The Outlook

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A Hudson Valley Bank Company

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As of 09/17/2008		
Index	**YTD % Change***	**Market Value**
Dow Jones Industries	-20.0%	10,609.66
S&P 500	-21.2%	1,156.39
Nasdaq	-20.9%	2,098.85

The observations which we are making in this Outlook directly follow from our last Outlook that was written at the end of August. Recent news about Lehman Brothers, Merrill Lynch and American International Group revealed more stresses on the U.S. and global financial system. Human nature is such that market participants like to buy when they feel comfortable, which means buying in rising markets and not selling until markets decline. **The greatest returns are most often realized under just the opposite circumstances; the best returns for investors are realized when shares of undervalued companies which have strong and rising earnings are purchased during periods of extreme market stress.**

The continued de-leveraging of institutions including hedge funds, commercial banks and investment banks, and the government bail-out of Freddie Mac and Fannie Mae reflect the deteriorating condition of the U.S. financial system. The impact this is having on equity markets is clearly negative. In the process, investments unrelated to the financial sector and which benefit from continued global growth have become even more attractively valued than they were before the market's recent decline.

The Financial System and its Impact on Company Valuations

The deterioration of the U.S. financial industry has been occurring over the years as more and more leverage has been put on the system. The amount of borrowing in relation to the underlying value often involved excessive leverage of up to 30 times. Combining this with the poor state of regulatory and supervisory oversight governing the creation of complex financial products, it was likely that something would trigger the unwinding process that we are now experiencing. That trigger has been the decline in housing prices. What must ultimately emerge is a new business model for the banking system.

As the federal government, the U.S. Treasury, and the Federal Reserve have taken on the responsibility and burden of protecting the economy, the cost can have a negative impact on the federal budget deficit and on the foreign exchange value of the U.S. dollar. As a result of the AIG crisis, the Federal Reserve has made an historic and unprecedented decision by taking a 79.9% equity stake and providing $85 billion short-term funding.

In light of these financial stresses, we expect to see the prices of precious metals and other commodities traded in world markets to rise in dollar terms over time. **We also expect to see a general recognition that the greatest investment beneficiaries of these events will be those companies that produce real goods and products and not financial paper.** We anticipate continued global growth, although perhaps at a slower pace. The demand for the products and output of corporations which serve the industrialization and urbanization of overseas economies will continue to increase. Many companies benefiting from global growth have experienced stock market declines to the point where they are now selling at a discount of 40-60% of their real-world values, or 4 to 8 times earnings and 3 to 6 times cash flow from operations. These companies have solid balance sheets, strong managements, and important global market positions. **Of equal importance, the strong cash flow and balance sheets reduce their reliance on financial institutions to support their growth. In our view, many of these companies represent what we like to call the crown jewels of the world's industrial economy.**

Conclusion

As professional investors, our focus remains on increasing purchasing power and building capital for our clients over time. The challenges we have experienced over the last 12 months serve as daily reminders of our purpose. The demise of firms such as Bear Stearns and Lehman Brothers is farther-reaching than just the loss of two premiere U.S. institutions and the jobs and people within those companies. New York City estimates that for every financial job lost, two or three non-financial jobs are also lost. In addition, the impact affects many 401K and pension plan participants invested in these firms.

This year we have witnessed a partial and temporary breakdown of the global financial system. Recent events have proven how difficult it is to predict what stage we have reached in the de-leveraging process. We expect to see continued pressures in the financial system. **However, we believe that this may be a time to take advantage of extraordinary opportunities and to do this in a measured way over the coming weeks and months.** One critical factor we are watching closely is the amount of cash held by sovereign wealth funds, private equity funds, hedge funds and money market funds, much of which is positioned to take advantage of these increasingly attractive equity valuations. Still, we continue to expect a significant amount of market volatility. In these times, market participants' decisions tend to be driven by emotions and perceptions while losing sight of the business fundamentals. **Notwithstanding the uncomfortable environment in which we are operating, we continue to identify and invest in companies that are demonstrably undervalued in terms of assets, cash flow and earnings power. At some point in the future, investors will be able to look back and see the investment opportunities that had developed.**