INVESTMENT IDEA

Arch Capital Group

NASDAQ: ACGL

El Médico Inversor

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Purchase of Arch Capital Group ($ACGL).

Average entry price: 96.26 USD.

Purchase date: April 27, 2026.

Position taken in main portfolio and replicated in public eToro portfolio (verifiable in real time).

Arch Capital is an insurance company. It sells insurance of three types.

The first half of its business is insurance for companies. For example, a maritime transport company needs to insure its ships against sinking. An energy company needs to insure its facilities against accidents. The directors of a listed company need personal insurance against lawsuits they may face. All this is professional and specialized insurance, not standardized like your car insurance. Each policy requires technical analysis to set the price.

Approximately thirty per cent of the business is reinsurance. This is insurance for insurance companies. A small insurer covering thousands of houses against hurricanes in Florida cannot afford for a hurricane to arrive and wipe out all the houses at once. It needs to protect itself. So it buys reinsurance from a larger company, like Arch, that will cover its losses if a catastrophic event arrives. Arch charges a premium for taking on that risk. It is a business where the strength of the balance sheet is the main barrier to entry. Only reinsurers with very high credit ratings (Arch has the highest from the three major agencies) can compete in this market.

The remaining twenty per cent is mortgage insurance. When a bank lends money to buy a house, the bank carries default risk. To protect itself, the bank buys insurance from companies like Arch. If the borrower stops paying, Arch covers the loss. It collects premiums every month for years before any claim materializes.

The company numbers are as follows.

I have paid 96.26 dollars for each share.

The company earns a little over eleven dollars per share per year. That means I have paid less than nine times annual earnings. For a quality company this is very low. The historical sector average is eleven to twelve times.

Last year, the company had an excellent ROE: its own funds generated twenty per cent.

The free cash flow the company generates, divided by its current price, gives almost eighteen per cent. This means that if the company kept generating this cash flow every year, in less than six years it would have returned to the shareholder everything paid in cash alone. It is a rarity, and I think the market is treating it as a cyclical about to collapse.

And here is the dissonance. The market is pricing Arch as a company about to collapse, but the latest sector data point to moderation, not collapse. Meanwhile, the company itself is aggressively buying back shares at these cheap prices, which is a very clear signal that management thinks the stock is undervalued.

The idea is that. A quality company priced as if it were mediocre. Let me develop why I think the market is wrong.

Before we continue: on Bermuda

It happened to me when I started studying the company, so it will probably happen to the reader. When you see that a company has its headquarters in Bermuda, an alarm goes off. Bermuda sounds like a tax haven, like opacity, like something murky. It is worth clarifying this immediately because the reality is very different from that first impression.

Bermuda has been for forty years the global hub of specialized insurance and reinsurance. The reason is historical. In the early nineties, two very serious hurricanes destroyed the catastrophic insurance market. The traditional large insurers in London and the United States could not absorb that much risk. New capital was needed and a group of investors created a new generation of insurers in Bermuda with clean balance sheets. Arch Capital is one of those insurers born from that crisis, founded in 1995. Other serious and well-known companies share the same origin, such as RenaissanceRe, Everest Re, Axis Capital or the current Chubb.

Insurance regulation in Bermuda is, in important respects, stricter than that of the United States. Bermuda has been compliant since 2024 with the OECD agreement to impose a global minimum tax of fifteen per cent. It is not an opaque tax haven, but a specialized jurisdiction with serious regulation.

For reference, Berkshire Hathaway has a good part of its insurers structured in Bermuda or taking advantage of similar setups. Markel itself also operates with Bermudian subsidiaries. Fairfax Financial has its main reinsurer (Odyssey Re) domiciled there. Any investor who wants exposure to the global high-quality insurance sector will pass through Bermuda.

What makes Arch special

There are two specific things that distinguish Arch from other insurers. I explain them one by one.

They know how to say no

In the insurance sector there is a key metric called the combined ratio. It is very simple. Add everything the insurer pays out (claims plus expenses) and divide it by everything it collects (its premiums). If the result is less than one hundred, the insurer makes money on underwriting alone,

without counting what they earn investing the cash on the balance sheet. If the result is more than one hundred, they are losing money on underwriting.

The historical sector average is ninety-five. Arch has a historical average between eighty-seven and eighty-nine. That means Arch systematically loses less money on claims and expenses than its competitors, maintaining superior technical margins.

How do they achieve it? By saying no to bad premiums. When between 2015 and 2018 insurance prices were weak, Arch deliberately reduced its market share. It let premiums go. It did not accept some business that competitors were signing because it knew that business would be paid for dearly later in losses. And indeed it was paid for dearly: between 2020 and 2022 competitors who had been aggressive had to reserve large adverse losses while Arch arrived at the next cycle with a clean balance sheet.

This ability to reject business that does not fit looks simple but is not. The internal pressure in a listed insurer to grow premiums is enormous. Analysts punish any insurance company that does not grow. Area managers have incentives to underwrite more. The fact that Arch's management has maintained discipline for an entire decade is what justifies it deserving to trade at a premium to the sector average. Although today it is precisely trading at a discount, not a premium, and that is where I see the opportunity.

They move capital among their three businesses

As I said before, they are three different insurance businesses within the same company. And management moves capital between them depending on where risk is best paid at any given moment.

When reinsurance is weak, they reinforce mortgage insurance. When mortgage insurance cools off, they reinforce catastrophic reinsurance. When professional insurance for companies weakens, they reinforce other segments. This dynamic allocation flexibility is what has allowed them to maintain a return on capital of seventeen per cent for ten years in a row. Almost no insurer manages this. Most are a single product and therefore suffer fully when their specific theme weakens.

On the mortgage segment

The insurance business has cost me considerable effort to understand well. It is a non-sexy sector. It is probably also the least understood by the analysts who cover this company. I have read the full annual reports and the earnings call transcripts. After all that work, my conviction on this segment is good but I do not consider it fully complete. My position in Arch rests basically on the professional and reinsurance segments, which I understand well. The mortgage segment is something added and is not the central piece of my investment.

What I do understand is the following. When someone buys a house but only contributes from their own pocket, say, fifteen per cent of the price, the lending bank takes default risk. If the buyer stops paying and the bank takes the house, it might not recover the entire loan, especially if house prices have fallen. To protect itself from that risk, the bank takes out insurance with companies like Arch.

The interesting thing about this business is what is called float. Premiums are collected monthly over years, while claims, if they arrive, do so much later. This means Arch has the cash from premiums on its balance sheet for years, generating interest, before having to pay any claims. The average duration of the float is over seven years. It is as if the client were lending money to Arch for seven years at a very low interest rate, while Arch invests that money at a higher rate.

The market's fear with this segment, and the one any investor may feel, comes from the 2008 crisis. Analysts remember the massive mortgage defaults in the United States and apply a default discount to any mortgage exposure. But Arch's current portfolio bears no resemblance at all to what existed in 2007. The average credit quality of borrowers is high (measured by the FICO score, which is a credit risk scoring system in the United States): the average of Arch's portfolio exceeds 750 points out of 850. The loan-to-value ratio is seventy-eight per cent, which means there is significant equity protection before Arch has to respond. And the geographic diversification is very good, so there is no concentration in a single region.

Mortgage volume in the United States is at lows for two reasons. Interest rates have been high between 2022 and 2025, which has made mortgages more expensive and reduced home purchases. And inventory of houses for sale is fairly low. If rates fall gradually over the next two or three years and real estate activity reactivates, the volume of insured mortgages could grow. That is why I think this is a favorable optionality the market is not pricing in.

On who runs the company

Marc Grandisson, who led Arch as CEO from 2018 after running the reinsurance segment for the previous ten years, retired from the company in October 2024 after 23 years at Arch. His successor is Nicolas Papadopoulo, until then president and chief underwriting officer of the group.

Papadopoulo has been with the company since 2001. He has been managing director of the international insurance segment since 2021. Before that he was chairman and managing director of the reinsurance segment between 2014 and 2017. That is, he has contributed for 23 years to building the specific Arch culture. He is not just any executive who came from outside to change course, but the successor chosen by the board precisely to maintain it.

This matters for the idea. One of the doubts in any investment in a company with specific culture is what happens when leadership changes. It is the current problem, to give an example, with Berkshire Hathaway and Greg Abel. In Arch's case, the transition already happened eighteen

months ago. Results since then, including Q4 2025 with record net income of 1.2 billion dollars (3.35 dollars per share and an annualized return on capital of 21.2 per cent), confirm that Papadopoulo continues to maintain discipline.

Why I think the market is wrong

The market discounts three things I consider exaggerated. I explain them one by one in the order in which they most impact valuation.

First: that the insurance cycle will collapse soon

To understand this argument it helps to know that the insurance sector works in cycles. There are periods when prices rise for years, known as a hard market, where insurers earn a lot of money. And there are periods when prices fall for years, known as a soft market, where margins compress. The sector has been in a hard cycle since 2019.

The bearish narrative that justifies the current cheap price is that this hard cycle is about to disappear and that when the soft cycle arrives Arch's earnings will fall a lot. The cycle will change, yes. But I think this is exaggerated. Prices are moderating from the extreme levels of 2023 and 2024, but moderation is not collapse. The January 2026 renewals on property catastrophic insurance went up between five and ten per cent more. Liability lines continue to harden. Capacity remains restricted after the California fires of early 2025.

And here is the important point. Even if the market entered an absolute soft phase, Arch has a historical combined ratio between eighty-seven and eighty-nine. For the company to stop earning money on underwriting, the combined would have to rise to one hundred sustainably. The current price already discounts a combined of one hundred per cent, a scenario that historically has only occurred in years of specific mega-catastrophes such as 2001, 2005 or 2017. Never as a sustained baseline for years. The asymmetry is there.

Second: the unjustified fear of the mortgage segment

As I explained earlier, the market carries the trauma of 2008 in its memory. Any mortgage exposure is automatically discounted. But Arch's current portfolio is nothing like the one from that era. Credit quality is high. The loan-to-value ratio is prudent. Regulatory capital ratios that the company has in this segment exceed required minimums by a factor of three to four times.

A moderate recession will increase claims but the portfolio is over-capitalized for stress scenarios. And if the gradual normalization of rates and mortgage volumes arrives, this segment will activate a growth lever the market is not pricing in.

Third: the underestimated power of buybacks

When a company with nineteen per cent return on capital buys back shares at 1.4 times book value, every dollar repurchased generates more value per share than almost any equivalent organic growth. If Arch keeps buying back at the historical pace of three or four per cent annually, earnings per share will grow between four and six points just by reduction of share count, even if total earnings stay flat. And if the price stays depressed, buybacks accelerate.

There is recent data that reinforces this. On April 19, 2026, eight days ago, Arch expanded its buyback authorization by an additional 3 billion dollars, leaving a total of 6 billion authorized and approximately 3.1 billion available to execute. Evercore, one of the most respected research houses, estimates that the company will deploy 2.75 billion in buybacks during 2026 and 2.58 billion in 2027, figures significantly above consensus. Management is signaling with facts what valuation should say: at these prices, the best investment the company itself can make is to buy its own shares.

And why Arch and not Markel?

There is a question I asked myself before and that any investor in the sector will ask seeing my position. Markel Group is a company similar to Arch. It also combines specialty insurance with an investment portfolio. It also has quality capital management culture, led by Tom Gayner, probably one of the most respected investors of his generation. Why Arch and not Markel?

Markel is a company I admire and consider comparable in quality. The choice of Arch over Markel for this specific position does not mean Arch is a better company, but a purely price criterion.

Markel today trades at eleven times earnings. My valuation gives me a discount to fair value of two or three per cent. That is, it is close to fair value. Good company, reasonable price, no real margin of safety. Arch trades at 8.4 times earnings and 1.4 times book value. Applying valuation models, I get a discount to fair value of over thirty per cent. My own analysis suggests the real discount may be between thirty and fifty per cent depending on the scenario.

If two businesses are comparable in quality and one trades with a much greater margin of safety than the other, rational capital allocation favors the more undervalued. Markel remains on my watch list. When its price reflects a discount similar to Arch's today, I could add it to the portfolio. But today, with this information available, Arch is the rational choice.

Even so, my conviction in Arch is high, although my conviction that Arch is objectively a better company than Markel is moderate. At the current price of each, Arch offers more value per dollar invested. If prices converge in the future, I might perfectly prefer Markel for its structural simplicity and Tom Gayner's consistency over decades. Tom Gayner is someone I follow whom I admire as a manager.

What I expect to earn

Before explaining the scenarios, a note on methodology.

I build the model conservatively. I use book value per share as the anchor (what the company is worth on its own balance sheet), not estimates of future earnings that can be volatile. I apply moderate exit multiples relative to the sector median. And I describe scenarios without assigning exact probabilities, because any numeric percentage I put here would be false precision.

The starting data are as follows:

- Book value per share at the end of 2025 is around 68 dollars.
- Analyst consensus expects EPS in 2026 close to 9.40 dollars.
- Sustainable return on capital target is seventeen per cent.
- Combined ratio target between eighty-seven and ninety.
- Annual buybacks assumed, around three per cent of shares outstanding.

Most likely scenario — 9-10% annual

Arch keeps operating as it has for the past decade. Book value per share grows at twelve per cent annually. The company keeps buying back at three per cent annually. The multiple normalizes to eleven times earnings, which is the current sector median (today Arch trades at 8.4, clearly below). In three years, book value reaches ninety dollars per share. EPS at around 11.50. The target price from applying eleven times to that earnings is 127 dollars. From my entry price of 96.26, that would be a thirty per cent return in three years, equivalent to roughly nine to ten per cent annualized, plus the small dividends it pays. That is, the base scenario already beats the S&P; 500 without anything extra happening, just with the company operating as it has done over the past decade.

Bullish scenario — 13-14% annual

The market recognizes that the insurance cycle stays strong a year or two longer than expected and the multiple revives to twelve times earnings on EPS of twelve dollars. The target price would be 144 dollars. Total return of forty-seven per cent in three years, equivalent to thirteen to fourteen per cent annualized.

Very bullish scenario — 19-21% annual

The bullish scenario plays out and additionally the mortgage segment accelerates with the recovery of the U.S. real estate market. The market finally recognizes that Arch's return on capital is structurally superior to the sector and applies a valuation premium. EPS could reach 13.50 dollars at a multiple of thirteen. Target price 175 dollars. Return close to eighty per cent in three years, around twenty-one per cent annualized.

Bearish scenario — -25 to -30% loss

A severe soft market arrives. The combined ratio rises to between ninety-five and ninety-seven and stays there for three years. EPS falls to around seven dollars. The multiple stays where it is, at eight or nine times. The target price would be 60-70 dollars. Loss of twenty-five to thirty per cent from my entry price.

What this means together

Weighting the four scenarios with conservative bias, I expect a medium annualized return between eleven and fourteen per cent over the next three to five years. The asymmetry is favorable. In good scenarios, return between thirteen and twenty-one per cent annualized. In the base scenario, around nine to ten per cent. In the bad scenario, the loss is limited to thirty per cent. The potential loss is significantly less than the potential upside in bullish scenarios. That is why I enter.

What can go wrong

Risk one: that the soft cycle arrives sooner and is more severe

The sector is in one of the longest hard cycles in recent history, between 2019 and 2025. When this cycle finally turns, and it will because cycles always do, the margin compression could be more severe than I am modeling. During prolonged soft markets combined ratios can rise to between one hundred and one hundred and five sustainably for three to five years. This happened between 1998 and 2001, between 2007 and 2010, and more moderately between 2013 and 2018. If a similar period arrives starting in 2027, my base scenario will not be met. Arch would still be profitable because its superior discipline keeps it better than the average sector, but book value growth would moderate to between six and eight per cent annualized. Managing this risk means sizing the position so that this scenario does not destroy the portfolio, and reserving the capacity to add if the price falls without fundamental deterioration.

Risk two: tax change in Bermuda

Bermuda has been under international regulatory pressure. The progressive implementation of the global minimum tax of fifteen per cent could increase Arch's effective tax burden in coming years. An effective tax burden 250 basis points higher than current would reduce recurring net income by between five and seven per cent. This justifies a discount of approximately ten to twelve dollars in my base scenario target price. The good thing is that it is already partially reflected in the current price.

Risk three: major catastrophes

Like any insurer, Arch is exposed to super catastrophes. Major hurricanes, California earthquakes, pandemics, large-scale systemic cyber attacks on the banking sector, geopolitical scenarios of

nuclear war. Arch's risk management track record is excellent, but the risk is there. A scenario that deserves specific consideration is a season of very strong hurricanes in the United States combined with a major earthquake in California in the same year. Industrial loss could exceed three hundred to four hundred billion dollars. Although Arch has retroceded reinsurance (i.e., it itself buys reinsurance to protect against the largest risks), it could lose one or two points of book value in an event like that.

Risk four: that the market takes a long time to recognize this idea

This is probably the most likely risk and the least discussed by investors generally. The market could keep applying a multiple of eight times for many years. The stock might never improve its price, even if the business fundamentals are good. It is exactly what happened with Markel from 2009 to 2018. Solid fundamentals, depressed valuation, and never the something that improved the general situation of the company. If this happens with Arch, the compounding of book value would still generate returns between twelve and fourteen per cent annualized, but the total shareholder return would be compressed to organic growth, without the extra that would come from multiple normalization. This would convert an idea with potential of thirteen to fourteen per cent annualized into one of eight or nine per cent annualized. It is something I have to accept. Eight or nine per cent annualized is still competitive with the S&P; 500 long term. The problem with this risk is earning less than expected.

The fundamental warning signal

Beyond the risks there is a specific signal I would watch with special attention. If Arch starts growing premiums significantly above the market in liability lines during a future soft market, it would be a sign of loss of discipline. What distinguishes a disciplined Arch from an Arch that gives in is the willingness to pull back when prices fall. If on a 2027 or 2028 conference call I hear Nicolas Papadopoulo say "we are seeing growth opportunities" while all competitors are pulling back, I would have doubts. If I hear "we are being selective", I will keep the conviction.

When I would sell

A price drop in itself is not a reason to sell. It is a reason to review the idea and possibly add if fundamentals have not deteriorated. I would sell the position in any of the following circumstances.

- If the combined ratio exceeds ninety-five sustained for two consecutive quarters without a clear, specific catastrophic cause. This would indicate structural deterioration of the discipline I described before.
- If management loses discipline in M&A;, paying excessive prices for growth.
- If return on capital falls structurally below twelve per cent for more than a year without a detectable cause.
- If evidence of deterioration appears in the quality of the mortgage insurance portfolio.

- If Nicolas Papadopoulo leaves his post without a clear successor or if the underwriting discipline culture deteriorates.

My investment horizon is between five and ten years. I expect to hold this position unless any of the above criteria is met.

My commitment with this idea

The position is taken before these lines are published. The operation is verifiable in my public eToro portfolio from the day of execution.

Best regards,

El Médico Inversor

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