

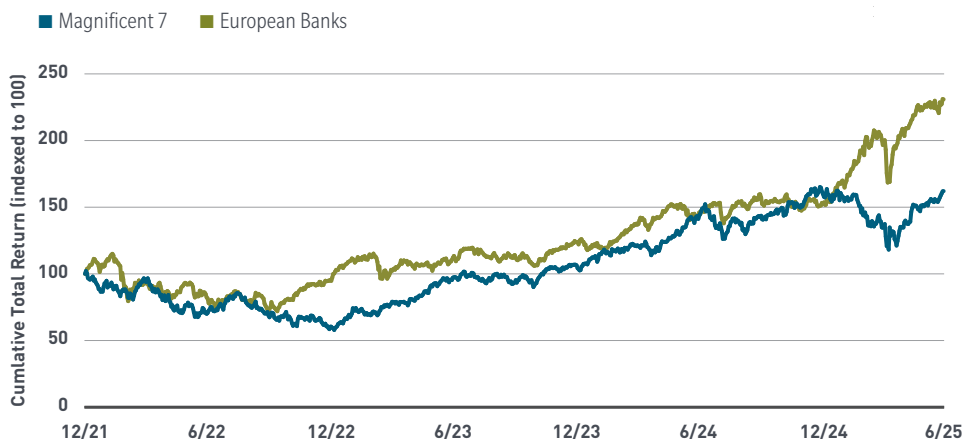
WHITE PAPER / JULY 2025

Beyond Earnings: Evaluating Banks Across Borders in a Higher-Rate World

A New Industry Exhibiting Leadership Abroad

It's no surprise that in the period following the Global Financial Crisis through Covid-19, non-US banks markets delivered paltry returns. This was a period characterized by low interest rates (negative, in some cases) with an onerous regulatory backdrop; hardly a conducive environment for banks to deliver returns on behalf of shareholders. But since the end of 2021, as inflation became entrenched across economies and the low-interest rate regime shifted to a higher-rate regime, we've seen strong performances out of banks and in particular European Banks, which outperformed even the Magnificent Seven, a group of stocks that has dominated headlines and market performance for a prolonged period of time.

Exhibit 1: European bank stocks outperforming Magnificent Seven stocks



Source: FactSet Portfolio Analysis. Daily data as of 31 December 2021 to 30 June 2025. Magnificent Seven = Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla. European Banks = MSCI Europe Banks Index. Magnificent Seven returns are gross and in USD. European Banks returns are net and in USD.

Navigating This Potential Paradigm Shift

In late 2023 and implemented in June 2024, as the financial world adjusted to a higher interest rate regime that, in our opinion, appears here to stay, our global financial sector team saw a unique opportunity to leverage our integrated global investment platform to unlock value in the banking industry. Recognizing the shifting dynamics and the critical need for clarity amidst complexity, we brought together our collective expertise to develop a Global Banks Comparison Framework — a powerful tool designed to promote consistency in analysis, drive discussion and debate, specifically, drive broader ownership of banks across the firm and continue to ensure our analyst run strategies focused on holding our most compelling stocks.

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Banks are inherently complex entities, differing significantly across regions and countries due to factors such as government involvement, regulatory environments, credit profiles and requirements, and management structures. This complexity is heightened by evolving regulatory changes, making it critical to possess both detailed knowledge and tools to compare banks across jurisdictions. Unlike staples or capital goods companies, banks require a nuanced approach to analysis, as their structures and operations are not easily comparable.

For example, the recent changes to the Supplementary Leverage Ratio (SLR) in the United States illustrate how regulatory shifts can significantly impact the attractiveness of banks across as well as within a region. Adjustments to the SLR have altered the capital requirements for US banks, reshaping their competitive landscape relative to banks in other parts of the world. This reinforces the importance of understanding how regulatory changes influence capital needs and total shareholder returns over a multi-year horizon.

A frequent point of discussion within financial services sector team meetings was the challenges non-bank specialists face when attempting to compare banks across regions and countries. While we had various tools to aid this process, we identified the need for a robust framework that would help portfolio managers cut through the complexity of jurisdictional differences particularly as regulatory changes were closer to their end-game. Importantly, this framework is not focused solely on earnings, as earnings alone do not always align with capital returns. Instead, it enables portfolio managers to think holistically about total shareholder return while allowing investors to compare banks against their investable universe.

With the banking industry poised to benefit from structural tailwinds in this new macroeconomic environment, this initiative enabled our team to capitalize on opportunities that others might overlook.

Through the framework, the analyst team sought to accomplish three goals:

1

Assess the long-term return profile and the range of possible outcomes of banks across the globe, including major banks as well as mid-size regional leaders.

2

Evaluate existing positioning in banks across analyst-run strategies and ensure positioning is appropriately communicated to the rest of the MFS investment platform.

3

Ensure that we owned the stocks of banks in which we had our strongest conviction aimed to thrive in period ahead and that would be the ones most likely to thrive in the period ahead.

Key inputs to the exercise included the following:

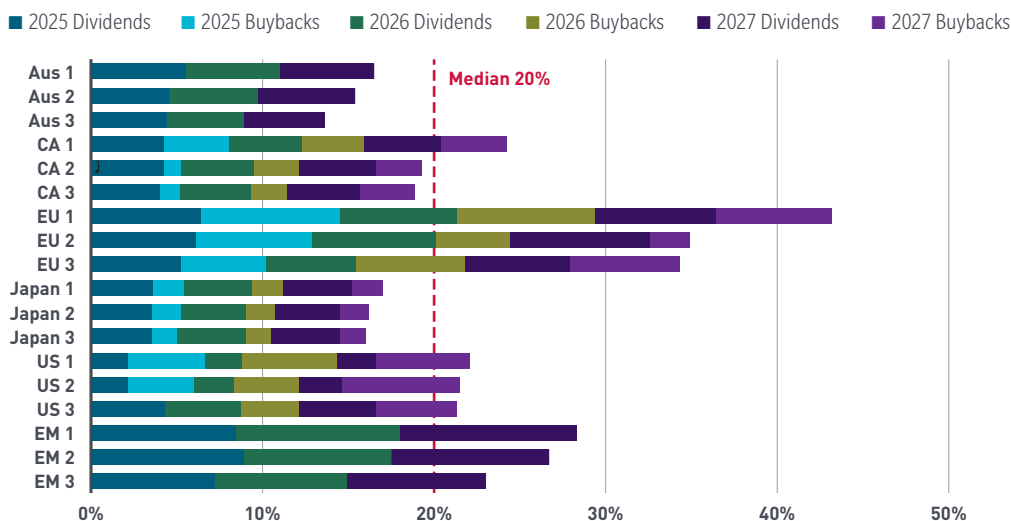
- **Fundamentals** — Comparing companies on a like-for-like basis
 - The team examined Return on Tangible Equity (RoTE), broken out by region, because it has generally been a benchmark metric used to examine balance-sheet intensive companies. While future RoTE looked elevated across the globe compared to the post-Global Financial Crisis and -Covid periods, select banks in Europe in particular had a much-improved return profile. There were also specific regions that upon first glance looked attractive but through the lens of this analysis appeared much less appealing, given the team's expectations.
 - To compare banks with differing growth profiles, the team used Free Capital Generation Yields (FCGY) as a proxy for free cash flow and which accounts for reinvestment needs, regulatory changes and ultimately capital distribution potential. They felt it was more instructive for this exercise than earnings yield, which can at times provide an inconsistent perspective. FCGY was able to highlight numerous examples of banks that stood out across both developed and emerging markets.

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When examining capital returns, the team compiled a combination of dividends and buybacks. Buybacks have become an important component of capital returns in the US and Europe. The team utilized their own projections for capital returns over the next three calendar years and expressed it as a percentage of a bank's current market cap. This provided a single, easily understood figure that allowed the team to capture the difference in capital return methods across the globe. The analysts found that European banks looked attractive, as they possessed high FCGY and low loan growth which provided some reassurance on credit risk.

Exhibit 2: Projected Cumulative Capital Returns within the Banks Comparison Framework



Buybacks have become an important component of capital returns in the US and Europe.

Source: MFS Investment team. The team utilized their own projections for the next three calendar years and expressed it as a percentage of a bank's current market cap. Top 3 banks with the highest projected capital returns are shown for each region. A total of 63 banks were included in the framework analysis. Aus is Australia, CA is Canada, EU is Europe, Japan is Japan, US is United States and EM is emerging markets. No forecasts can be guaranteed.

- **Valuation** — When assessing the banks from a valuation standpoint, the team utilized inputs from each analyst and then compared and challenged across the team for suitability and consistency.
- **Range of Outcomes** — Analysts assessed various ranges of outcomes around ROTE and capital return profiles by using consistent in-house assumptions around net interest income in different rate environments.
- **Resilience** — Banks' exposure to credit risk as well as loss absorption capacity was assessed ensuring historical precedents and current exposures were considered.

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Results of the Exercise

We believe the Global Banks Comparison Framework is a proprietary tool that has enhanced our ability to evaluate future return profiles and risk/reward dynamics across banks globally, while helping portfolio management teams make more informed and strategic capital allocation decisions. The initial exercise helped close bank underweights across analyst run strategies and helped maintain and reinforce conviction in select European banks across the platform. Additionally, following the analysis, one portfolio management team that had very little bank exposure coming into 2022 and had increased their weighting, was able to leverage the framework to reassess their existing holdings in banks. While valuations were similar across Japanese and European banks that they held, the analysis revealed that the European banks had consolidated market structures and stronger capital return potential. Acting on these insights, the team reduced exposure to Japanese banks and shifted that capital to new European bank holdings, strengthening their conviction.

This initiative underscores the strength of MFS' globally integrated investment platform, which fosters collaboration across regions, drives timely insights and ensures portfolios are positioned to capitalize on high-conviction opportunities. By connecting ideas across markets, we aim to deliver consistent outperformance in an increasingly complex financial landscape. ▲

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