Bank to the Future

Banks are changing, they're more resilient, more disciplined, and better capitalised for the future...

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Imagine stepping into the bustling streets of ancient Babylon, nearly 4,000 years ago. Amidst traders hawking spices and textiles, another quieter commerce unfolded inside the shaded temple chambers and merchant houses: the business of banking.

Here, clay tablets served as the first ledgers of credit and risk. Merchants etched loan agreements in cuneiform script, recording grain or silver lent, interest charged, and repayment dates. These early bankers provided working capital for agriculture, trade and ambitious construction projects; core functions of banking that endure today. Among these tablets may have been loans financing Babylon's most famous wonder: the Hanging Gardens, a feat of botanical and engineering grandeur, whether rooted in fact or legend.

Today's banks may seem worlds away from those ancient scribes, but their role in driving economies and creating value remains pivotal. For much of the post-global financial crisis (GFC) era, however, they've been viewed with deep scepticism, particularly among income and value investors. But over a decade marked by regulatory reform, economic upheaval, and ultra-low interest rates, banks globally have steadily transformed from crisis survivors into resilient profit engines.

Capital buffers have strengthened, returns on tangible equity have improved, and major players, from Barclays in the UK and Chase Bank in the US, are demonstrating their strength through sustainable dividends and robust share buyback programmes.

Investment trusts are increasingly seeing banks as pillars of total return, drawn by improving earnings quality, attractive valuations, and a commitment to shareholder returns. Some trusts, like **Temple Bar (TMPL)** and **Schroder Oriental Income (SOI)**, have long maintained sizeable allocations to UK and Asian banks, respectively (now around 19-20%), whilst others, like **Dunedin Income Growth (DIG)**, have more recently reassessed their long-standing aversion, arguing that the sector now offers pockets of undervalued quality amid an improved backdrop.

We explore that shift, focussing on how banks have rebuilt since the GFC, what's driving their appeal, and why some of their lesser-known tools may make these once-maligned institutions a more enduring feature of trust portfolios in the years ahead.

Analysts:

Josef Licsauer
josef@keplerpartners.com

Why banks fell out of favour and what's changed

Before exploring current opportunities, it's worth reminding ourselves why banks earned such a tarnished reputation in the first place.

The scars of the GFC run deep. The 2007–08 meltdown, triggered by the collapse in the US housing market and the widespread use of complex, poorly understood mortgage-backed securities, exposed just how over-leveraged and undercapitalised banks had become. With thin capital buffers and huge off-balance-sheet exposures, many institutions faced catastrophic losses when credit markets froze and asset values plummeted. The result: a wave of bailouts, dividend suspensions, regulatory overhauls and a prolonged period of ultra-low interest rates that squeezed bank profitability, reinforcing investor apathy.

Global banks, particularly those in the UK, Europe and US were considered investment pariahs. Some investors may have forgiven, but few forgot, particularly income and value investors who remained wary, scarred by repeated failures to deliver consistent returns.

Today, however, the backdrop has changed. More than a decade of rebuilding has left the sector far stronger: better capitalised, less risky, well-regulated and crucially, now generating returns above the cost of equity. The return of higher interest rates and the likelihood that rates will stay higher for longer have restored a vital earnings tailwind. Net interest income (NII) has surged, fuelling profitability and strengthening balance sheets.

That in turn has supported a renewed and, in some cases, accelerated flow of shareholder returns through dividends and share buybacks, which we explore in more detail later. For trusts with value, dividend, or reflationary tilts, banks have once again become key contributors to both income and capital growth.

Why banks are back in favour

After years of being under-owned and unloved, banks are firmly back on the radar for many investment trust managers. The appeal is both cyclical and structural in nature and reflects a sector that is, overall, in its best shape for over a decade.

One of the clearest attractions is valuation. After the banking crisis triggered by Silicon Valley Bank's collapse in early 2023, when rising rates caused the value of its bond holdings to plummet, sector-wider valuations hit rock bottom. Whilst earnings growth has since driven a sharp recovery, many banks continue to trade at attractive levels.

Take the UK's top five banks. At the end of 2024, most were trading on sub-1× price-to-book (P/B) ratios. Six months later, after strong share price gains, valuations rose slightly above their ten-year averages. But this rerating tells a story of recovery: better returns on equity,

Bank Valuations

	CURRENT P/B RATIO	2024 YEAR-END P/B RATIO	TEN-YEAR P/B RATIO	YEAR-TO-DAT SHARE PRICE RETURN (%)
Barclays	0.74	0.65	0.56	23.6
Lloyds	0.96	0.84	0.90	39.0
HSBC	1.20	1.06	0.91	13.0
NatWest	1.16	0.95	0.71	30.1
Standard Chartered	0.83	0.67	0.58	18.7

Source: Bloomberg, as of 12/06/2025. Averages based on annual reported figures

stronger balance sheets, and renewed confidence. Even so, valuations remain reasonable on an absolute basis, particularly given the strength of earnings and the scale of shareholder returns. And whilst less relevant for banks given asset-heavy balance sheets, price-to-earnings ratios for each bank remain significantly below their ten-year averages, a potential sign the rerating hasn't yet run too far.

Alex Wright, manager of **Fidelity Special Values (FSV)**, acknowledges lingering scepticism about the sustainability of recent returns but argues that valuations remain compelling, particularly given the attractive yields, significant share buyback potential and c.15% return on capital on offer. Financials remain FSV's largest absolute sector weighting, even after locking in some profits following their strong run of returns since 2022. But the managers remain alert to opportunities, viewing better-capitalised, higher-quality banks as well-placed to weather potential downturns, buoyed by relatively healthy corporate and consumer balance sheets. Another rerating, they argue, is far from out of the question.

The trio behind **JPMorgan Claverhouse (JCH)**, Callum Abbott, Anthony Lynch and Katen Patel, share this view, having steadily increased exposure to banks, including the recent addition of Barclays. They highlight Barclays' strategic pivot towards domestic retail banking and cost efficiency, which, alongside a favourable rate environment, is starting to deliver tangible gains, supporting its climbing share price. Despite this, Barclays continues to trade at the steepest discount to asset value of all the major domestic UK banks, which the team behind JCH sees as a compelling entry point underpinned by the potential for continued capital appreciation and progressive dividend growth.

Rising profitability is another key reason for many banks' revival. A major driver has been the significant uptick in net interest income (NII), the difference between what banks earn on assets like loans and the interest paid on liabilities like deposits and wholesale funding. The sharp rate hikes since 2021/2022 have lifted NII for many, underpinning the rebound in profitability. JCH has built up a position in NatWest, for instance, a notable beneficiary of this trend as it has refinanced assets at higher rates.

As the table below illustrates, most of the top five UK banks have seen NII climb since 2021. Whilst Standard Charted saw a dip in reported NII in 2024, which has technically resulted in a decrease since 2021, it was driven primarily by FX-hedge accounting impacts. However, the bank's underlying NII, which excludes hedge-related volatility, grew approximately 10% in FY 2024, reflecting solid core performance.

Net Interest Income (NII)

	2021 NII (M)	2022 NII (M)	2023 NII (M)	2024 NII (M)	INCREASE SINCE 2021 ANNUALISED (%)
Barclays (£)	8,073	10,572	12,709	12,936	12.5
Lloyds (£)	9,366	12,922	13,298	12,277	7
HSBC ($)	26,489	30,377	35,796	32,733	5.4
NatWest (£)	7,535	9,842	11,049	11,275	40.6
Standard Chartered	6,807	7,599	7,769	6,366	-1.7

Source: Bloomberg & bank annual reports (financial year).

This foundation: rising rates, strong NII and growing profits, continued into 2025. February's swath of Q1 results revealed this continued momentum, with banks across the sector reporting healthy profit growth, further NII expansion, structural hedging gains and upbeat capital return guidance. That strength is reflected in bank share prices and the performance of several trusts with sizeable financials exposure. **City of London (CTY)**, for instance, holds meaningful stakes in Lloyds, HSBC and NatWest. The wave of strong earnings reports helped boost these names, contributing to CTY's outperformance this year.

CT UK High Income (CHI) also benefitted. Manager David Moss points to improved returns on equity, stronger NII, and rising shareholders returns through growing dividends and buybacks as reasons for his growing conviction. He too has added NatWest to the portfolio drawn by its robust dividend profile, share buyback programme and strong results, but also HSBC due to its attractive valuation, strong market position, and dividend profile. Whilst Barclays is recognised as a quality business, David currently prefers to gain banking exposure through NatWest, Standard Chartered, Lloyds and HSBC, a mix he feels aligns more closely with his current strategy.

Banking buybacks

One of the clearest signs of how far banks have come since the financial crisis is the scale of capital now being returned to shareholders. Buybacks have become central to the investment case for banks today, offering a clear signal of confidence from management teams who view their shares as undervalued and thus, allocate capital accordingly.

When executed at prices below intrinsic value, buybacks enhance earnings per share and compress valuation multiples over time, helping lift share prices and total returns. Combined with healthy dividends, the effect can be profound. For investment trusts and other long-term investors, a growing dividend per share and a shrinking share count could translate into meaningful capital compounding. It's a dynamic that Nick Purves and Ian Lance, managers of TMPL, have long championed.

They've consistently highlighted the total return yield potential of undervalued UK stocks that are simultaneously buying back their own cheap shares and paying out dividends. Two standout examples in TMPL's portfolio are NatWest and Standard Chartered.

Based on latest annual reports, we can calculate NatWest repurchased nearly 11% of its shares across 2023 and 2024, whilst paying dividends worth around 14% of its market capitalisation. Notably, in 2025, the bank conducted another large buyback, returning it to full private ownership for the first time since the GFC, marking the end of a long period of government involvement. Meanwhile, Standard Chartered bought back 19% of its shares and distributed dividends equal to around 9%. In total, this equates to cash shareholder yields of 24.5% and 27.8%, or annualised returns of approximately 10.6% and 13.9%, respectively.

These figures show how banks are rewarding shareholders, whilst signalling a deeper transformation in capital discipline and shareholder alignment. Other UK banks, including Barclays and Lloyds, are following suit, but for now, these examples illustrate how buybacks and dividends, when used together, can drive significant shareholder value.

Returns To Shareholders

UK COMPANY	TWO-YEAR DIVIDEND PAID (EX-SPECIAL) (%)	TWO-YEAR SHARE BUYBACK RETURN (%)	TWO-YEAR CASH SHAREHOLDER YIELD (%)
NatWest	13.7	10.8	24.5
Standard Chartered	8.9	18.9	27.8

Source: Bank annual reports (31/12/2022 to 31/12/2024), Kepler Partners calculations

Caterpillar power

Readers might be thinking, sure, higher rates have boosted bank earnings, but what happens when rates fall? It's a fair question and a reason banks are inherently cyclical. NII is indeed sensitive to interest rate movements and lower rates will put pressure on earnings for most traditional banks. But there's a lesser-known, underappreciated tool quietly safeguarding their income: structural hedging.

This strategy allows banks to smooth NII over time by locking in yields using rolling interest rate swaps—that pay floating and receive fixed—across staggered maturities. It helps balance liabilities such as customer deposits and shareholder equity, creating a steadier income stream and improving earnings visibility, even as rates fluctuate.

Most UK banks deploy a mechanical approach, replacing swaps as they mature. Many of these were originally set when rates were near zero, which has technically dampened margins as rates have risen. However, as these legacy contracts roll off and are reset at higher rates, they're providing a delayed but meaningful uplift to earnings. In a falling rate environment, these new, higher-rate hedges should help protect income, especially for banks that have actively managed and optimised their hedging strategies along the way.

Take NatWest. With its old, low-rate hedge inventory positions, it's well-positioned to benefit as these contracts mature and reprice, improving the bank's earnings visibility and one of the key reasons behind its recent inclusion in DIG's portfolio. Historically, DIG's managers have taken a cautious stance on banks, citing structural vulnerabilities such as macroeconomic sensitivity, regulatory pressure, and exposure to unpredictable rate cycles. But the landscape has shifted. Today's banks are, in their view, far stronger than during the GFC, marked by improved capital discipline, sound fundamentals, a clear focus on shareholder returns, and the added cushion of structural hedging. Whilst still selective, the managers' stance has softened slightly in light of this progress.

Job Curtis of CTY also flags structural hedging as a quiet but critical tailwind, and a key reason UK banks' net interest margins (NIMs) could remain near long-run averages, even as rates begin to fall. He points out that this tailwind could persist through 2026 and 2027, with earnings smoothing providing not only visibility but confidence, particularly for income-focussed investors. Just as hedging dampened the benefit to NIMs as rates were rising, it should now soften the downside as rates fall.

We think that stronger balance sheets, healthier dividends, and the income safeguard provided by structural hedging as rates fall, point to one thing: today's banks are not what they were 15 years ago. For investors seeking total returns, it may be time to take a fresh look.

Beyond UK banking

Whilst much of the discussion has centred on the UK, these supportive dynamics are not all unique to its banks. Similar patterns emerge globally, from continental Europe and the US to Asia and emerging markets, where demographics, improving fundamentals and renewed capital discipline are also driving returns.

In Europe, many leading banks continue to trade on modest valuations despite well-capitalised balance sheets, rising earnings estimates, and attractive double-digit returns on tangible equity. Together, this has enabled them to ramp up dividends and buybacks, echoing trends seen in the UK.

JPMorgan European Growth & Income's (JEGI) managers—Alexander Fitzalan Howard, Zenah Shuhaiber, and Timothy Lewis—have been steadily increasing exposure, with 2024 additions including Banco Santander and Deutsche Boerse selected for their compelling valuations, improving operational performance and renewed capital allocation discipline. In the case of Deutsche Boerse, JEGI's managers also see structural appeal in its above-market organic growth outlook and growing share of high-quality, recurring revenues. They believe European banks have delivered strong performance underpinned by rising NII and improving returns on tangible equity. And whilst share prices have begun to respond, valuations still lag earnings upgrades, offering potential further upside, particularly with credit conditions stabilising and the upcoming rate-cut cycle expected to be shallow.

Across the Atlantic, the growth and value teams of **JPMorgan American (JAM)** see similar opportunities in underappreciated US financials. One standout in their portfolio is M&T Bank, which trades at historically low multiples despite consistently strong financial performance. Its focus on core deposits, cost control, credit quality and talent management has driven returns, and with momentum building in mortgages and savings activity, the managers view M&T as well-placed to continue delivering for shareholders.

Opportunities extend to emerging markets too. Nick Price and Chris Tennant of **Fidelity Emerging Markets Limited (FEML)** have found value across emerging Europe and Latin America. In Europe, they favour Greece's Piraeus Financial and Georgia's TBC Bank, both trading on low multiples and supported by earnings upgrades and strong dividends. In Latin America, FEML holds Inter & Co in Brazil, a digital banking platform with lending growth potential and a focus on shareholder returns, and Banorte in Mexico, where a strong balance sheet is also enabling meaningful shareholder distributions.

Meanwhile, in Asia, SOI manager Richard Sennitt continues to find opportunities in mature banking markets. Following strong performance from Australia's banks, he trimmed National Australia Bank and reallocated into Singaporean peers, viewing their recent pullbacks as attractive entry points into well-capitalised banks with strong deposit franchises and attractive yields. Richard has also increased exposure to faster-growing markets like Indonesia, building positions in Bank Mandiri and Bank Negara Indonesia. He sees parallels with the earlier phases of India's banking transformation and whilst falling rates may pressure margins slightly, he believes this could be offset by lower credit costs, faster loan growth and greater revenues from areas like wealth management.

So where next for banks?

Whilst we've showcased the strength of banks, risks remain ever-present. First, economic weakness or a recession could hit earnings and pressure margins, in turn weighing on the performance and subsequent appeal of banks. The sector may also still carry some of the reputational baggage from the GFC, with legacy concerns resurfacing whenever markets wobble. Further pressures around ring-fencing tweaks in the UK to shifting lending models like the rise of shadow banks in the US may also be weighing on sentiment.

Market turbulence hasn't helped either. In times of uncertainty, investors have often sought perceived safe havens: reducing equity exposure in favour of gold, bonds, or cash. Add that to the fact that some investors may not be fully aware of tools like structural hedging, dismissed for years in a low-rate world, which are now quietly reshaping earnings resilience.

And yet, today's banks are not what they once were 15 years ago. Across the US, Europe, and Asia, many have evolved into well-capitalised, profitable businesses. Core lending is being supplemented with wealth management, insurance, and digital innovation. Risk management is more advanced. Regulation is tighter. Capital and cost discipline are now central to the strategy, with dividends and buybacks driving shareholder value.

Crucially, the trusts we've discussed aren't backing banks blindly. Most adopt selective, diversified approaches spanning regions, sectors and business models. Some favour banks broadening into non-rate-sensitive revenue streams; others blend traditional banking exposure with insurers, exchanges, or digital platforms to reduce reliance or impact of rate cycles.

And for investors seeking broader exposure to the entire financials sector, **Polar Capital Global Financials Trust (PCFT)** offers a more catch-all approach. With around 34% in banks and the rest spread across insurance, asset management and data platforms, it provides a distinctive route into the sector via a specialist team, and may soon appeal more to income-seekers with a new proposed dividend policy: paying 1% of NAV from capital where necessary, therefore offering a considerable yield, equivalent to 4% annualised, thus broadening its appeal.

Either way, we think banks have rebuilt themselves into dependable, cash-generating businesses. Omitting them entirely risks overlooking a quietly compounding source of total return. Back in Babylon, banks emerged from a need to safeguard value and facilitate growth. Thousands of years later, they may not be glamorous, but for total return or income-seeking investors navigating a more volatile world, they could once again be proving their worth.

Click here to register for our summer event 'Livin' on a prayer (we're halfway there)' 30th June - 3rd July

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