

## Activity is Slowing in the Eurozone Again

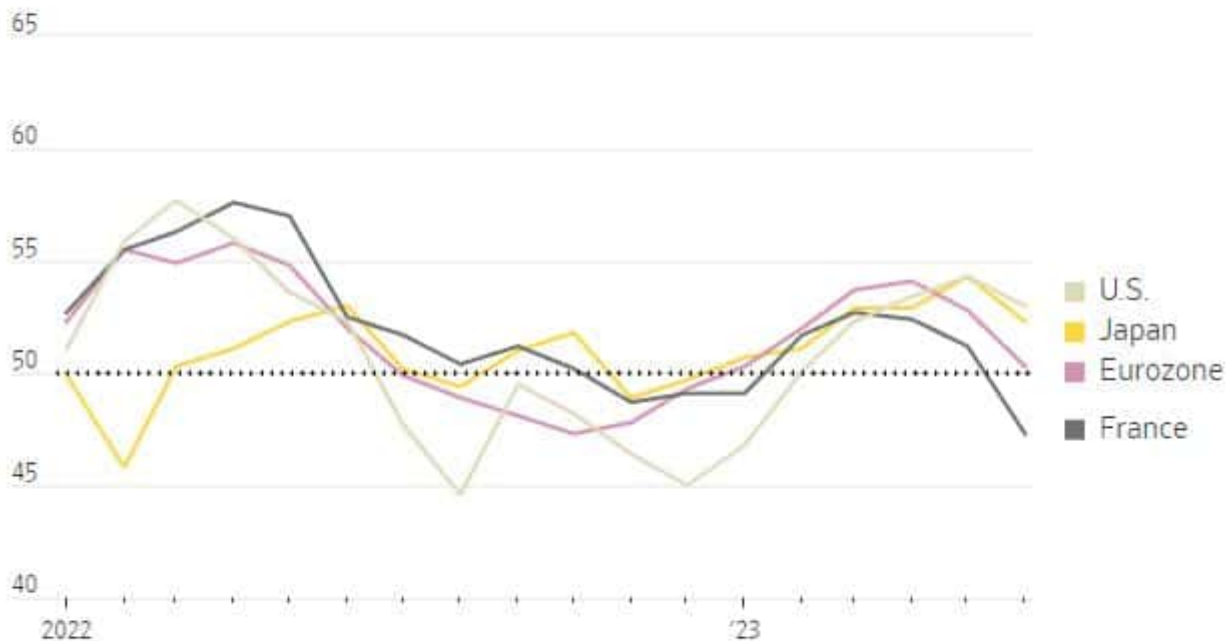
Business activity is slowing in the Eurozone once again. The Eurozone's composite PMI for June, released on Friday, fell to 50.3 from 52.8, marking only a slight expansion of business activity during the month. The slowdown was due to weakening service growth and a deepening downturn in manufacturing activity. Despite the ongoing weakness in the Eurozone, the ECB is still expected to raise its policy rate at the upcoming July meeting.

In contrast to the Eurozone, Friday's United States flash PMI data indicated a much less dramatic slowdown in services growth. The data came in higher than expected at 54.1 but fell from 54.9 in May. The Fed will likely maintain its hawkish rhetoric so long as services activity remains strong. Still, composite activity is slowing in the US as manufacturing activity moved deeper into contractionary territory in June. The composite PMI fell to 53 from 54.3 in May, notching its first pullback this year. The chart below, from the Wall Street Journal, shows how composite PMI's are evolving in the US, Europe, and Japan.

## Global Slowdown

Business activity in the U.S., Europe and Japan slowed sharply in June.

### Composite purchasing managers index



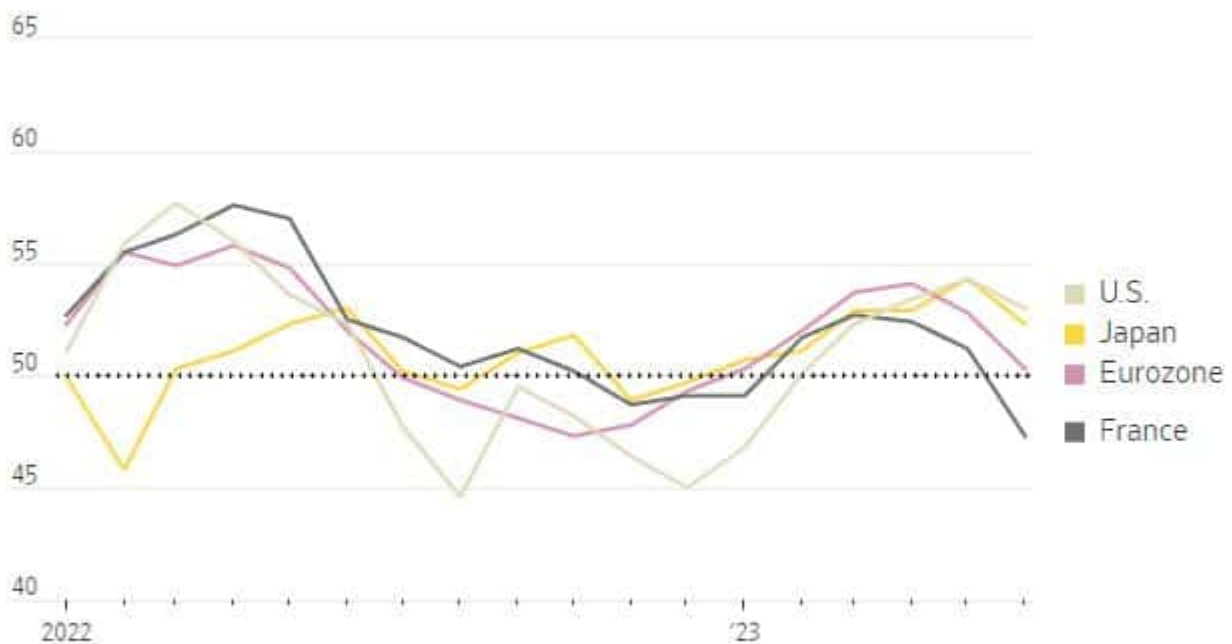
Note: Seasonally adjusted. Readings above 50 indicate an increase in activity, and below that threshold, a decline.

Sources: S&P Global, au Jibun Bank (Japan); Hamburg Commercial Bank (eurozone, France))

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## What To Watch Today

### Earnings

	Company	Time	Estimate		Growth Show only confirmed?	Surprise
✓	<b>CCL</b> Carnival Corp.	9:15 AM ET	(\$0.35)	\$4.76 B	98.3%	+ = -
✓	<b>CUK</b> Carnival PLC	BMO	(\$0.38)	-	-	+ = -

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### Economy

MONDAY, JUNE 26							
14:30	🇺🇸 USD	Dallas Fed Manufacturing Business Index(Jun)	<div><div></div></div>	-	-	-26.5	-29.1 🔔
15:30	🇺🇸 USD	3-Month Bill Auction	<div><div></div></div>	-	-	-	5.13% 🔔
15:30	🇺🇸 USD	6-Month Bill Auction	<div><div></div></div>	-	-	-	5.17% 🔔
17:00	🇺🇸 USD	2-Year Note Auction	<div><div></div></div>	-	-	-	4.3% 🔔
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### Market Trading Update

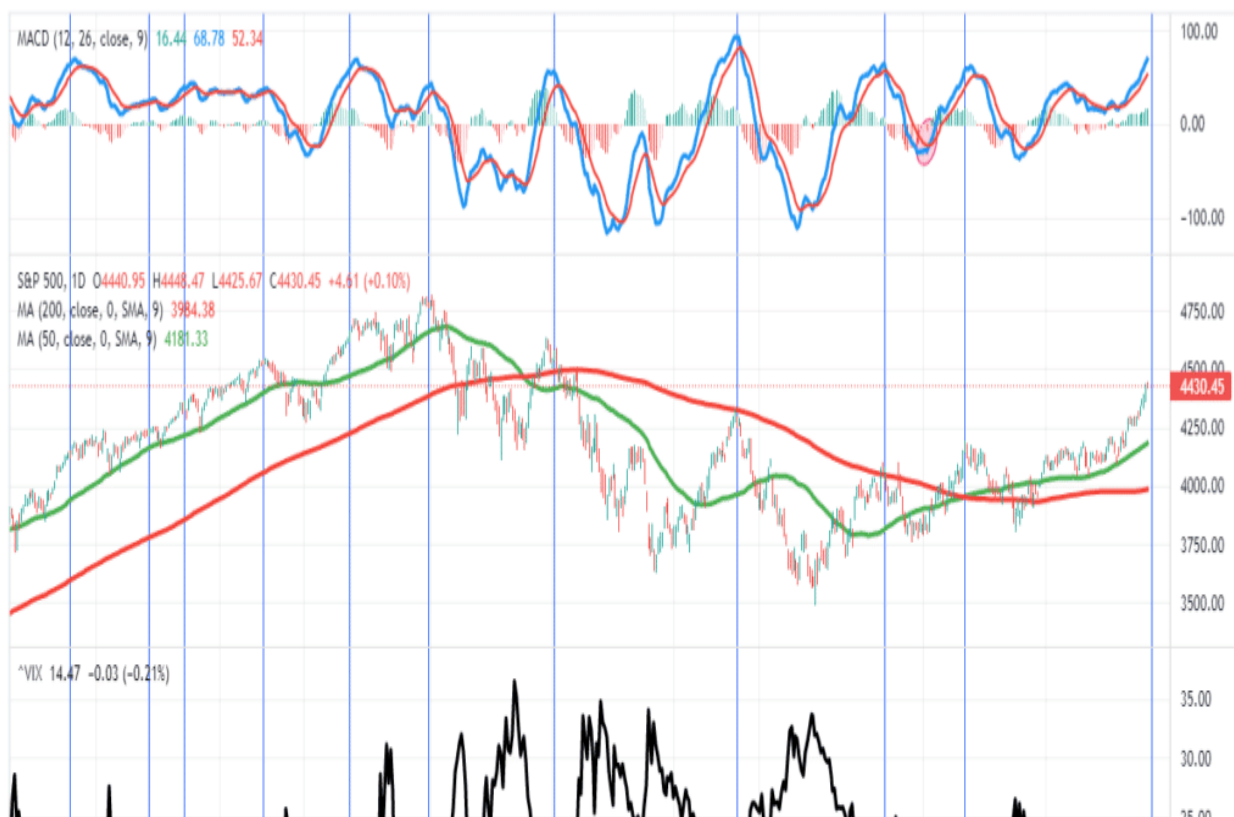
As stock prices continue to push higher, investor and consumer sentiment indexes have also risen. As discussed this weekend, such should be expected. However, that increase in the sentiment index is also working against the Fed. Such is something Jerome Powell noted this past week during his testimony before Congress. Combined with the Fed's comments that more rate hikes are likely coming, continued weak economic data and persistent inflationary pressures weighed on the markets this week. [As noted last week](#), such was unsurprising.

*?This past week, the market pushed well past our previous price target and is moving well into 3-standard deviations above the 50-DMA. Furthermore, the market is very overbought on multiple levels. Lastly, the volatility index is at extremely low levels, **which has almost uniformly preceded corrections of 5-10% during both bull and bear markets.**?*

This is the attendant chart from last week. Specifically, take note of the more extreme reading of the top and bottom indicators.



TradingView



This week's correction has pushed our buy signals close to confirmed sell signals. Notably, should these sell signals trigger, such will occur from fairly elevated levels suggesting a more protracted correction or consolidation ahead.



# MoneyFlow Indicator ( ^GSPC ) - beta



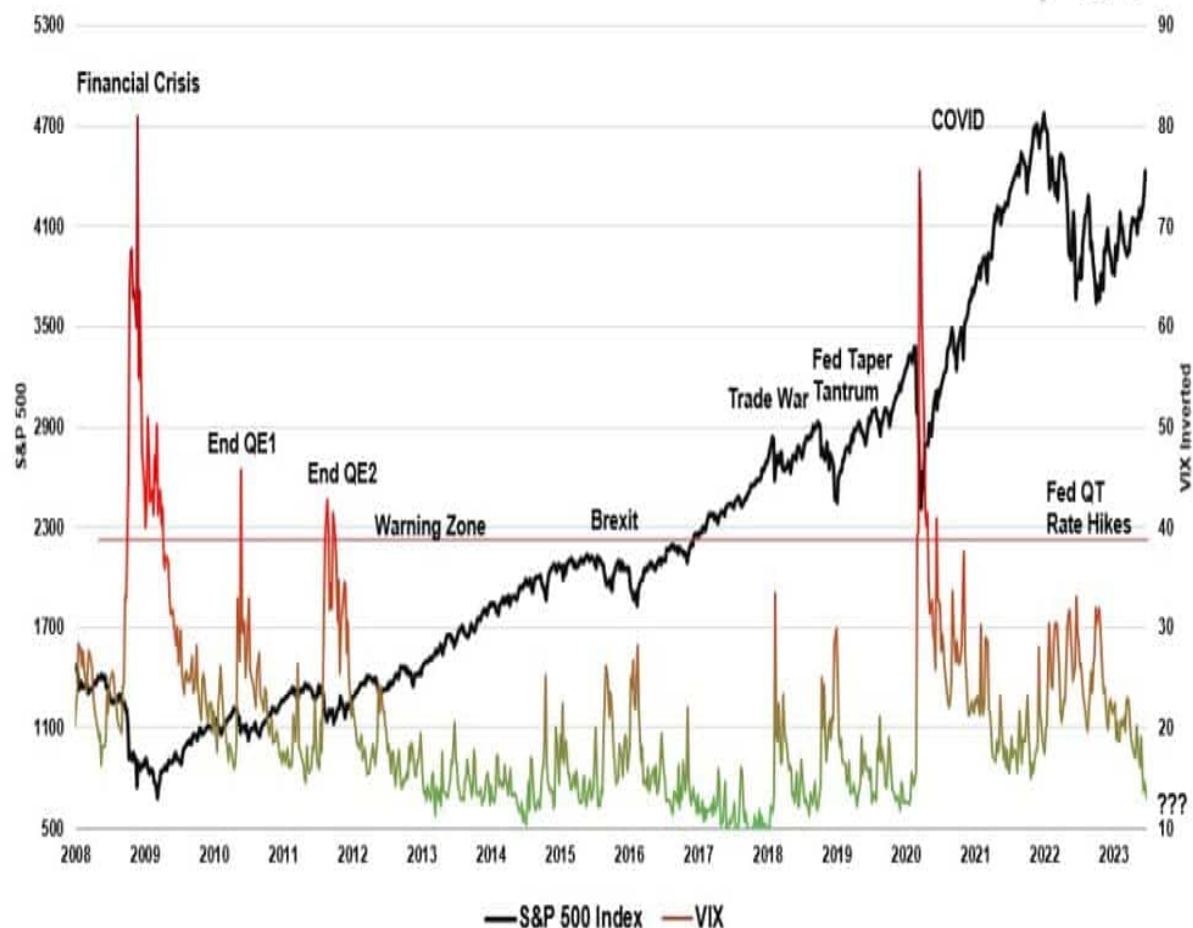
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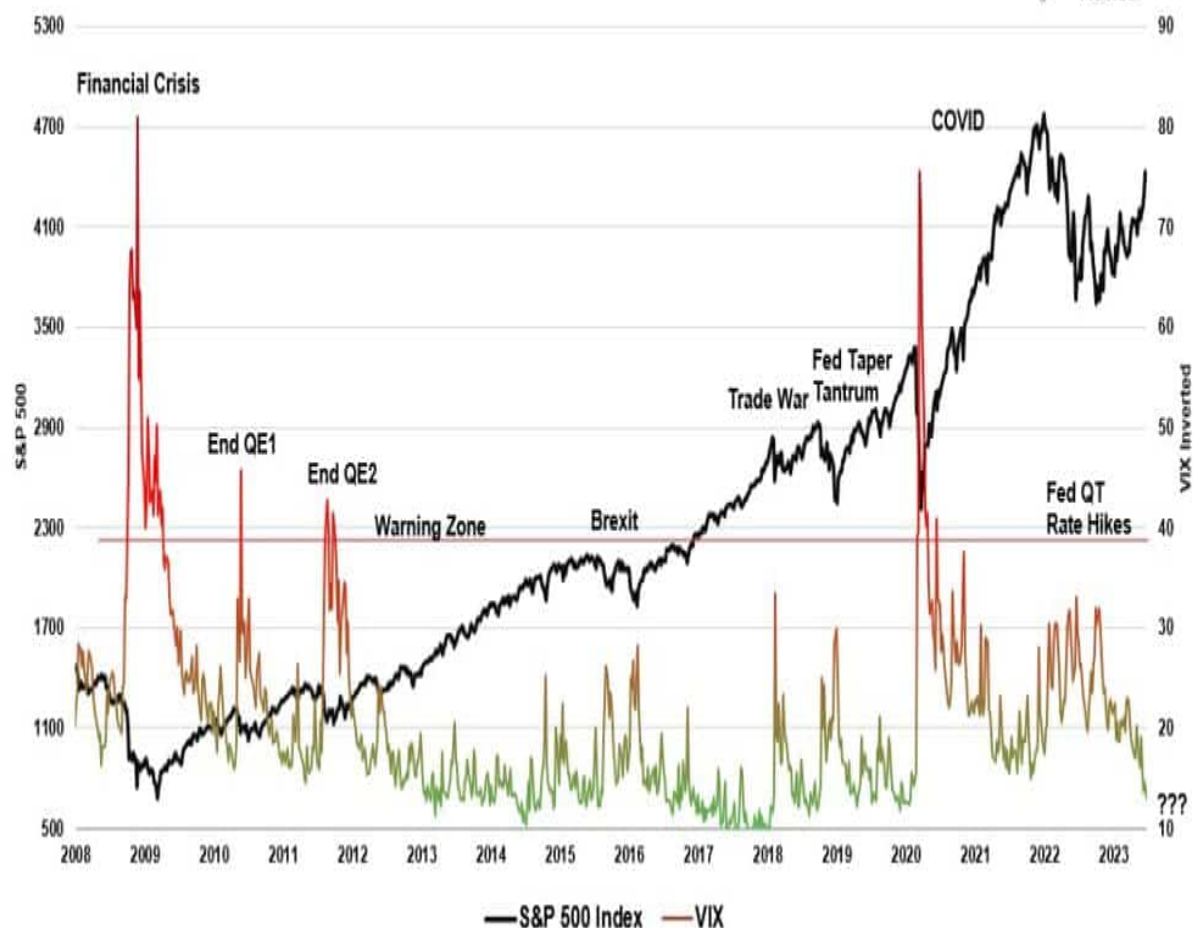
Another concern we have about the current rally is the collapse in market volatility. While there is strong momentum, and bullish psychology, behind the rally, extremely low volatility readings tend to align with short-term market peaks and corrections.



## VIX VS. S&P 500



## VIX VS. S&P 500



With bullish sentiment pushing into *extreme greed* territory, this past week's correction did little to resolve the bullish, overbought, and deviated conditions. With the end of the quarter approaching, we could see additional selling pressure this coming week as managers rebalance portfolios for second-quarter reporting. Furthermore, July tends to be one of the weak trading months of the year, and following a strong May and June, a respite should be expected.

However, corrections to previous support levels should be used to add equity exposure opportunistically.



## The Week Ahead

This week will be somewhat light on economic data. Today kicks off with the Dallas Fed Manufacturing Index for June. The index has deteriorated for five consecutive months, with the latest reading at -29.1. The consensus expectation is for a slight rebound in June to -26.5. Tomorrow we'll get an update on both Durable Goods Orders and New Home Sales for May.

Fast forward to Friday, and we'll get an update on the Fed's preferred inflation measure, the Core PCE Price Index for May. The consensus estimate is for an increase of 0.4% MoM, the same rate we saw in April. Finally, we will hear from Fed Chair Powell twice this week, once on Wednesday and once on Thursday.

## Rate Hikes are Beginning to Impact Earnings

Interest costs are becoming a drag on earnings after more than a year of rate hikes by the Fed. According to [Bloomberg](#),

Interest costs at US companies rose by 22% in the first quarter compared to a year earlier, soon after the Federal Reserve started raising rates, according to a recent survey of about 1,700 businesses by [Calcbench Inc.](#), a data provider.




















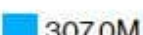




Alongside rising wages and higher costs, growing interest expenses are pressuring on companies to preserve cash and reduce debt.

Until March 2022, below 6% was the weighted average cost of capital for companies in the S&P 500, Mankins said. Now, that cost is higher than 9%. In that world, choices are very different, he said, referring to decisions made by finance executives.

Some companies have it worse than others, depending on their debt structure. As shown below, junk-rated Carvana has seen its interest costs grow 150% YoY. Interest coverage ratios may have faded into the background during the 'cheap money' era of the past decade, but they're as important as ever in this environment.

## Companies face year-on-year rise in interest expense

























Interest costs in the first quarter of 2023 and 2022, in US dollars

Company	Q1 2023	Q1 2022	YoY growth (%)
Charter Communications Inc.	 1.3B	 1.1B	 19
Verizon Communications Inc.	 1.2B	 786.0M	 54
Apple Inc.	 930.0M	 691.0M	 35
Amazon.com Inc.	 823.0M	 472.0M	 74
American Airlines Group Inc.	 540.0M	 463.0M	 17
Carnival Corp.	 539.0M	 368.0M	 46
Union Pacific Corp.	 336.0M	 307.0M	 9
Carvana Co.	 159.0M	 64.0M	 148

Source: Calcbench, Bloomberg

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## The Next Risk Facing Regional Banks

Interest-only commercial mortgages have become increasingly popular since the financial crisis. The differentiating feature of these loans is that borrowers only pay interest throughout the loan period, with a balloon payment on the principal due at maturity. Borrowers usually make the final payment by refinancing or selling the building, but higher rates and risk aversion from lenders could

throw a wrench in that plan. We share a few quotes on the topic from the [Wall Street Journal](#).

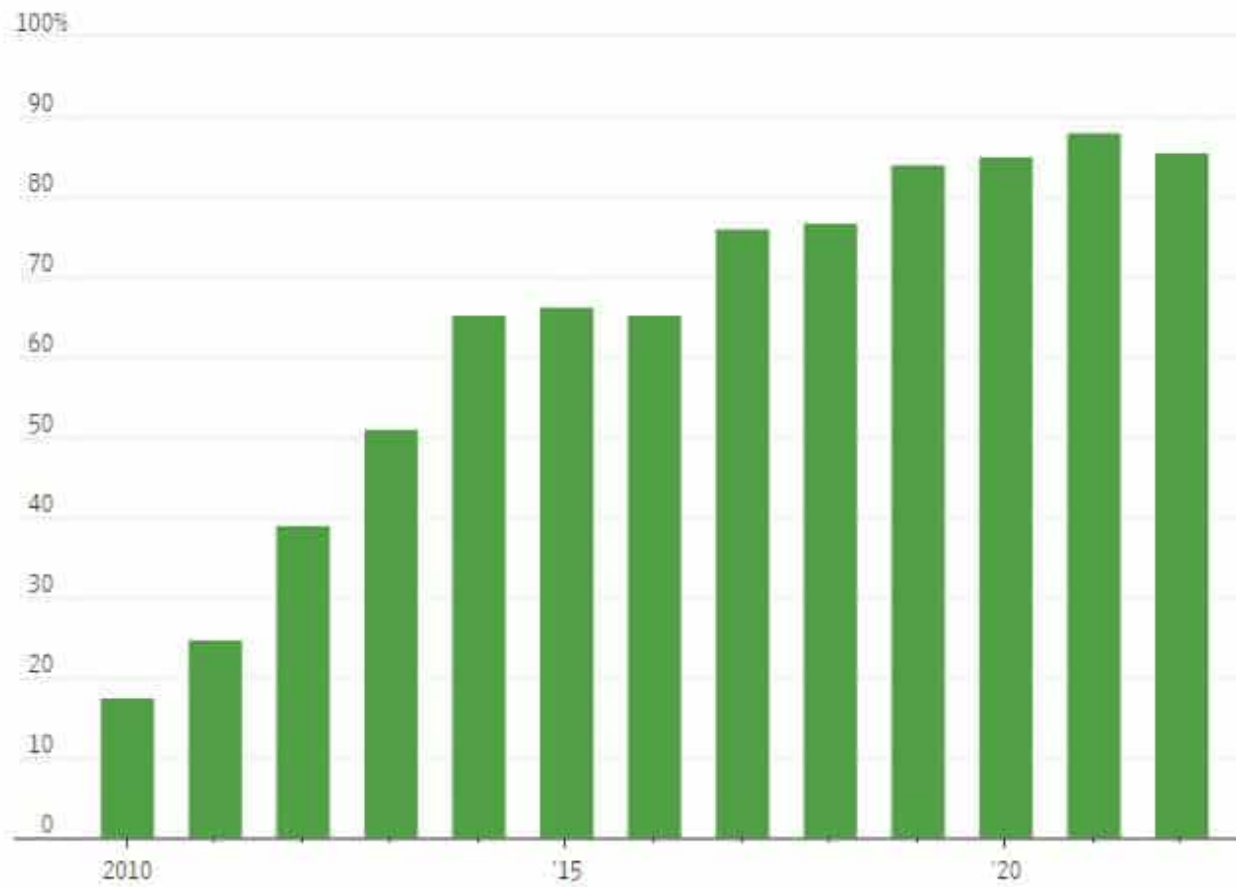
Many banks, fearful of losses and under pressure from regulators and shareholders to shore up their balance sheets, have mostly stopped issuing new loans for office buildings, brokers say.

Xiaojing Li, managing director at data company [CoStar](#)'s risk analytics team, estimates that as much as 83% of outstanding securitized office loans won't be able to refinance if interest rates stay at current levels.

A rise in defaults could ripple through the commercial real-estate market by forcing distressed sales and pushing down property values. It could also hit regional and community banks that [are heavily exposed to the sector](#), forcing them to write down the value of commercial mortgages on their books and set aside more cash to cover for losses.

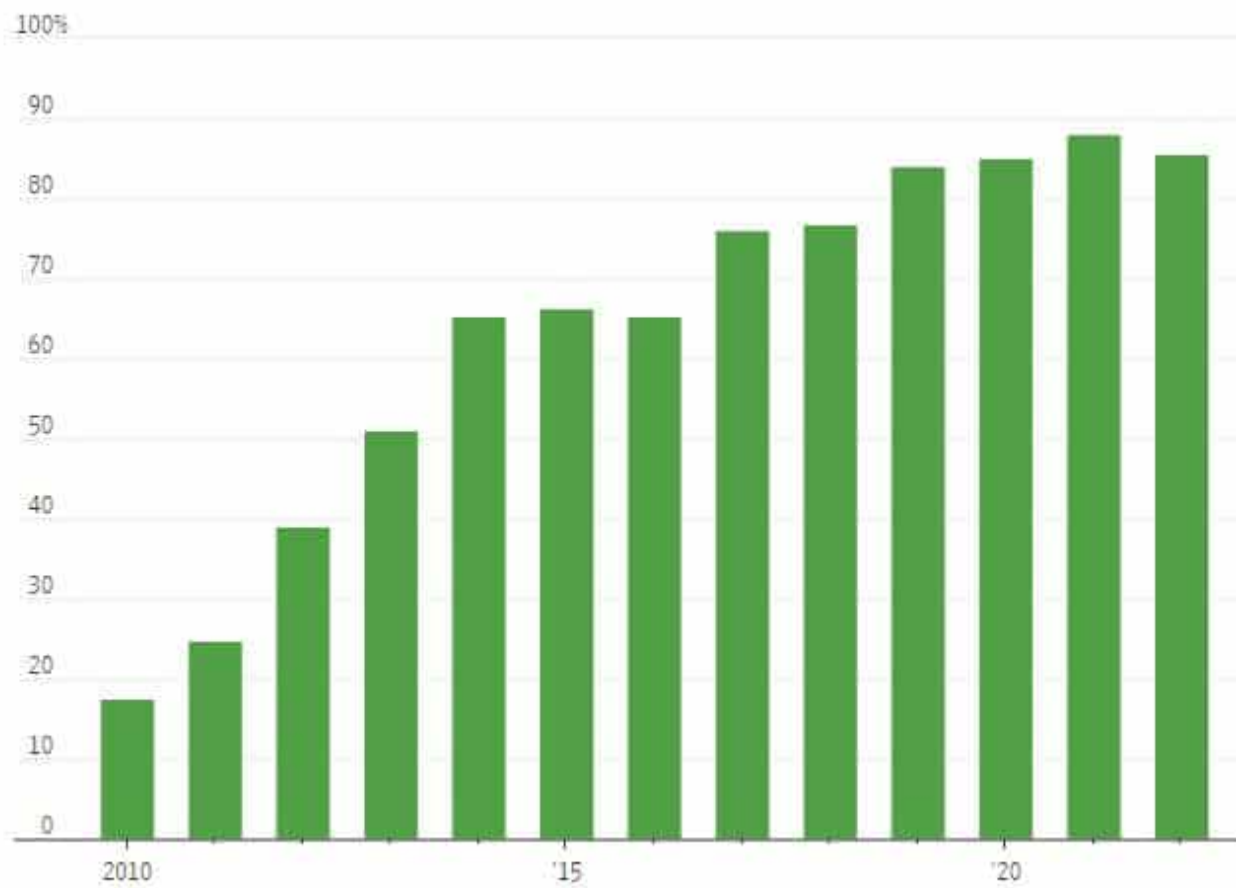
As previously [noted](#), banks hold the mortgages on about 55% of office building debt. The next risk facing regional banks lies in the upcoming maturities of these mortgages, just as refinancing activity is slowing to a halt in this segment.

Share of CMBS loans that are interest-only, by year of issuance



Source: Trepp

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