

NASHVILLE NOTES

Widening the fairway**Monday, December 22, 2025 10:09 AM CT**

By Jeff K. Davis

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As I pen this final post for 2025, the S&P 500 Bank Index is up 28% year to date as of Dec. 18, compared to 8% for the Nasdaq Bank Index. It has been a great year for most large banks, most notably [Citigroup Inc.](#), which is up 60%, whereas the performance for smaller banks is varied.

Next year is shaping up to be a good and maybe great year for banks, even though credit costs may grind higher. Most banks will enter the year with notably higher net interest margins (NIMs) than a year ago, and NIMs should expand a bit further with the steeper yield curve and the repricing of low-rate assets that were regrettably originated and/or purchased from 2020 to 2022.

Investors can count on a very good backdrop for M&A, too, as long as bank stocks hold up absent an exogenous event like "Liberation Day" or a popping of the AI bubble that pulls the market down — unlike the popping of the dot-com bubble in March 2000 that saw capital flow to banks and other value stocks.

Not to be underestimated in contributing to this era of good feelings are the deregulation initiatives by the Trump administration, whereby its regulatory approach is akin to a greenskeeper widening the fairways to make a course easier. The last time this occurred was during the 1990s and, to a limited extent, in 2016 to 2020 during the first Trump administration. Otherwise, 2009 to 2024 reflected a regulatory regime that punished banks and turbo-charged private credit, also aided by fixed-income investors who pivoted to alternatives when interest rates were microscopic.

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In no particular order, the administration has eviscerated the Consumer Financial Protection Bureau by idling and firing most of its employees; it has turbo-charged M&A with a faster approval process and has greenlighted large bank deals; it has eased capital rules by freezing the Basel III endgame implementation and [lowering](#) the community bank leverage ratio threshold to 8.0% from 9.0%; and it has implemented a number of small changes such as reducing the frequency of compliance exams, indexing asset thresholds and rescinding climate change directives.

And, on Dec. 5, the Federal Deposit Insurance Corp. and the Office of the Comptroller of the Currency [rescinded the leverage loan guidance](#) that limited banks' ability to participate in a leveraged transaction when leverage exceeded 6x earnings before interest, taxes and depreciation. The Federal Reserve has not affirmed the decision yet, but is expected to do so soon.

Loans by definition entail leverage. How much leverage depends upon who is counting. I occasionally work on leveraged transactions. Given the addbacks that credit documents often allow, the threshold could be upwards of 7x to 8x. Regardless, the guidance slowed banks somewhat, but did not eviscerate what was a great business in 2013 when the guidance was adopted. It has since morphed into a phenomenal business.

The Trump administration wants to widen the fairways for banks, easing constraints that have hampered lending and profitability in order to run the economy hot. It is a decidedly positive backdrop for EPS growth when combined with the steepening yield curve.

It should be a good year for banks — more lending, higher earnings and deal flow in a supportive regulatory environment. But for bank stocks, it depends.

Aside from the one-third or so of US consumers who appear to be tapped out, one item to watch is the private equity and credit ecosphere, where there is widespread skepticism about valuation marks. There are plenty of data points here: rapid growth of continuation funds to acquire assets from private equity funds that are near the end of their life; [payment-in-kind](#) interest elections rather than cash interest; publicly traded funds that trade at a discount to NAV versus private funds that hold similar assets that are marked to NAV; and [multiyear lows](#) in distributions paid to limited partners.

I do not think the issue is a systemic one for banks that have experienced rapid growth in lending to non-depository financial institutions, but a sustained bear market in the public markets could produce widespread markdowns in private assets that have negative second and third derivatives in financial markets.

Alternatively, the private assets might not be marked down much, since low volatility and sticky valuations are features rather than bugs that appear to be favored by investors.

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good news, presumably, is mostly priced in, though the earnings outlook may be better than advertised (or worse if I am underplaying credit losses). Valuations imply there could be a shift in performance, given that regionals trade for roughly 11x 2026 consensus EPS, compared to the Wall Street banks at around 14x, except for Citigroup at 12x.

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