

US large banks: The peak of the cycle is not the time to be complacent

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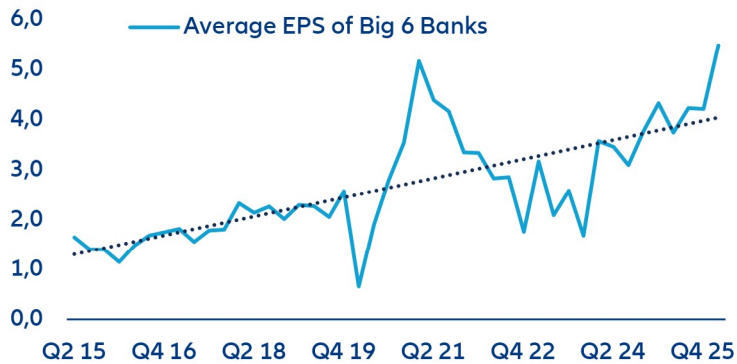
In Summary

- **US large-cap banks posted record Q1 2026 earnings, and both earnings growth and asset quality sits well above trend. Yet, investors seem wary about how long the good times can last, for at least four reasons.** Bank equities underperformed the S&P 500 and credit spreads widened versus non-financial peers. The market is looking beyond balance sheets and pricing a gap between reported solvency and true loss-absorption capacity.
- **First, buybacks offer short-term support but have limits.** The Big Six returned over USD110bn in 2025 and ~USD32bn in Q1 2026 alone via share repurchases, mechanically inflating EPS levels. But buybacks support EPS growth only as long as they continue: once excess capital is exhausted, the growth tailwind disappears with a cliff effect, leaving valuations resting entirely on business growth. Elevated trading income and the M&A cycle are both volatile and unlikely to persist at current levels.
- **Second, regulatory softening reduces buffers.** The March 2026 Basel III/GSIB/stress-test proposals will cut CET1 requirements for the largest banks by ~5–6% cumulatively. Banks have already positioned for this: CET1 ratios for the Big Six fell ~100bps y/y, and this direction will persist as big banks still have rich buffer of around 2pps against the minimum required CET1 ratio.
- **Third, SRTs artificially lift reported CET1.** Synthetic risk transfers (SRT) have grown five-fold since 2016 (~EUR800bn outstanding), allowing banks to shed risk-weighted assets and boost CET1 ratios without reducing actual exposure. “Organic” solvency, which is not at the mercy of high-risk-buyers, is lower than headline ratios suggest – an estimated gap of 43bps from the CET1 ratio, plus the procyclical and liquidity risk that have not been tested yet.
- **Last, long financial cycles analysis points to weaker fundamentals for the banking industry in the years ahead.** Based on BIS methodologies, potential financial strains can be detected by examining credit-to-GDP, real credit growth, and residential property prices over 8–30 year periods. This framework, which successfully identified the two last U.S. financial or banking crises (the S&L crisis and the GFC), helps spot out cycle reversals that typically precede stress, though timing remains uncertain. Current signals indicate the U.S. long financial cycle has passed its peak and entered a downturn phase between 2021 and 2023. Emerging strains may extend beyond banks to non-bank financial institutions, given their larger role in the economy. Although real corporate credit growth has been picking up recently, and credit standards have loosened, most other segments (such as mortgages) have been subdued for several years now, suggesting that the US economy is indeed entrenched in the downward phase of the long financial cycle.
- **The conclusion is asymmetric.** Equity prices may capture the upside created by continuous share buybacks in the short term. But the valuations, which already embed rate-driven net interest income (NII), buyback-fueled EPS growth and M&A super cycle tailwinds, are fragile and leave no room for disappointment. Credit spreads have widened modestly but do not compensate for structurally thinner capital buffers. The largest banks may be well-positioned to weather a downturn; the question is whether their investors are being paid enough for the risk that one arrives.

Is it the peak of the cycle for US banks?

America's large banks entered Q2 2026 in their strongest collective shape since before the financial crisis. Five out of the biggest six banks beat Q1 consensus estimates, supported by high trading income and the M&A and IPO cycle. Bank of America's equities trading income jumped 30%, representing its best trading quarter in 15 years. JPMorgan's markets revenue hit a record USD11.6bn, with fixed income up 21% and equities up 17%. Goldman Sachs' investment banking fees grew 48% year-over-year to USD2.8bn. However, Wells Fargo stood out, with the NII revenue miss sending its stock price down 5-6% on results day. Looking past the decade, the current cycle is clearly well above the long-term trend. Plotting the average earnings per share of the Big Six against its long-run trend shows that the group's average EPS now sits materially above trend at levels that have historically preceded compression rather than continuation.

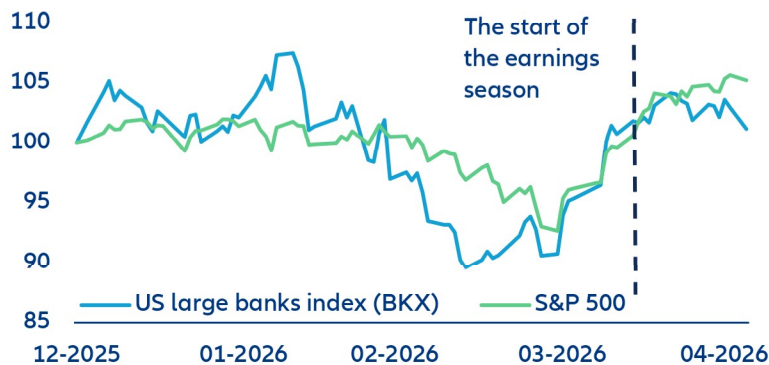
Figure 1: Earnings cycle goes above long-term trend



Sources: Bloomberg, Allianz Research

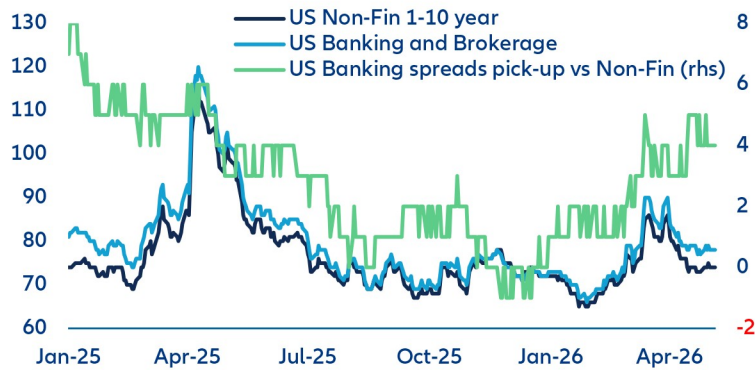
Nevertheless, markets are wary about how long the good times can last. The recent market reaction demonstrated more concerns than confidence. Since earnings season kicked off on 13 April, US large banks (KBW Bank Index) have dropped 0.6%, and underperformed the broader index (S&P 500) by more than 5pps. In credit, the divergence is subtler but more structurally revealing: US bank and broker spreads have widened relative to non-financial investment-grade issuers (keeping ratings and maturities equal). Investors have started to demand more compensation to hold bank credit than comparable corporates.

Figure 2: US bank stocks performance year to date (rebased to 100)



Sources: Bloomberg, Allianz Research

Figure 3: Credit performance - US banks credit premium is picking up



Sources: LSEG Datastream, Allianz Research

In the short term, the large scale of share buybacks is a cause for concern. America's six largest lenders returned more than USD110bn to shareholders in 2025, and Q1 2026 suggests the pace is accelerating with around USD32bn total repurchased. Share buybacks are, mechanically, among the most direct levers available to support earnings per share and the stock price: the fewer the shares outstanding, the higher earnings per share – an immediate signal of management confidence. But this is capital optimization, not capital creation. As buyback programs slow – whether from unstable trading revenue or simply from the pool of excess capital being exhausted – the mechanical EPS support they have provided will diminish. The equity story then rests entirely on the underlying earnings power of the business. At current multiples, that is a thin margin of safety because the elevated trading income and investment banking income is inherently volatile and not guaranteed to persist.

Figure 4: US Big Six banks distributed more than USD120bn capital in 2025 by share repurchases



Sources: Bloomberg, Allianz Research

For credit investors, it hurts more. The equity on a bank's balance sheet is the buffer that absorbs losses before bondholders are impaired. Each repurchase, executed at a premium to book, reduces that buffer in absolute terms. The Tier 1 capital ratio across the US banking system, which reflect banks' credit quality, is now turning for the first time after the interest rate shock in 2022. Tier 1 capital adequacy fell 13bps in the last quarter of 2025, reflecting the capital return program and signaling the peak of the credit cycle. And the new Basel III proposal announced last month was explicitly designed to push it further down.

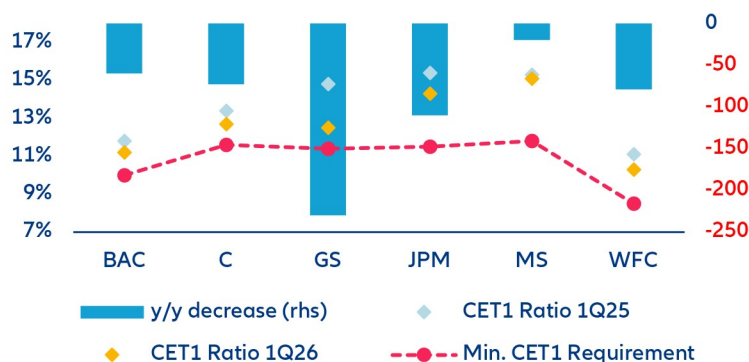
Figure 5: US banks regulatory Tier 1 capital to risk-weighted asset



Sources: LSEG Datastream, Allianz Research

In the medium term, deregulation is reducing buffers. The turning trend of bank Tier 1 capital adequacy brings us to the mid-term concern of deregulation. On 19 March, the Fed, OCC and FDIC jointly issued three proposals that cover Basel III Endgame, the GSIB surcharge and stress testing. The Basel III component revises capital requirements specifically for the largest banks (Category I and II banks) – setting higher requirements on trading activity while deliberately lowering risk weights on traditional lending. However, the GSIB surcharge revision reduces additional capital charges on the eight largest systemic institutions. Combined with proposed stress-testing changes, CET1 requirements for the largest banks will decline by 4.8% on a cumulative basis, while Tier 1 requirements will fall by approximately 6%. Banks had anticipated the direction and positioned accordingly. Ahead of formal confirmation, the Big Six had built an average CET1 buffer of 2pps above regulatory minimums to guard against the threat of the original, more punitive 2023 rules. With that threat now formally lifted, the incentive to maintain the excess is gone. CET1 ratios fell by an average of nearly 100bps y/y – Goldman Sachs and Wells Fargo led the compression – with excess capital flowing directly into the buyback programs detailed above.

Figure 6: Big Six CET1 Ratio Q1 2026 vs Q1 2025, y/y change in bps



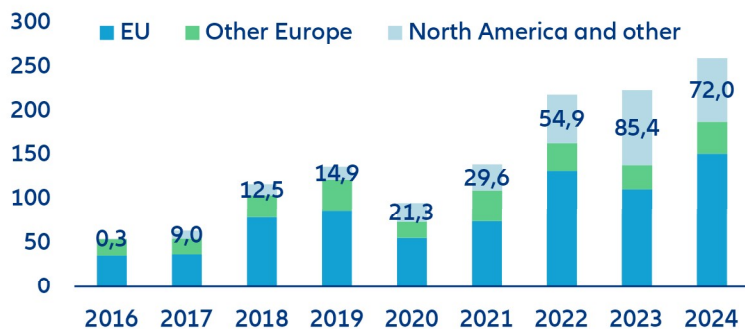
Sources: Bloomberg, Corporate reports, Allianz Research

The second engine is less visible but runs parallel. Even before deregulation formalized the relief, banks had been quietly optimizing regulatory capital through synthetic risk transfers (SRTs). Through these structures, banks transfer the credit risk of a tranche of their loan book to private investors – typically private credit funds, insurers or hedge funds – retaining the loans on their balance sheets while the CET1 ratio improves. Globally, SRT issuance has grown fivefold since 2016, with outstanding loan portfolios protected reaching almost EUR800bn as of end-2024¹. European banks have traditionally dominated the market, but US banks expanded this market rapidly in 2023 and

¹ International Association of Credit Portfolio Managers (IACPM) (2025): Global SRT Bank Survey 2016–2024.

2024 and account for roughly 20% of global issuance volume by the end of 2024.² While SRTs volume is still small relative to bank balance sheet, procyclicality risk and liquidity risk that haven't been tested by a credit downturn are the core problems. In a broad economic downturn, banks may find credit protection expensive or unavailable when capital needs are greatest – forcing a simultaneous pullback in lending that amplifies the very downturn it coincides with. The liquidity dimension compounds this when open-ended funds investing in SRTs face redemption pressure in stress.

Figure 7: Underlying pool size by issuer region (EUR bn)

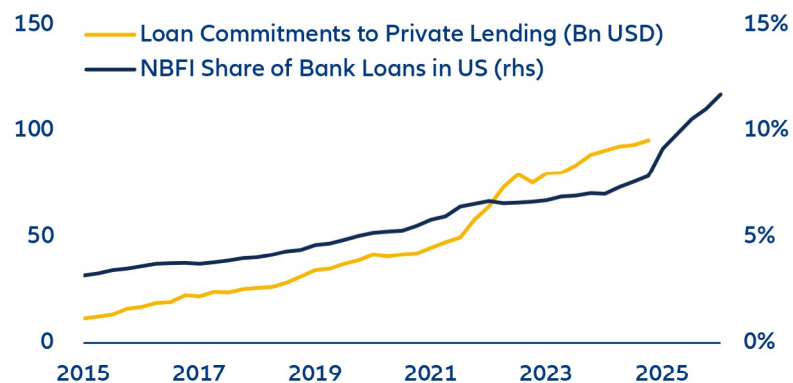


Source: Basel Committee on Banking Supervision (BCBS), Allianz Research

Regulatory relief lowered the floor, while SRTs removed the risk from headline ratios. Combining those two engines, the financial system is not as well-capitalized as its headline ratios suggest: everything that has been moved into the shadows should also be deducted. When stress surfaces, the gap that is invisible on paper will become visible in prices.

The opacity of fast-growing private lending has created another risk in the longer term. In response to growing market concerns on private credit, the Big Six have voluntarily disclosed more detail on their non-bank financial institution (NBFI) lending in recent quarters. Without a certain reporting standard, banks brought similar reassurance – NBFI exposure is growing slowly but the size is still relatively small.

Figure 8: Increasing amount of US bank loans to NBFIs



Source: FED, Allianz Research

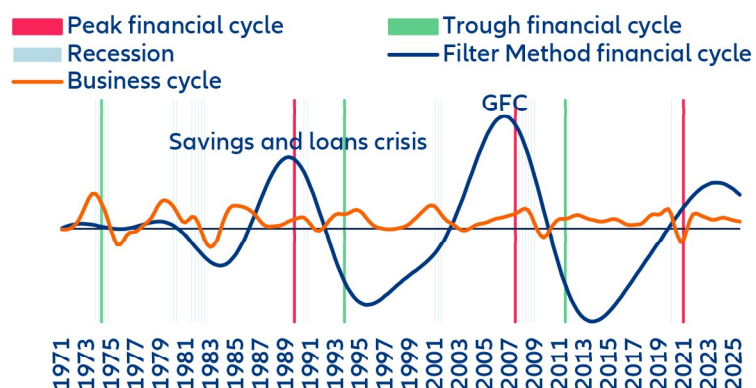
² Basel Committee on Banking Supervision (BCBS) (2026): *The rise and risks of synthetic risk transfers*.

Detecting downturn risks

Long financial cycle analysis offers valuable insights to detect potential banking strains before they occur. We build on the work from the BIS³ which seeks to characterize empirically the booms and busts of the financial cycle since the 1970s. The analysis combines two analytic approaches: turning-point analysis and frequency-based filters. It looks at three macro-financial variables that are found to best capture the medium-term financial cycle, lasting between 8 and 30 years: the credit-to-GDP ratio, the growth of real credit and the growth of real residential property prices. Only credit to the private credit is included. When the statistical analysis identifies a consistent turning of the cycle across these macro-financial variables, including past the trough, financial strains are likely to occur in the next couple of quarters or years – the timing being uncertain. The long financial cycle has been a good indicator to anticipate the two banking crises in the US over the past 40 years: the L&S savings crisis starting in 1988-89 and the Global Financial Crisis (GFC) starting in 2007. Unfortunately, a big caveat is that there have been only two occurrences of banking or financial crises over the past couple of decades, so the empirical regularity of the signal has to be taken cautiously. Nevertheless, the long financial cycles have also been good predictors of banking and/or financial strains in other markets, which leads us to take these signals seriously.

The financial cycle now signals weakness for the finance industry ahead. Figure 9 depicts the financial cycle for the US since the 1970s. It shows that we are past the peak of the cycle recently, with both signals converging, and signaling the beginning of a downturn phase in the cycle, which had begun between 2021 (turning-point analysis) and 2023 (filter method). Figure 10 shows the evolution of the three underlying variables. Since 2021, the year-on-year growth slows down, or even becomes negative since 2024-25. The strains looming in the finance industry are not necessarily bank-driven. The analysis looks at aggregate measures of credit. Supply of credit by banks makes up only 30% of the total supply of credit. Hence, strains could also emerge in non-bank financial institutions (NBFIs) rather than banks, though the links between the two are closely tied.

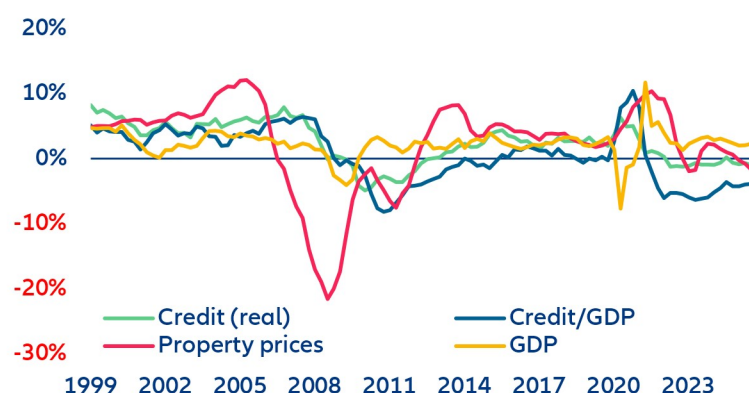
Figure 9: Long financial cycle in the US



Sources: BIS, Allianz Research

³ Characterizing the financial cycle: don't lose sight of the medium term!, BIS Working Papers No 380, June 2012.

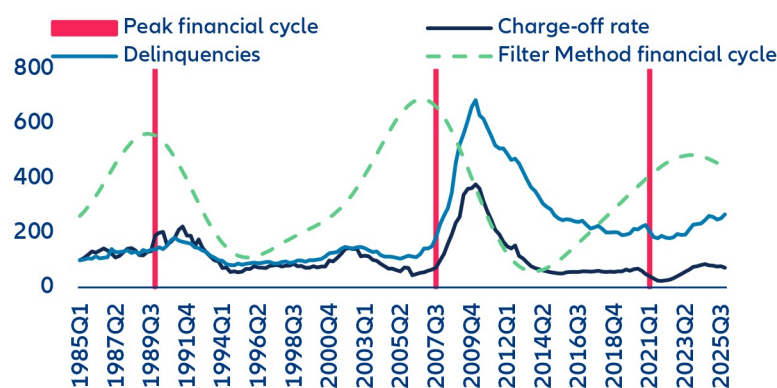
Figure 10: Growth y/y (%) of the components of the financial cycle and GDP



Sources: BIS, Allianz Research

The turning of the long financial cycle has just begun and signals further rises in delinquencies and charge-offs ahead. The turning of the financial cycle reflects the combination of potentially several factors but are mostly determined by rising Fed interest rates when the central bank strives to reduce inflationary pressures or financial exuberance (loose credit standards and increased supply of credit to risky products). Higher interest rates are gradually feeding into higher rates to the private sector and tightening credit standards as borrowers become weaker amid rising interest expenses. In turn, curtailed supply of credit and higher interest rates lead to decelerating real property prices, pressuring down the value of collateral for households and some corporates, which further exacerbate the credit downturn. This is related to the financial accelerator theory. Eventually, it means typically slower growth of banks' revenues, and increasing costs related to provisions as more borrowers struggled to replay their debt. Figure 11 shows that after the financial cycle turns down (with the turning point method sending a signal before the filter method in the last episode), delinquencies and charge off rise. In the current environment, private credit defaults would appear much higher if borrowers held to public market standards. Figure 12 shows that including distressed exchanges realized default rates on leveraged loans would indeed have been much higher, corresponding well to the current trend of the financial cycle.

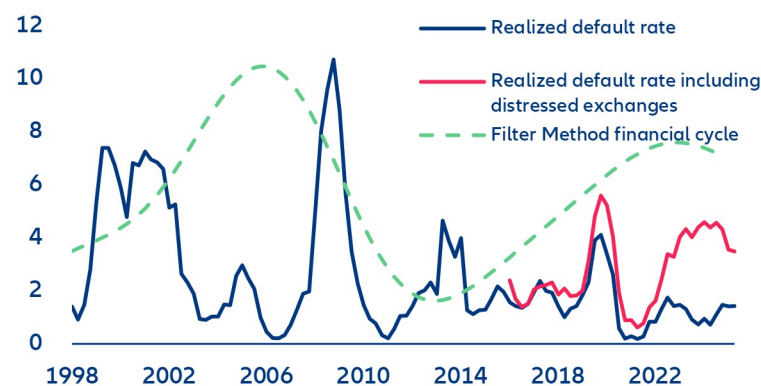
Figure 11: Financial cycle compared to the evolution (basis 100) of the charge-off rate (on all loans) and delinquencies (on all loans and leases, all commercial banks)



Sources: FED, BIS, Allianz Research

It is important note that this analysis captures long-term trends: within this long cycle, we are currently witnessing easier credit standards and a pickup of credit creation, suggesting that strains are not imminent. For instance, the Fed SLOOS survey indicates that banks have loosened credit standards for corporate loans since early 2023 and that real credit growth has accelerated from end-2025. But those are unlikely to be sustained if the downturn phase of the long financial cycle is entrenched. Our analysis suggests that this short term cycle will reverse soon.

Figure 12: Financial cycle compared to default rates on leveraged loans including distressed exchanges



Sources: FED, PitchBook, BIS, Allianz Research

Note: The default rate on leveraged loans including distressed exchanges is calculated as the number of issuers in default or distressed exchange over the past 12 months divided by the total number of issuers at the beginning of the 12-month period. These loans are issued to highly leveraged companies and are more sensitive to changes in the financial cycle.

What does this mean for investors?

US large-cap banks have entered mid-2026 in their strongest operational position since 2008 – earnings at cycle highs, balance sheets well-capitalized, capital returns at a record pace. However, as discussed above, the forces pushing the cycle turning are cumulating. Beyond the cycle, structural headwinds form from digitization, where low-cost disrupters are manifold. The American Bankers Association warned that a stablecoin market scaling toward USD2trn could drain up to 10% of core bank deposits, raising funding costs by roughly a quarter of a percentage point – a modest but directionally unwelcome addition to an NII outlook that is already plateauing⁴. At the same time, current equity valuations and credit spreads offer investors almost no cushion against disappointment.

Share buybacks and high ROEs will keep benefiting equity holders in short-term. Current valuations price in three tailwinds continuing simultaneously – rate-driven NII, a buyback-fueled EPS ramp-up and a M&A super-cycle. But none are guaranteed in the long-term. The market has already paid for the good news but has not priced in the medium-term and long-term cycle turning pressure.

With tight spreads, the upside is more limited for credit investors. Downside risk would be amplified if the large amount of capital distributed to shareholders and the persisting downtrend of solvency has been billed to them, as lower required capital means a thinner equity buffer sitting above bondholders. Though solvency is still healthy and far from triggering concerns even after the proposed capital release, credit investors are not being asked to absorb such structurally lower protection at historical thin compensation. Senior bank spreads have widened relative to non-financial investment-grade peers, but only modestly, and not in a way that reflects the structural shifts.

The banks themselves, in launching CDX Financials index, have built another instrument to make the shadow system they created legible and hedgeable — and declined to include themselves in its perimeter. The largest banks, at their peak, are still well-positioned to weather the downturn. **The question the market is beginning to ask in the gap between record earnings and cautious share prices is whether their investors are being adequately paid to stand in the rain with them.**

⁴ Huther, J. and Wang, Y. (2025). "How stablecoins could affect borrowing costs for the government, businesses and households." ABA Banking Journal, August 2025.

These assessments are, as always, subject to the disclaimer provided below.

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