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

Second Quarter Outlook

As of July 6, 2022

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*

Summary

The second quarter of 2022 was an inflection point. Many cross-currents moved the economy from strong, steady above-trend growth to one that was negatively influenced by government policies. The quarter saw one of the worst markets for both stocks and bonds in close to 50 years. Coming out of COVID-19, economic imbalances became more pronounced. Economies around the world were impacted by inflation, interest rates, logistics, and government intervention. Stocks reacted to this higher level of anticipated rates by having a contraction in multiples paid for stocks. Fixed income, which has acted as a hedge for equity investments over the past decade, did not counter the down movement in stocks. Yields on the U.S. 10-year Treasuries rose to 3.5% during mid-June from near zero at the start of the year while investors reassessed interest rates and inflation. The Federal Reserve tried to tackle higher inflation by increasing interest rates by the largest rate increase (75 basis points) seen in over two decades. These dynamics were also at play around the world as supply was limited while demand spiked driving up prices around the world. The European ECB also increased rates to head off inflation. To normalize markets, there is a need for supply of all types to be increased, which is a longer-term solution but will better position economies. Meanwhile, we expect economic growth to slow but remain positive over the long term. Despite the tough first half of 2022, the chart below shows the worst first halves of market returns and their corresponding rebounds. Keep in mind, that demand is still above historical trends which should help the economy get through this period of transition.

S&P Worst Performances In 1H

		1H	2H
1.	**1932**	-45%	+53%
2.	**1962**	-27%	+20%
3.	**1940**	-21%	+7%
	2022	-21%	?
4.	**1970**	-20%	+25%
5.	**1939**	-18%	+16%

Source: ISI

Much of the inflation increase was self-inflicted in the United States. Overly stimulative policies meant that inflation was set to increase before the Ukraine-Russia conflict occurred. A higher level of inflation pushed rates higher which were met by investors reducing multiples for higher growth stocks. We are expecting inflation to decline over the coming quarters, as growth slows and supply increases for goods, while increased labor reduces pricing pressures. The Fed's aggressiveness may be short-lived as in past tightening cycles we have seen the Fed's rate increases potentially overtighten and put risk on the side of market disruption.

In spite of the risks, the U.S. economy has a tight labor supply, household and business balance sheets are strong and business profits are still solid but most likely declining. In addition, we are anticipating lower earnings estimates while goods inventories are now in oversupply.

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

Second Quarter Outlook

As of July 6, 2022

This may cap goods inflation and cause deflation in certain segments of the economy. Services have picked up and we are anticipating that as the economy softens, we will witness more people come back to the workforce and increase labor supply for areas that were under labor pressure. Energy prices took a step back from reaching over $120 per barrel. We would expect higher pricing over the long term as economies advance and the limited amount of additional oil supply maintains pressure on prices.

The U.S. has led most of the world out of COVID-19. Keep in mind many areas around the world are still working their economies away from lockdowns. At the end of the quarter, we believe that we may be already in a mild recession that will allow for slowing inflation and the rebalancing of inventories. We have seen more individuals reentering the workforce as public programs have worked their way through the system.

As we stated in our last quarterly letter, we believe, the restriction of 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 productivity-enhancing capital investments. This trend is anticipated to continue to grow to replace labor and gain scale. This change, longer-term, will limit inflation and help with production. As the input price increased, many companies passed along the higher costs to consumers.

The Ukraine-Russia conflict continues to impact markets. Russia has been impacted by the world's response as seen by their removal from the world economy. This response may cause a bifurcated world and enhance China's position as our most aggressive adversary. Close to 40% of the world's wheat comes out of the Ukraine - Russia area located near the Black Sea. This is putting additional pressure on commodities and may cause an issue in the future for world food security.

At Hudson Valley Investment Advisors, Inc. (HVIA) we believe inflation may have plateaued but may stay higher for longer as the benefits from outsourced manufacturing and the use of supply chains that lowered costs over the past twenty-five years, may potentially come to an end. We have been keeping an eye on inflation to see if it remains anchored or do individuals look at the inflationary environment as now part of the economic fabric. We believe if we head into a mild recession, investors will reassess that inflation is limited long term.

The last two weeks of the quarter saw a negative feedback loop. What does this mean? It points to the fact that consumers are pushing back on prices that have grown too far too fast. Because of the higher interest rates we have seen a pullback in housing and other areas tied to the consumer such as goods pricing. In addition, this should have the impact of putting a top on inflation and lowering potential rate increases. The Fed is trying to slow demand and thread the needle to slow the economy but limit a potential recession. Our thoughts were that markets were overly aggressive in both assessing the potential level of rate increases while earning numbers were adjusted higher during the quarter.

Economy In Review

As we ended the quarter, investors stopped buying the dips in stocks and moved to shorter duration value-oriented investments. The U.S. Federal Reserve is trying to actively slow the economy to lower inflation. The Federal Reserve was perceived to be slow to address inflation and lost credibility during the first half of the year. In response, it became aggressive in raising rates and communicating that future rate increases would continue. This forced down investors' willingness to purchase long-duration assets, such as stocks and longer-term bonds, along with things such as Cryptocurrencies.

HUDSON VALLEY INVESTMENT ADVISORS, INC.

A subsidiary of Orange County Bancorp, Inc.

Second Quarter Outlook

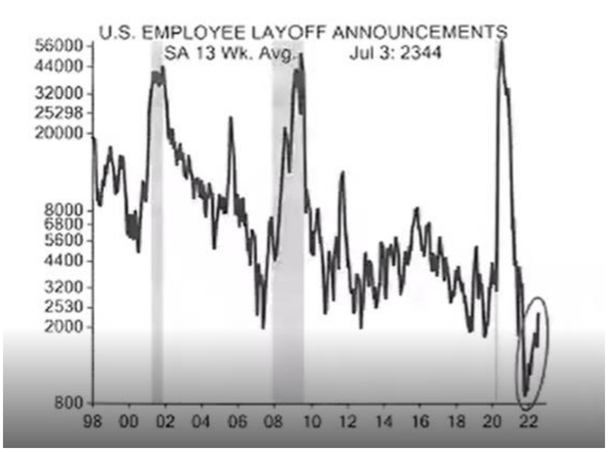
As of July 6, 2022

The Ukraine-Russia conflict is limiting all types of commodities. This limited supply we believe will continue to push up food prices and may cause friction in the developing world. Food is subsidized in many developing economies and was responsible for the Arab Spring approximately a decade ago. This situation could reemerge over the coming quarters as supply remains restricted. Estimates are that over 10 million people could die from limited food supplies. The outcome of this conflict could come to some conclusion before the winter as the ground freezes and Russian tank groups, the largest in the world, have an easier time advancing over the frozen plains of Ukraine. We believe that the longer this goes on without a resolution the greater likelihood that the reversing of globalization will accelerate.

U.S. politicians continue to be in the crosshairs due to inflation. Politicians are scoring to lowest approval ratings in recent history as inflation is listed by voters as the number one concern. Approximately 40% of the electorate votes are being hurt due to higher gas, food, and shelter costs. The Federal Reserve has been put in charge by President Biden to reduce inflation. Unfortunately, the Fed's toolbox of monetary options limits its ability to elegantly reduce inflation. We view this as similar to a post-WWII period, when demand exceeded supply, employment was robust and the imbalances pushed up prices. Just like in the WWII period, we expect that the improvement in supply and availability of labor will lower inflation rates. These changes will still not get inflation back to pre-COVID-19 levels as other factors, such as offshoring will not be as impactful in the future.

The U.S. remains one of the best-positioned countries for future economic growth. The U.S. is mainly self-sufficient in commodities, has a significant economic base, has a 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. countries.

We have seen strong investment by U.S. corporations to improve productivity and replace labor with technology. This will be a long-term trend that will impact everyone's daily lives from going to a fast-food restaurant to how corporations operate. The current labor shortage looks to be slowing with employee layoff announcements increasing (as seen by the chart below) and may limit future labor inflation. The investment in manufacturing technology-based 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.



Source: ISI

The S&P 500 recorded a loss of 16.1% for the first quarter. In terms of sectors, all eleven groups reported losses for the quarter as higher interest rates and inflation impacted all sectors of the economy. Quarterly results included Consumer Staples (-4.62%), Utilities (-5.09%), Energy (-5.17%), Health Care (-5.91%), REITS (-14.72%), Industrials (-14.78%), Materials (-15.90%), Financials (-17.50%), Information Technology (-20.24%), Communication Services (-20.71%) and Consumer Discretionary (-26.16%). The quarter's economic data has slowed but remained above historical trends for a larger number of categories.

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

Second Quarter Outlook

As of July 6, 2022

As we look at the remaining quarters of 2022, we expect earnings to see some slowdown but remain near record levels. Demand is still strong but is starting to slow but consumers continue to shift from goods purchases to a focus 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

At HVIA we believe that we are in the midst of an economic rebalancing that will lead to growth in the future. We had anticipated a slowdown in inflation which we believe will come. Goods prices are receding, and demand has been impacted by higher interest rates but there appear to be limited imbalances which could cause a mild recession as companies continue to replace inventories and make capital investments.

We continue seeing major investment in 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 North American market, from overseas locations, is expected to increase providing higher levels of economic growth and starting a virtuous cycle of reinvestment. This will lift productivity and grow GDP above other developed markets.

Innovation is increasing with greater levels of technology being added to all areas of the economy. Tasks such as eating at a fast-food restaurant via an app enhance productivity which helps profits and utilizes fewer workers. GDP should be lackluster in the short term but rebound longer-term as inventory rebuilding, housing, and car manufacturing will provide an economic base. This will be further supported by increased demand for services. State and local governments are sitting on strong balance sheets and budget surpluses that will most likely be deployed into infrastructure. Public companies are showing resiliency maintaining margins near record levels. We are expecting margins to remain robust but be below the current, near-record levels. As we move through the remainder of 2022, we continue to see strong demand for travel, housing, and all things associated with entertaining.

Compared to Developing markets, the U.S. has higher growth, and strong demand for its products and appears to be maintaining a stronger economy than its European or Asian counterparts. Internationally, the U.S. is uniquely positioned. China is injecting investment dollars directly into its economy to help stimulate demand. Lockdown policies and individual lack of investment will limit growth in 2022. Europe may be going into a recession based in part on the increased inflation and the Ukraine war.

Earnings are what drive equity markets. The earnings projection for the S&P 500 is higher than at the start of 2022 but may see a pullback as higher costs and slowing growth impact returns. Earnings continue to move higher in the first half of 2022. Currently, the 2022 earnings expectation sits at approximately $225 and $250 for 2023. The next move in the markets will be based in part on the company management earnings outlooks given over the next few weeks. At HVIA we continue to anticipate that there will be more volatility as the Federal Reserve manages interest rates through year-end. We have focused on shorter-duration fixed income investments and the use of rate strategies to limit the impact of higher rates over the past 12 months. The Federal Reserve has put us in a position that looks to be playing catch up to limit inflation. Despite the expected increase in volatility for stocks, Hudson Valley Investment Advisors, Inc. is balancing investing for both opportunities in equities as well as fixed income over the remainder of 2022.

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

Second Quarter Outlook

As of July 6, 2022

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

- On June 29, 2022 we held via Zoom, our "*Economic Update Conference Call*". A replay of this call can be found on our website **hviaonline.com** under the Insights page titled: **Market Update June 2022**.

- As we move into the back half of 2022, we are planning an in-person Economic Update, more details will follow.

- As of *July 1, 2022*, Hudson Valley Investment Advisors, Inc. has engaged the services of Chicago Clearing Corporation (CCC) to provide class action litigation monitoring and claims filing services. As a client of HVIA, you are automatically included in this new service, unless you have chosen to opt-out. As part of the service, you will no longer need to mail in any claim forms to us that you may receive in the mail. CCC handles the processing for you, saving you time and postage.

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.

Second Quarter Outlook

As of July 6, 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.