

record its strongest three-day rally in about fourth months – spurred by comments last week from the Bank of Indonesia that the country's trade balance returned to surplus in May. The AUDUSD is also poised for a solid gain (+0.25%) after the RBA maintained its neutral tone in today's policy meeting.

The last trading day of 1H14 failed to bring with it any volatility associated with month-end and half-end portfolio rebalancing. Indeed, yesterday's S&P 500 volumes were about half that compared to the last trading day of 1H13. Adding to that, the S&P 500 closed virtually unchanged at -0.04%, and for the record the last time we saw a gain or loss of more than 1% in the index was April 16th. One theme to note though was the continued underperformance of European banks across the equity and credit spectrum. Yesterday's underperformance was sparked by a 17% fall in the stock of Banco Espirito Santo which is Portugal's largest bank. The price action was dictated by reports that regulators were concerned over corporate governance between the bank and other related companies and there were also reports that Luxembourg justice authorities had launched an investigation into one of the bank's holding companies (Reuters). Portuguese securities regulator banned naked short selling on the bank's stock for one day. The news weighed on Portuguese bond yields which added 8bp, and also on European banking stocks in general (-0.75% vs Stoxx 600 -0.09%). Peripheral bank credit traded about 3-5bp wider yesterday – and the European senior financials index (+2bp) underperformed Main (+1.375bp). The two credit indices were trading flat to each other in the middle of June but the recent underperformance of banks has pushed the basis back to nearly 6bp. We still think its likely that Fin Senior will trade through Main in H2 though.

Across the Atlantic, there was focus on the Chicago PMI and home sales data, following which treasury yields spiked up briefly before retracing the move to be largely unchanged on the day. The US Chicago PMI was slightly below expectations 62.6 (vs 63.0 expected) and also below last month's 65.5. Still, our economists note that the PMI was consistent with a large snapback in growth in Q2, and they noted the three-month to June average was 63.7 which is the highest since the three months to April 2011. The other regional activity indicator, the Dallas Fed manufacturing outlook rose to 11.4 (vs 8.5 expected and 8.0 prior). Pending home sales rose 6.1% MoM (1.5% expected) which benefited US homebuilders on the equity side (+1.5% yesterday). In terms of Fed speak, the SF Fed's Williams commented that a first rate hike in 2H15 will be appropriate, but he also reiterated that it may be optimal for the Fed to let inflation run above target in order to balance the Fed's dual mandate.

Perhaps one of the key themes of 1H14 was the surging M&A activity globally. With 1H14 books closed, the final M&A tally was \$2.2trillion according to Bloomberg which is a YoY increase of 77%. By region, leading the way was the resurgence of corporate activity in Europe (+109% YoY), though this was coming off a low base, followed closely by North America (+79%). In terms of industry the biggest pickup in activity came in pharma (+677%) and healthcare (+140%). One reason for the surge in M&A has been the accommodative capital markets. We saw an example of that yesterday with a jumbo bond deal from Oracle who priced \$10bn in bonds (the second largest USD offering in the year-to-date according to Bloomberg) to fund the purchase of Micros Systems. The deal was sufficiently large to drag other TMT bonds several basis points wider on the day.

Looking at some of the geopolitical headlines, Ukrainian President Poroshenko said late on Tuesday that we would end the cease-fire with pro-Russian rebels and vowed to intensify military operations in the country's east. However the president also made some concessions including guaranteeing Russian-language rights and more regional autonomy. Russia also offered some concessions yesterday including allowing Ukrainian and international observers in its own border posts along the border with Ukraine. In Iraq, semi-autonomous Kurds plan a referendum for independence according to a regional government spokesperson (Reuters). The Kurds plan to keep control of the Kirkuk oil fields.

There are some mixed headlines elsewhere in China. Firstly China's banking regulator announced a small change in the way that loan-to-deposit ratios are calculated which our banking analysts think will reduce the system regulatory LDR ratio by 410bp based on end 2013 data. Our analysts think that this will pave the way for more relaxation of Chinese bank liquidity requirements. Secondly, the latest Macau gaming numbers were reported which showed June casino revenues fell 3.7% YoY in June. This is the first drop since 2009, but some are attributing this to the effects of the World Cup.

Turning to the day ahead, the rest of the global manufacturing PMIs/ISMs will be released starting with the final PMIs for Europe. The US manufacturing ISM is expected to show a small bump up to 55.9 (vs 55.4 in May) which would mark a six month high. DB is expecting a print of 55.0. Other highlights on the US data docket are May construction spending and the IBD/TIPP economic optimism index.

YTD performance review