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Hudson Valley Investment Advisors, Inc.

A subsidiary of Orange County Bancorp, Inc.

THE DELIBERATE INVESTOR

Gus Scacco

CEO and Chief Investment Officer
Hudson Valley Investment Advisors, Inc.

Gus brings over two decades of experience investing on behalf of individuals and institutions. If you watch Fox Business, you'll often see Gus as a regular guest talking about the markets. When he's not looking after portfolios, Gus is active with several not-for-profit organizations across the Hudson Valley.

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Economy and Markets in Review

Q1.2025: Outlook & Market Commentary

Q1 2025 Dashboard

Markets: S&P 500 Index: -4.6% YTD return through 3/31/2025

Interest Rates: FOMC held rates steady at both January and March meetings (currently 4.25%-4.5% target range)

Economy: 2.4% annualized Gross Domestic Product (GDP) growth in Q4 2024 (versus 3.1% in Q3 and 3.0% in Q2)

Inflation: 2.8% increase in Consumer Price Index (CPI) over 12 months through February

Q: Gus, could you provide a broad overview of what happened over a volatile first quarter of 2025? Especially what everyone is talking about now—tariffs.

GS: Sure. For the underlying market, you had record earnings and record margins last quarter, profitability is robust. There was a changing landscape as the Q1 earnings season ended, and that had to do with tariffs being contemplated.

Just to set the stage a bit, when we came into the new year, we had 93 executive orders issued by the new administration in its first 77 days. By comparison, there were 220 executive orders over the entire four years of President Trump's first term. So, they are ramping things up at a much faster pace, and many of those executive orders have to do with tariffs on imported goods.

Q: Do tariffs have the same set of strategic objectives for all countries?

GS: No. There are different objectives for different trading partners. For example, China, Canada, and Mexico are our three largest trading partners, and together they account for half of all U.S. imports, which is why the administration started with those three countries.

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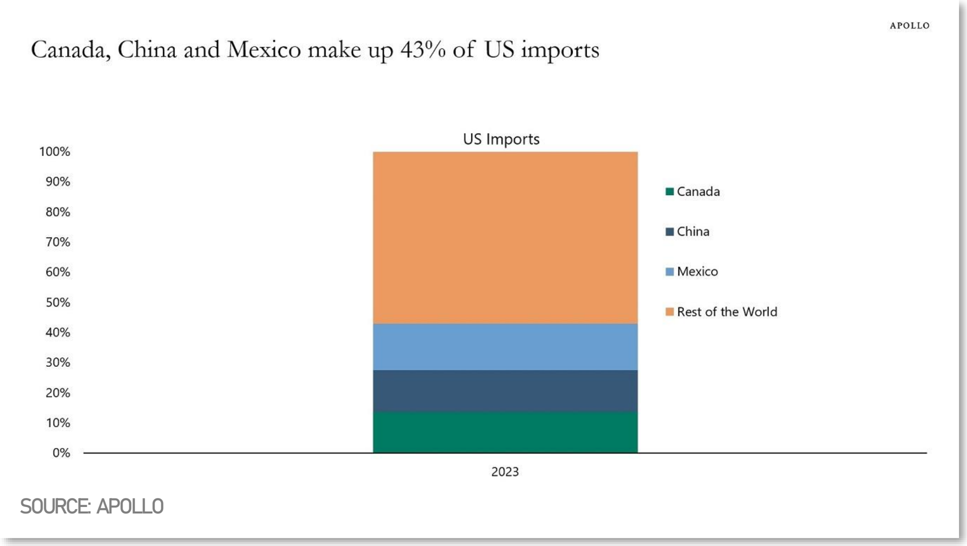
Economy and Markets in Review (continued)



With China, it is about restricting them. But they are going to negotiate with China separately.

But for Mexico and Canada, it is different because we need them for cheaper labor and manufacturing. So, it was about getting ahead of the U.S.-Mexico-Canada trade agreement (USMCA), which renews next year. With Canada, it is also about oil, specifically heavy-grade oil, which we need but do not produce domestically.

Q: Are there any interesting trading dynamics among the three countries?

GS: Behind the scenes, Mexico is pre-empting trade with China. China built car factories in Mexico so they would fall under NAFTA. What is interesting is that about 20% of the vehicles and parts made in Mexico come from China. To give you an idea, roughly 44 million electric vehicles were produced in China last year. They kept 20 million and exported the rest.

The administration is using tariffs as a lever to affect policy change and free trade. It sets everything up for the new USMCA.

Q: What other big-picture dynamics were at play in the economy over the quarter?

GS: Not everyone realizes that 22% of the economy is supported by government spending; that is up from about 15% if you go back 20 years. In the last two years of the Biden administration, the federal government hired more people than at any time since World War II.

So nearly a quarter of the economy is now fueled by government spending, and everything is coming under review by the new Department of Government Efficiency (DOGE). DOGE is looking more closely at Medicaid; in New York State for example, 1 in 3 people have Medicaid coverage. So, there is an impact there.

The other thing is, DOGE is breaking things along the way, so people may get rehired. The cost savings may not be as big as expected, only about $100 million to $200 million in savings, instead of the $1 trillion you hear about.

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Economy and Markets in Review (continued)

Q: Where does inflation net out with all these big moves at the Federal level?

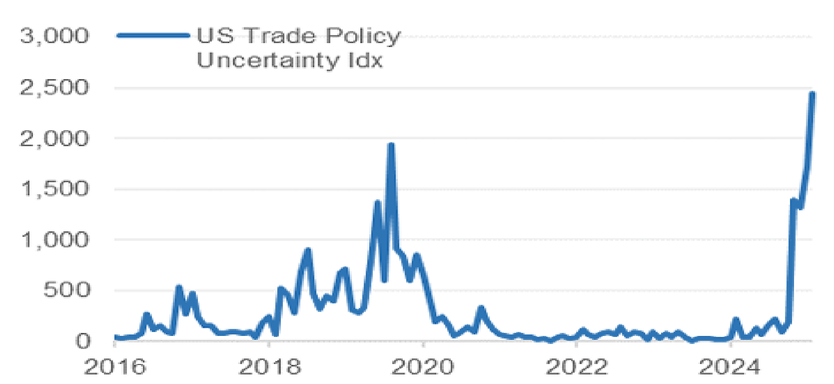
GS: Tariffs are expected to increase inflation in the short term (because of the substitute effect), but over the long term it should be a non-factor. Since all these things are happening at the same time, it does not give you the time to find substitutes. The first things to get hit are goods you cannot easily or quickly find substitutes for. For example, there is really no substitute for soybeans.

Canada, Mexico and China account for about half of U.S. imports, and imports only make up 10% of our GDP. If you get a 25% increase due to a tariff, it is only about 1/5 of a percentage increase (20 basis points) in inflation. So, the impact is not as huge as people may fear.

Q: So really it is more noise than it is a significant long-term impact?

GS: Yes. The impact we are talking about has been illustrated by some of the big construction groups. They are still moving forward with their projects; however, they have not started them yet. They are sitting on their hands because they do not know the cost structure. If I am one of these construction companies and I need steel or wood, for example, or if I am building something that needs cement, I am waiting to see what the fallout will be from tariffs.

Figure 7: Trade Uncertainty Has Gone Parabolic



Source: Baker Bloom & Davis, Bloomberg, Evercore ISI Research

Q: How have ripple effects from tariffs brought the economy to where it is now?

GS: We have essentially manufactured a slowdown, and in doing that you are taking inflation out of the system. Both the economy and real estate have slowed, home prices have come down, manufacturing has also slowed, and manufacturers are building up inventories.

People around the world are selling U.S. dollars, which is making the dollar cheaper and acts as a discount when buying supplies here in the States.

Q: In the fog of a trade war, how much has the economy truly slowed?

GS: That is the interesting thing. Capital expenditure has halted, but you have seen an increase in S&P 500 earnings. The economy has not really slowed, because 70% is services not directly impacted by tariffs in the same way. People are still spending money. They are going out to restaurants on a Saturday night, and spending money on travel.

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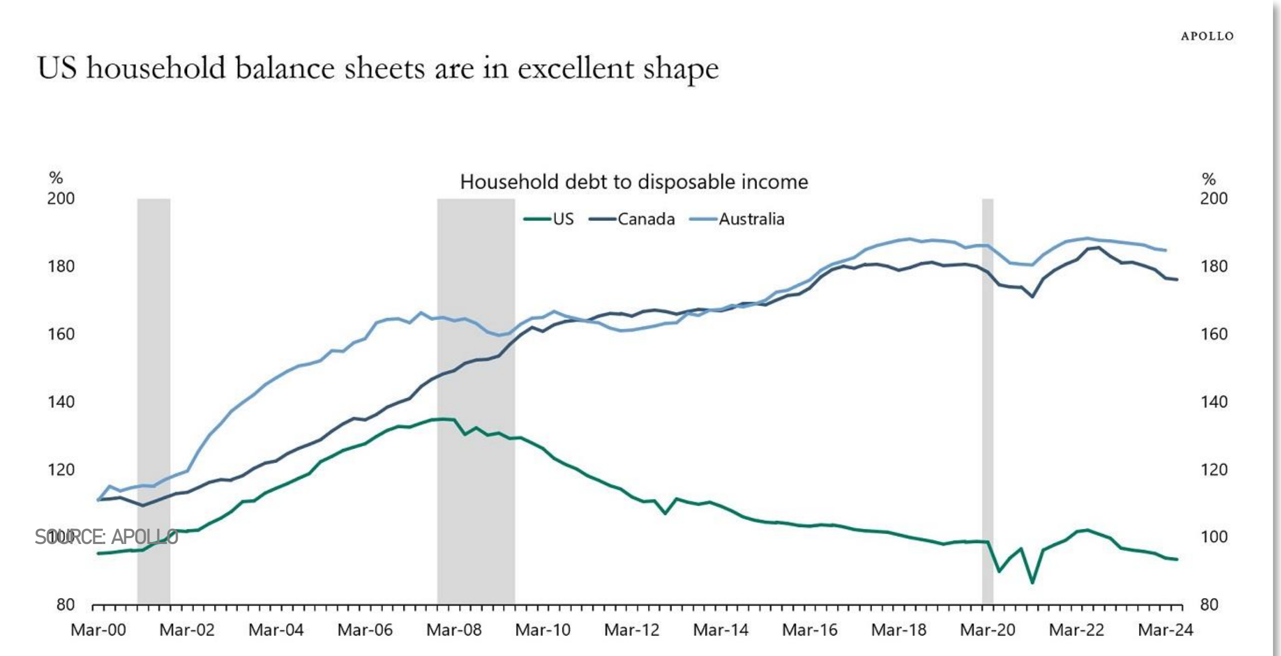
Economy and Markets in Review (continued)

"It's the eggs you're buying at the diner, not the eggs themselves."

Q: So, is there some good news in all of this?

GS: Yes. Consumers' balance sheets are good, businesses' balance sheets are good, banks have not seen bad debt, and real estate has slowed, wringing out some of the inflation.



Source: Apollo

We are also in the middle of a productivity cycle because of AI. Historically, productivity has run at about 1% for the past decade, but it is currently running above 2%, which is good. Why is that important? If you put that 2% together with population growth of about 1%, you get a GDP run rate upwards of 3%. That means you are doubling the economy every 24 years as opposed to every 36 years.

Q: What's the latest with the Federal Reserve and interest rates?

GS: The Fed is on hold, and we think they are likely going to cut interest rates. Everything is in place. The economy has slowed, and inflation is on the backstep. The Fed is just waiting to see what the tariff impact is going to be, but they may not get clarity on that for an extended period.

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Economy and Markets in Review (continued)

Q: Can you talk a little bit about the geopolitical landscape?
GS: War is coming to an end or at least deescalating in two places.

In the Middle East, it has been all about chaos. But if you look at the groups that were causing the volatility, whether it is the Iranians, the Syrians, Hamas, or Hezbollah, they are all on the back foot now or have been taken over.

Then the world's three largest oil producers, the U.S., Saudi Arabia, and Russia are negotiating an end to the war in Ukraine. What you will likely end up with is more oil getting pumped, which lowers inflation.

Q: How does this all tie together for the U.S. economy?
GS: If I am looking at this from the outside, there is a lot of volatility, you have tariffs that are basically the tail wagging the dog, and the economy is slowing but not going into a recession.

How do we have confidence in that? Usually there is some sort of correction for too much inventory, too many people not working. This is one of the first times when there are no overages or debt. Consumers and businesses typically take out debt to keep momentum going, but that is not happening, and banks have had the lowest leverage since World War II.

Inflation is on the "last mile" to get to 2% target, and the government is trying to lower budget deficits, while at the same time issuing tariffs.

Q: Where is the onshoring trend currently?
GS: Onshoring will continue, and companies will come here because we are more of a consumption-based economy. China's economy, for example, is slowing and it is not a consumer economy like the U.S.

Businesses have held off, but now there are chipmakers outside the U.S. investing hundreds of billions into U.S. manufacturing plants. Hyundai and BMW have plants here, but they are getting hit with tariffs for imported parts. Plus, they are putting off building those plants because there's not enough adequate and affordable housing for workers.

> *"You have to have the people, the housing and the manufacturing plants themselves."*

We have talked before about an insulin manufacturing facility in Massachusetts, where they have retrofitted an old Coca-Cola bottling plant in Springfield. Our edge in technology is making onshoring even more attractive. They are producing four times more with a third of the workers they had when the factory was in China.

If you want to get products sold in the U.S., you are almost forced to come here. The longer you wait to build that factory, the more it is going to cost. So, yes, onshoring is the trend that is here to stay for the near future.

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Outlook

Q: Where does the economy go from here?

GS: People are in a wait and see mode, but there is money on the sidelines. What do I mean by that? Interest rates have come in so that mortgage rates are down a bit. So, once you get consumer angst out of the way, you will see pick-up in house purchases. The second thing is that the economy is okay when you look at that 2-3% growth rate. Lastly, as long as people are employed, they are going to continue to spend.

Q: So not as bad as it may feel sometimes?

GS: Correct. We are cautiously optimistic. We think the consumer and the economy are more resilient than people expect.

There is about $80 trillion in assets held by Americans, and 65% of that held by people over the age of sixty-five. They are getting 5% on their assets where they got nothing for a decade, and they are spending it. They have paid off their houses, which have also gone up in value. They are feeling rich, and they are going about their business and not slowing down, which helps keep the economy going. So even though it may not feel like the economy is doing well, that is what statistics tell us.

Unemployment is low. It is really sentiment more than anything else now.

Source: Apollo

Q: Speaking of which, how good of a barometer is consumer sentiment as a forward-looking economic indicator?

GS: Consumers are concerned now more about tariffs than anything else. They think the job market has slowed, as well as the economy. Egg prices, along with gas prices are good barometers of how consumers are feeling.

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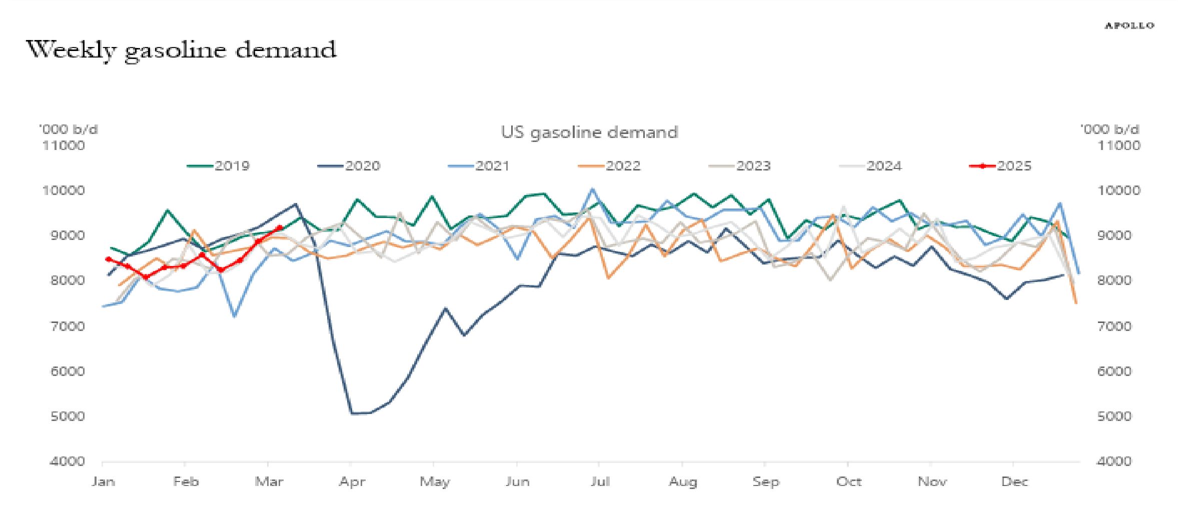
Outlook



Source: Apollo

Q: What is the outlook for interest rates going forward?

GS: Interest rates are not in too bad of a place. If the Fed does not signal at its next meeting in May, that they are going to cut later this year, they are probably going to hold off cutting for a longer period. They are trying to balance growth with inflation because things have slowed.

What this Means for Your Portfolio

Q: A big part of HVIA's investment approach has been focusing on U.S. based multinationals over foreign securities. With European stocks doing so well over the past quarter, how does that stack against HVIA's philosophy?

GS: There has been a big differential between U.S. and non-U.S. valuations. European stocks, led by Germany, caused a pop in those markets mostly from defense spending. In the U.S., there are several more funding sources and alternatives, allowing risk-takers to invest and to start to open businesses. This does not exist overseas. It is why you have such a concentration of technology companies being funded and based in the U.S.

The additional and diverse funding sources in the U.S. help weed out good and bad foreign investments. We still think you want to be in the U.S. In addition, both China and Germany are export led economies. They will come under pressure from the U.S. due in part to its trade deficit. Longer term investment in those markets may be impacted by the current tariff policy. There have been only a couple of instances over the last 25 years where you wanted to be in overseas stocks rather than U.S. stocks.

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As an added benefit , we'd like to share the following insights from our colleagues at Orange Wealth management and Orange Bank & Trust

Should You Consider a Living Trust?

THE "PEACE OF MIND" STRATEGY FOR WEALTH MANAGEMENT

One of the most useful and flexible wealth management tools is the revocable living trust. Traditionally, we like to point to three basic benefits that these trusts offer.

Professional asset management.

After studying your goals and circumstances, our asset-management specialists will propose a diversified investment program appropriate to your requirements. Like many of our clients, you may authorize us to select specific investments on your behalf, confident that we will carry out this responsibility faithfully. (We have no securities to sell, nor do we receive commissions on purchases and sales. Our annual compensation is limited to the moderate fees that we charge as trustee.) Our objective is not only to add to your financial security, but also to give you more opportunities to enjoy it.

Uninterrupted family financial protection.

A living trust agreement can instruct us to perform a wide variety of special tasks when the need arises. These tasks might be as simple as paying a world traveler's quarterly estimated taxes while he or she is out of the country… or as complex as handling all household financial matters for a customer who has suffered a stroke and needs a housekeeper and nursing home care.

Older men and women often find this "future protection" aspect of our services especially attractive. With proper planning, living trusts can do much to avoid the financial management problems that arise during a prolonged period of incapacity—problems that might otherwise have to be dealt with by a court-appointed conservator or guardian of the estate.

Probate avoidance.

Assets placed in a living trust are said to avoid probate because these assets are removed from your "probate estate"—the property controlled by your will. Trust assets are distributed to beneficiaries, or held in continuing trust, as you direct in the trust agreement. Thus, using a living trust as the core of an estate plan may lead to reduced settlement costs.

More important, delays are avoided. For example, a married person's living trust can simply keep operating, uninterrupted by estate-settlement procedures, for the benefit of the surviving spouse. Living trusts also help to keep estate plans private. Unlike probated wills, provisions for the distribution of assets contained in living trust agreements do not normally go on public record.

CHECKLIST OF POTENTIAL LIVING TRUST BENEFITS

- ✓ Professional asset management
- ✓ Uninterrupted
- ✓ Potential probate avoidance
- ✓ Family financial privacy
- ✓ Minimizing identity theft
- ✓ Protecting aging retirees
- ✓ Serving disabled loved ones
- ✓ Potential asset protection in divorce

continued…

Should You Consider a Living Trust? (continued)

NEW PERSPECTIVES

But living trusts can do more. Among the emerging benefits that have appealed to many:

Minimizing identity theft. The problem of identity theft has exploded in recent years. A funded revocable trust may have its own tax ID number, rather than using the settlor's Social Security number. In the event that the settlor's Social Security number is compromised, the trust assets will still be protected.

Protecting aging retirees. More and more retirements are lasting longer than 20 years, and more and more elderly are developing some level of cognitive impairment. A living trust can provide for successor trustees as the beneficiary's abilities decline. Checks and balances can be built into the plan, in the form of co-trustees or trust protectors. A care management plan might also be included, to provide annual or quarterly assessments of how the beneficiary is doing.

Serving disabled loved ones. A revocable trust may contain special-needs language to provide for an ill relative or incapacitated adult child. The trust may also provide for successor trustees should a caregiver become incapacitated.

Asset protection in divorce. If gifted or inherited assets are segregated into a trust, they won't be commingled with other marital assets. As such, those assets won't be vulnerable in a subsequent divorce proceeding.

Notwithstanding the decline in estate planning attributable to the increase in the federal exemption from estate taxes, the traditional and emerging benefits associated with revocable living trusts will make them an essential part of late-stage life planning for years to come.

SEVEN FACTORS FOR SUCCESSFUL TRUSTEESHIP

To unleash the power of a living trust as a wealth management tool, you need to select the best trustee for your family. Here are seven good reasons to place your trust in our care.

1. Group judgment. Our trust investment committee monitors the investments in the trusts in our care.

2. Reliability. We understand the special responsibilities of a trustee. All trust funds in our care are safeguarded by both internal and external audits.

3. Experience. Trusteeship is our business.

4. Responsiveness. Financially successful individuals and their families expect personal attention and responsive service. We deliver.

5. Objective investment guidance. Unlike investment advisors who are compensated mainly by sales commissions, we earn our trustee's fee by providing our trust clients with unbiased, personalized guidance.

6. Convenience. From bill paying to retirement planning, we can provide or obtain just about any convenience or special service that our trust clients desire.

7. Neutral arbiter. When trust provisions permit discretionary invasions of principal in specified circumstances, our neutral judgment in exercising fiduciary powers may help smooth disagreements among beneficiaries.

To set up a living trust with our partner Orange Bank & Trust, please visit OrangeBankTrust.com

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