With each passing quarter since the pandemic began to disrupt the economy in early 2020 and the outlook for US banks was upended, the industry has managed to successfully retrench and position itself to help lead the economy's broader recovery. Nearly all publicly traded US banks have released first-quarter results as of this writing, and the industry as a whole continues to exceed the US bank portfolio management team's expectations. Based on our analysis, here are nine salient points about the current state of banks and the implications for equity investors.

Bright outlook: 9 takeaways from a strong quarter for US banks

1. **Strong overall results, improved outlook**—The vast majority of US banks exceeded Wall Street analysts' first-quarter earnings expectations; 97% that had reported results as of April 23 had surpassed analysts' estimates,[1] while the overall backdrop for US banks remained robust.

2. **Better than forecasted operating earnings per share (EPS)[2]**—First-quarter operating EPS growth rose 11% over last year's fourth quarter and surged 72% relative to the first quarter of 2020,[1] when the pandemic-driven economic slowdown was at its worst. These gains have been driven largely by improving trends regarding credit, expense efficiency, and fee income.

3. **Credit metrics came in strong**—Two categories of negative credit metrics that banks track—nonperforming assets and net-charge-offs—both declined in the latest quarter.[1] These gains, coupled with improved economic assumptions in 2021 and beyond, drove banks to release some of the specific loan loss reserves they had built up last year to manage negative credit trends. Assuming the US vaccine rollout continues to progress and economic normalization occurs, we expect to see further loan loss reserve releases in coming quarters.

4. **Loan growth was relatively muted**—Banks saw a massive inflow of deposits as a result of the congressionally approved economic stimulus distributed in the quarter. While this dampened loan growth in the short run as borrowers paid down loans, the stimulus should provide a catalyst for economic growth as COVID-19-related restrictions are rolled back. We expect loan demand to build as we enter the second half of 2021, fueling accelerated revenue growth for banks.

5. **Average deposits continue to increase**—This metric grew 24% from a year earlier.[1] As a result, banks have excess liquidity, and we expect that deposit pricing will continue to trend downward.

6. **Fee revenues were strong**—These revenues rose 19% over the same quarter a year earlier, and mortgage- and capital markets-related activities were again robust during the quarter.[1] We expect mortgage volume to remain healthy.

7. **Expense management remains a focus**—Non-interest expenses were well contained, in our view. We expect to see continued positive operating leverage as technology investments drive improvement.

[1] "KBW Bank Earnings Wrap-Up 1Q21, v. 2: Banks Continue to Deliver EPS Beats on Mostly Favorable Credit Trends," Keefe, Bruyette & Woods, 23 April 2021.

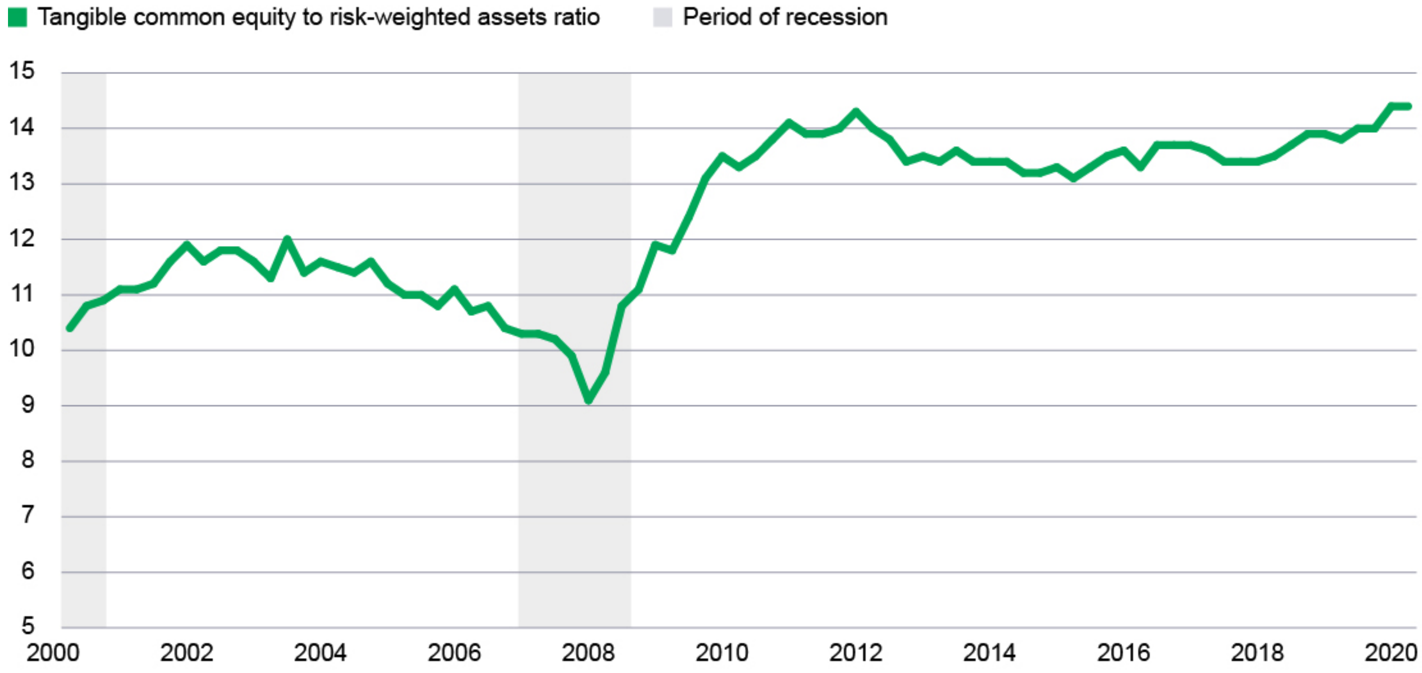
[2] Earnings per share (EPS) is a measure of how much profit a company has generated calculated by dividing the company's net income by its total number of outstanding shares.

8. **Capital management activity should accelerate throughout 2021**—Most banks have now resumed share buyback activity that regulators had suspended in the wake of the pandemic. More recently, the US Federal Reserve declared that its temporary restrictions on bank dividends and the amount of share repurchases allowed will end on June 30, 2021.[3]

9. **Significant acceleration in merger-and-acquisition (M&A) activity in 2021**—M&A has resumed following a pandemic pause, and we expect this to continue as banks have become more comfortable performing due diligence and executing deals in the current environment. M&A is a long-term trend in US banks and is supportive of efficiency improvement and future earnings.

US banks appear to us to be fundamentally strong, with historically high levels of capital and liquidity. As the economy has reopened, credit fundamentals have been materially better than had been expected a year earlier. Strong results from regulators' latest round of stress tests to assess major banks' abilities to weather further economic shocks triggered a further loosening of restrictions related to share buybacks. We view these developments as a testament to the industry's capital strength and improved underwriting. In addition, we believe that the most recent stimulus package that Congress approved in March should further support the economy and reduce credit costs. As these trends persist, we expect US bank earnings to accelerate throughout 2021.

US banks' capital levels have surged since a 2009 low



Source: Federal Deposit Insurance Corp., January 2021. A tangible common equity to risk-weighted assets ratio is used to assess the potential for future bank financial stress based on commonly measured capital ratios.

[3] US Federal Reserve press release, 25 March 2021.

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