Why Did We Choose Our Fee Structure?

If you are reading this document, you're likely someone interested in Arch Capital Investors Fund. If that is the case, you also might have questions about our fee structure, because it is different than most investment funds.

After reading this, we hope you are convinced our structure, while unique, is fair and aligns our incentives with you, the potential limited partner. To do that, we are going to compare three different investment vehicles:

1. An S&P 500 index fund or ETF. Most funds of this structure charge 5 basis points or less in annual fees, so to simplify things we are going to assume investors can invest in these funds for free (we also refer to this as "the benchmark" a few times in this document).
2. A fund that charges a 1% management fee, assessed annually, on all assets under management (AUM). We chose this one because it is the most unlike our fund, which charges 0% on AUM but has a sizable performance fee. It is also similar to what a lot of advisors and wealth management firms charge.
3. Our fund, which charges 0% on AUM but 33% on all positive gains in *excess* of S&P 500 returns, assessed annually.

For the following scenarios, we are going to assume our benchmark's (the S&P 500) returns are identical to the returns an investor would get through an index fund.

Scenario 1: Everyone Returns 9%

In this scenario, the benchmark returns 9% a year for 5 years, and the two other funds match it. The following table outlines what investors and managers make out with at the end of 5 years (the index fund has no manager).

**Fund two refers to the list above, and is the fund with a 1% flat fee. Fund three has the same fee structure as Arch Capital*

	Start Date	**End of Year 1**	**End of Year 2**	**End of Year 3**	**End of Year 4**	**End of Year 5**
S&P 500	$100,000	$109,000	$118,810	$129,503	$141,158	$153,862
Fund 2 Investor	$100,000	$108,000	$116,640	$125,971	$136,049	$146,933
Fund 2 Manager	$0.00	$1,000	$2,080	$3,246	$4,506	**$5,867**

Fund 3 Investor	$100,000	$109,000	$118,810	$129,503	$141,158	$153,862
Fund 3 Manager	$0.00	$0.00	$0.00	$0.00	$0.00	**$0.00**

In this scenario, we (fund three managers) would not get paid anything since our performance ended up matching the benchmark. Fund two's gross performance matched the benchmark, but since it has a flat 1% fee no matter what its returns are, its investors actually ended up *trailing* the S&P 500 by a significant margin.

Scenario 2: Fund 2 and 3 Underperform

In this scenario, we assume the benchmark returns 9% over five years, but that fund two and three's gross performance is 6% each year, or trailing the S&P 500 by 3% a year.

	Start Date	**End of Year 1**	**End of Year 2**	**End of Year 3**	**End of Year 4**	**End of Year 5**
S&P 500	$100,000	$109,000	$118,810	$129,503	$141,158	$153,862
Fund 2 Investor	$100,000	$105,000	$110,250	$115,763	$121,551	$127,628
Fund 2 Manager	$0.00	$1,000	$2,050	$3,153	$4,310	**$5,526**
Fund 3 Investor	$100,000	$106,000	$112,360	$119,102	$126,248	$133,823
Fund 3 Manager	$0.00	$0.00	$0.00	$0.00	$0.00	**$0.00**

Again, if this scenario happened, we would take in no fees as we didn't have positive returns *or* beat the S&P 500 (we need both to happen over an annual period to earn a performance fee). Fund two, which again provided no value relative to the S&P 500, ends up accumulating 5.5% (!) of an investor's cost-basis over five years.

(You can also assume under this scenario we would return all capital to investors, as our performance would show in no way that we deserve to manage other peoples hard-earned money)

Scenario 3: Fund 2 and 3 Outperform

In this scenario, we assume the benchmark returns 9% over 5 years, and that fund two and three's gross performance is 12% a year, or beating the S&P 500 by 3% a year.

	Start Date	End of Year 1	End of Year 2	End of Year 3	End of Year 4	End of Year 5
S&P 500	$100,000	$109,000	$118,810	$129,503	$141,158	$153,862
Fund 2 Investor	$100,000	$111,000	$123,210	$136,763	$151,807	$168,506
Fund 2 Manager	$0.00	$1,000	$2,110	$3,342	$4,710	**$6,228**
Fund 3 Investor	$100,000	$111,010	$123,232	$136,800	$151,862	$168,582
Fund 3 Manager	$0.00	$990.00	$2,089.00	$3,309.00	$4,663.32	**$6,166.75**

Under this scenario, the investors and managers of funds 2 and 3 keep around the same amount after five years.

Scenario 3: Fund 2 Underperforms and Fund 3 Outperforms

In this scenario, we assume the benchmark returns 9% a year over 5 years, and that fund two's gross performance is 6% a year, while fund three's gross performance is 12% a year.

	Start Date	End of Year 1	End of Year 2	End of Year 3	End of Year 4	End of Year 5
S&P 500	$100,000	$109,000	$118,810	$129,503	$141,158	$153,862
Fund 2 Investor	$100,000	$105,000	$110,250	$115,763	$121,551	$127,628
Fund 2 Manager	$0.00	$1,000	$2,050	$3,153	$4,310	**$5,526**
Fund 3 Investor	$100,000	$111,010	$123,232	$136,800	$151,862	$168,582
Fund 3 Manager	$0.00	$990.00	$2,089.00	$3,309.00	$4,663.32	**$6,166.75**

Under this scenario, clients of fund three have a cumulative return of 68.6%, while clients of fund two have a cumulative return of 27.6%. As well, in this time period, fund two and three managers earn similar amounts of compensation. *This scenario is a testament to why our fee structure is superior to traditional management fees*.

If you are concerned about our fee structure, you are likely thinking of a scenario where our fund and one with a flat management fee both materially outperform the benchmark. In that scenario, the net performance of our fund would still be substantially higher than our benchmark (or the overall market), but our distribution of the total returns would be higher than traditional funds. If sizable market outperformance is the worst-case scenario under our fee structure, we believe that is a good problem to have.

If you are going to invest with us (three people, who, as of this writing, have a minimal track record), we understand there is risk involved. But there is also an opportunity to generate life-changing returns. We believe we should only be compensated under the latter scenario, and our fee structure reflects that.

If you're still not comfortable with this fee structure, that is fine, we understand that one style is not a perfect fit for every investor. But if you want to join a partnership that is long-term focused with aligned incentives, don't hesitate to get in touch.