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Equity Insights

Banking sector: the bull run continues

Key Messages

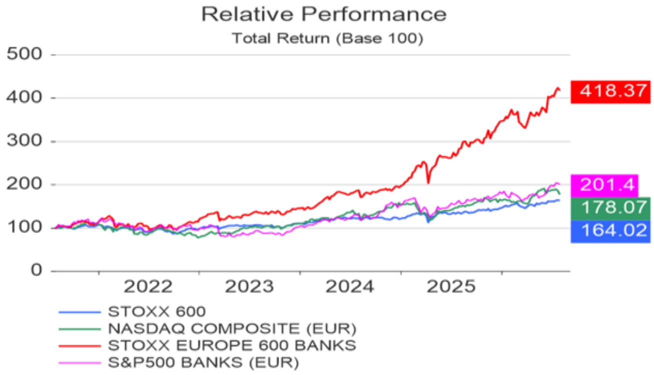
- European banks again among the top-performing sectors this year; American banks also doing well.
- Strong Q2 earnings growth reported by US universal banks.
- European banks have also delivered solid Q2 results and remain undervalued.
- Multiple growth and efficiency-gain opportunities for banks on both sides of the Atlantic.

European banks join the podium of best-performing sectors in 2026

Following an exceptional 2025 (with the sector up +67% ex-dividends), European banks have maintained strong momentum in 2026, delivering +20% year-to-date as at 30 July (+24% including dividends). This aligns with our initial upside target of 15–20%. Banks rank second in the European sector performance, trailing only energy. In this paper, we will demonstrate that European banks still hold significant upside potential of at least 10%.

Including 2025-2026 stellar performances, over the last five great years, European banks are the best-performing sector across both US and European markets, even outperforming the Nasdaq (see Chart 1). Over a 10-year period, they match the Nasdaq's return (~+400%) when dividends are included.

CHART 1: EUROPEAN BANKS STRONGLY OUTPERFORM OVER THE LAST 5 YEARS



Source: LSEG Datastream, 29/07/2026

At the start of 2026, we also forecast that US banks had less upside potential than their European peers, given their higher valuations and lower profitability. Additionally, the US financial sector faced strong headwinds due to concerns over private credit (a mini-crisis which now seems to be under control) and investor rotation toward AI-related sectors. Nonetheless, US banking stocks have still posted solid gains this year: +10% (including dividends) as at 30 July.

Goldman Sachs's and Morgan Stanley's shares, boosted by one-off gains (more details below), have outperformed their peers, with returns of 17% and 18% in 2026, respectively.

Restored solvency

In the wake of the Global Financial Crisis (2007-2009), the eurozone debt crisis (2010–2018), and the early-2020s COVID-19 shock, banks—under regulatory pressure—have made significant strides to strengthen their financial resilience and cost efficiency while substantially bolstering capital buffers, i.e. their solvency ratios.

The European supervisor regularly conducts stress tests simulating major crises, which confirm that the banking sector is now far better equipped to withstand shocks. Nowadays, large European banks maintain a Common Equity Tier 1 (CET1) ratio of around 16% (see Chart 2), well above the 13% threshold considered as very robust. All major European banks now meet or exceed this 13% level, as do leading US banks, including JPMorgan, Bank of America, Citigroup, Goldman Sachs, and Morgan Stanley.

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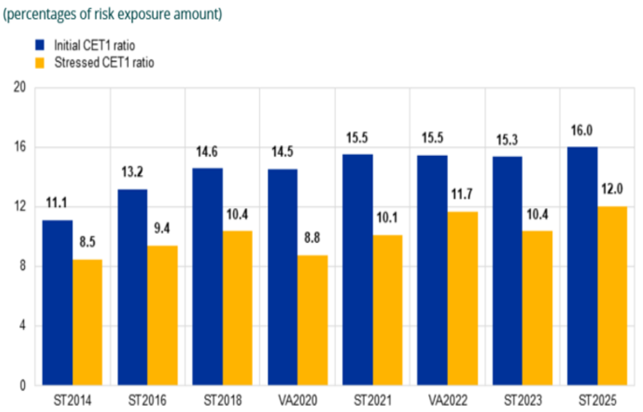
This restored solvency enables banks to:

- Increase investments in high-growth segments (such as Asset and Wealth Management) and in Technology, particularly AI. This is driving higher recurring revenue (management fees) and further structural cost reductions.
- Pursue value-creating M&A, unlocking synergies.
- Deliver strong shareholder returns through dividends and share buybacks.

CHART 2: EUROPEAN BANKS BOAST UNPRECEDENTED CAPITAL STRENGTH

Aggregate CET1 capital ratio at the starting point and at the end of three-year adverse scenario



Sources: EU-wide stress test exercises, ECB and ECB calculations.
Note: ST stands for EU-wide stress test and VA stands for vulnerability analysis, which is a desktop exercise conducted by the ECB.

A strong Q2 2026 earnings season

One key characteristic shared by European and North American banks is their consistent ability to outperform expectations quarter after quarter, a critical driver of their stock market gains. On 14 July, major US banks delivered standout results, with JPMorgan, Bank of America, Citigroup, and Goldman Sachs all surpassing analyst forecasts. Morgan Stanley followed suit the next day with equally strong figures. While these results include one-off tailwinds, such as a volatile yet supportive equity market, massive capital raises (including Alphabet's record USD 85 billion offering, the largest in history), and SpaceX's landmark IPO—the core banking businesses remain robust. This includes lending, buoyed by steady consumer demand and AI infrastructure financing.

These exceptional factors are expected to drive ~20% earnings growth for US banks in 2026, before moderating to +10% in 2027 and 2028.

European banks are also firing on all cylinders:

- Net interest income remains strong, with further upside as legacy low-rate loans (2010–2022) roll off and are replaced by higher-margin lending in today's normalised rate environment.
- Investment banking and trading divisions have capitalised on favourable market conditions.
- Asset and Wealth Management has further boosted results, as seen for instance in Amundi's and UBS's Q2 results.

Abundant opportunities on both sides of the Atlantic

Beyond supportive bond yield curves and financial markets, the macro-economic backdrop remains favourable. The US continues to enjoy a "goldilocks scenario" of strong growth and relatively contained inflation, despite geopolitical tensions in the Middle East. While a prolonged conflict, an inflation flare-up, or fiscal slippage leading to a sharp rise in yields could derail economic growth and the banking sector, this is not our base-case scenario.

In Europe, investment plans in infrastructure and defence are materialising. Authorities are working to better mobilise European savings for major continental projects (energy transition, digitalisation, and industrial sovereignty). They are also becoming more receptive to the emergence of "European champions", showing greater openness to sector consolidation, including cross-border M&A.

Finally, we believe artificial intelligence will drive massive productivity gains in banking, a factor we consider significantly underestimated by the market. JPMorgan has already announced having cut costs by USD 2 billion through AI, and all banks are now investing, to varying degrees, in AI-driven initiatives expected to deliver substantial efficiency improvements.

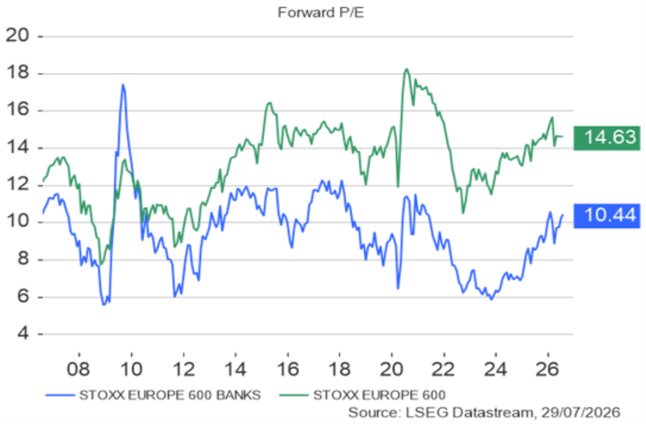
Banks now appear stronger than ever before. Their cost-to-income ratios are at multi-year lows, falling below 50% for most major US and European institutions. This structural cost reduction, further accelerated by AI adoption, comes at a time when growth opportunities abound. Double-digit earnings growth, today a reality for the sector, would have seemed unthinkable just a few years ago.

Undemanding valuations

Despite this favourable backdrop, valuations—particularly in Europe—remain undemanding, with forward P/E ratios at just 10.4x (see Chart 3).

In a healthy and supportive environment, a fairer multiple would be in in the range 11.5 to 12x, implying ~10% near-term upside potential—and even more over the medium term, given expected earnings growth.

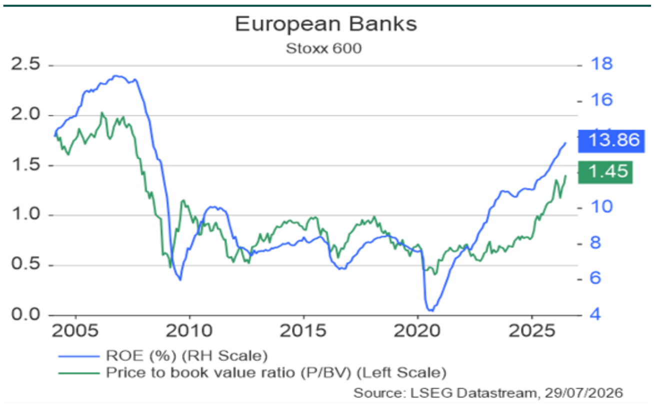
CHART 3: DESPITE HAVING RERATED, EU BANKS ARE STILL CHEAP ON A P/E BASIS



This is further supported by the price-to-book value (P/BV) ratio, a key metric in bank valuation analysis. European banks are trading at an unjustified discount given the sector's strong fundamentals.

When compared with their high return on equity (ROE), the P/BV ratio appears undemanding, especially as ROE is expected to continue improving in the coming years. Chart 4 illustrates that the P/BV should rise by at least 10% to realign with the sustained ROE expansion.

CHART 4: UPSIDE POTENTIAL ALSO ON BASIS OF IMPROVING ROE VERSUS P/BV



By comparison, US banks appear more fairly valued based on these metrics. While their profitability (ROE) is lower than that of European banks, their valuations remain higher, with an average forward P/E ratio of 12.48x (see Chart 5) and P/BV ratio of 1.65x (see Chart 6). This suggests that US banks are trading closer to fair value, leaving less upside potential than their European peers.

That said, we believe US bank stocks could still see modest appreciation, supported by a favourable economic and market environment, as well as AI-driven efficiency gains. For investors considering US banks, we recommend focusing on high-quality, agile and the most dynamic financial institutions.

CHART 5: US BANKS LOOK MORE FAIRLY VALUED AT A P/E OF 12.48X

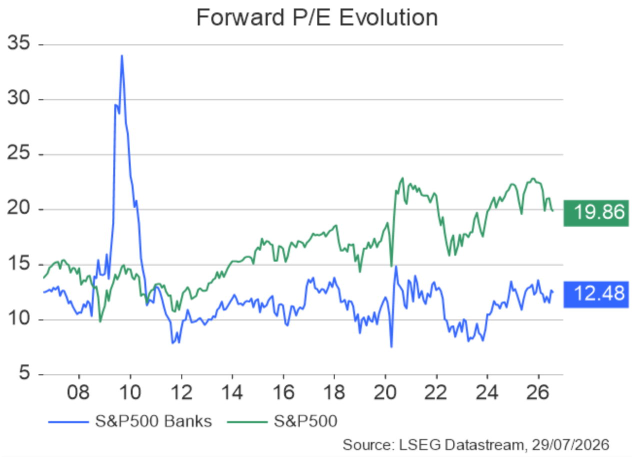
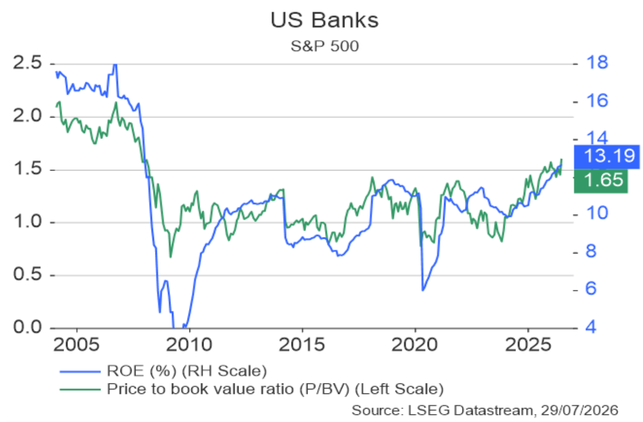


CHART 6: LIMITED US BANKS' POTENTIAL ALSO ON THE BASIS OF ROE VERSUS P/BV



What are the key risks?

The primary threats remain a sharp economic slowdown and runaway inflation, as seen during the start of the Middle East crisis, when energy prices surged. At the time, markets feared spiralling costs and weakening growth. While the US initially eased tensions in early June, escalations have resumed since mid-July.

The outcome and duration of this crisis remain uncertain. That said, as long as oil stays below USD 100 per barrel, markets are showing limited signs of panic.

Conclusion: Bank stocks' bull run is expected to continue, primarily in Europe

We have demonstrated that US bank stock prices already reflect much of the positive news, with valuations appearing fair (hence our Neutral rating on the US banking sector). While earnings growth for (large) US banks currently outpaces that of European peers, it includes many one-off factors. Consequently, following their strong Q2 results, the subsequent share price gains for US banks have remained modest. Goldman Sachs and Morgan Stanley have even seen their stock prices decline, reflecting concerns about the sustainability of their AI and tech-driven revenue streams.

For European banks, after 18 years of significant restructuring efforts and handsome Q2 results, we estimate ~10% upside potential by year-end 2026. The cost-efficiency efforts made by European banks remain underestimated by the market, as do the future efficiency gains from AI and the overall potential to achieve double-digit earnings growth in the coming years.

In comparison, US banking stocks are likely to deliver lower performances, hinging closely on their ability to surpass, or fall short of, market expectations.

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