials (-2.36%), Financials (-1.48%) and Staples (-1.01%). The quarter’s economic data has continued to expand despite bottlenecks and limited supply to meet the increasing demand.

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

First Quarter Outlook

As of April 4, 2022

As we look at the remaining quarters of 2022, we expect earnings to continue to grow and be strong but at lower growth than seen over the past 12 months. Demand is still strong as consumers become more focused on experiences such as travel and entertainment. Our concern still revolves around policy mistakes. We are keeping an eye on the Federal Reserve and its move to quantitative tightening which if too aggressive can push the economy into recession.

Outlook

Since the start of 2022 the Omicron COVID-19 variant has dissipated and, we believe, will not be as impactful moving forward. Headwinds from inflation we believe will be significantly reduced as we move through the year. The war in Ukraine is the main factor in our thinking as to how long inflation will remain at a heightened level. If this persists for an extended period it may elongate prices for longer than first thought.

At HVIA, we believe that we are heading into a period of product innovation, upgrading of infrastructure, strong labor markets, and more domestic stability compared to the rest of the world. The reshoring of companies to the U.S. from overseas locations will continue and cause companies to continue to invest in the U.S. and will show higher GDP growth than other developed countries.

GDP growth should continue to advance as inventory rebuilding, housing expansion and the increase in car production will provide a base for economic growth. This will be further supported by the pent-up demand from people increasing the use of services. Adding to this is the amount of monies that state and local governments will be deploying for infrastructure. Public companies are also showing resiliency as they are maintaining margins that are approximately 12% which is at the higher end of historical levels. Analysts have underestimated growth, revenues, and margins for several quarters. We believe that this is coming to an end with the outlooks including a higher percentage of companies that may see higher inflation limiting the continued expansion of margins into the remainder of the year. As we move through 2022, we continue to see strong demand for travel, housing, and all things associated with entertaining. We expect this to remain strong and the purchasing power of individuals remains above trend.

Internationally, the U.S. is uniquely positioned. China has maintained a Zero COVID-19 policy, shutting down various cities to limit the spread of the disease. In addition, the Chinese real estate market is still unsettled and investors have pulled away from their markets. This has limited outside investment and moved the Chinese government to help support these asset areas. Europe may be going into a recession based in part on the increased inflation and the Ukraine war. COVID-19 is still a factor outside the U.S. Our Government's use of offering vaccines and protocols differed from other parts of the world. This direct response has helped the U.S. work through the worst of this disease and positioned us to return to "normal" faster than many other parts of the world.

Earnings are what drive equity markets. The earnings projection at the start of 2022 looks to move higher. This is being compared to higher rates which will limit multiples that have come down from higher levels. Earnings continue to move higher as the quarter progressed. Currently, the 2022 earnings expectation sits at $225 and $248 for 2023 which would point to an S&P 500 that could have a higher valuation over the next 18 to 24 months. At HVIA we continue to anticipate that there will be more volatility as the Federal Reserve raises interest rates.

Hudson Valley Investment Advisors, Inc.

A subsidiary of Orange County Bancorp, Inc.

First Quarter Outlook

As of April 4, 2022

This has had us focus on shorter-duration fixed income investments and the use of rate strategies to limit the impact of higher rates. The Federal Reserve has put us in a position that looks to be behind the curve to limit inflation. Despite the expected increase in volatility for stocks, Hudson Valley Investment Advisors, Inc. expects earnings to continue to remain strong and drive equity prices higher while interest rates may cause underperformance for fixed income. Based on the above, HVIA continues to favor equities over fixed income over the near term.

In closing, we would like to make you aware of a few items:

- On 3/31/2022 we held via Zoom our March 2022 Q1 Market Update. A recording of this meeting can be found on our website at **hviaonline. com**

We are co-hosting two upcoming *Women Guiding Women* events.

- June 2, 2022, at 5:30 pm- Knollwood Country Club, Elmsford NY
  TOPIC: “Staying Safe Online”

- June 14, 2022, at 5:30 pm – Villa Venezia, Middletown NY
  TOPIC: “Take control of your financial future”

As always we are here for any questions you may have on the markets, your accounts, and the best ways we can help you achieve your financial and retirement goals.

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

First Quarter Outlook

As of April 4, 2022

Contact Us:

Hudson Valley Investment Advisors, Inc.
117 Grand St., Suite 201
PO Box 268
Goshen, NY 10924

P: (845) 294-6127
F: (845) 294-1438
e-mail:
operations@hviaonline. com
****
Appointments also available at:

4 West Red Oak Lane
White Plains, NY 10604
****
Visit us at
hviaonline.com
for more information

Disclosures:

1. Investments in securities are not insured, protected, or guaranteed and may result in loss of income and/or principal.

2. Registration with the SEC should not be construed as an endorsement or an indicator of investment skill, acumen, or experience.

3. All statements other than statements of historical fact are opinions and/or forward-looking statements (including words such as “believe,” “estimate,” “anticipate,” “may,” “will,” “should,” and “expect”). Although we believe that the beliefs and expectations reflected in such forward-looking statements are reasonable, we can give no assurance that such beliefs and expectations will prove to be correct. Various factors could cause actual results or performance to differ materially from those discussed in such forward-looking statements. All expressions of opinion are subject to change. You are cautioned not to place undue reliance on these forward-looking statements. Any dated information is published as of its date only. Dated and forward-looking statements speak only as of the date on which they are made. We undertake no obligation to update publicly or revise any stated or forward-looking statements.

4. Investment process, strategies, philosophies, allocations, and parameters are current as of the date indicated and are subject to change without prior notice.

5. Past performance is not indicative of any specific investment or future results. Views regarding the economy, securities markets, or other specialized areas, like all predictors of future events, cannot be guaranteed to be accurate and may result in economic loss to the investor.

6. This report may not be sold or redistributed in whole or part without the prior written consent of Hudson Valley Investment Advisors, Inc.

7. Industry recognitions or awards should not be construed as an endorsement or a recommendation to retain the Adviser by the ranking entity or any regulatory authority.