This article is authored by MOI Global instructor Jonathan Isaac, portfolio manager of Quilt Investment Management, based in Tucson, Arizona. Jonathan is an instructor at Best Ideas 2018, the fully online conference featuring more than one hundred expert instructors from the MOI Global membership community.

Index funds present a particular set of challenges, where money flow and mere inclusion in an index often creates individual buy/sell decisions. Those who invest in them may want to consider this final point: risk is investing without forming an idea of a company's expected value, investing without adequate knowledge, and investing without an edge. Presumably, if market efficiency (the "edge" of many index investors) is created through a pricing mechanism enacted by the active decisions of others (those who invest using valuation as an input for their decisions), passive investors could profit from this pricing mechanism en masse by investing in broad indexes.

But how does the continued growth of index investing impact the "efficiency" of the market's pricing mechanism? Like in so many instances, an analogy can prove our point. The first few people who stand on their tippy-toes in a crowded room (assume that everyone is the same height) can see the stage better, but as more and more do it, fewer and fewer people can see the stage. A belief in market efficiency is also a belief in the standardization of crowd behavior. What happens when someone pulls the fire alarm? As the hagiography of a parasitic way of investing continues to grow, we must wonder: what will become of the organism itself?

Warren Buffett, the last modernist

Comfort with the future in value investing history began to emerge with Warren Buffett, who can be viewed as an intermediary figure in ex-ante optionality becoming ex-post optionality. Investing in companies with durable competitive advantages presumes that certain demonstrable benefits, or protective "moats" surrounding a company's competitive position, extend from the past into the future.

There is a presumption of normalcy in this process that can be observed in a range of business practices: the continuation of a predictable act (people like drinking a certain branded soda; seeing the image produces a sensation that often leads, in repetition, to consuming it, which is also consuming the memory of it), creating the conditions for future protected innovations (a company consistently has the best engineers and a great patent history), or, in its most base form, investing in a regulated utility that produces something the population will always need and for which extensive transportation will probably always be uneconomical (for instance, a water utility).

Here, the past extends through the future in a similar way, and we can all share in the common practice of telling fortunes (although, clearly, some people are more perceptive than others). However, with ex-post optionality, there is not a presumption of normalcy: future conditions are altogether different from what exists on the balance sheet or in current economic reality; we have to look elsewhere.

Berkshire Hathaway's purchase of BNSF can be viewed as Buffett situating himself between the ex-post optionality of incremental margins and the ex-ante optionality of historical truths and their continuation; Buffett, to extrapolate, saw conditions under which the durable competitive advantages of BNSF would impact the realization of incremental margins, and future conditions for this occurrence were mispriced in the present.

In short, Buffett saw reflexivity between ex-ante optionality and ex-post optionality through which historical forces would impact the future. This was, perhaps, the highest art of a crystal ball that integrates the past, through which tendencies and drive find their codifications. Buffett is a late modernist, maybe the last modernist, while Graham—who almost became a professor of classics instead of finance—is a classicist, buried in a tomb of financial statements which act as a horizon to Buffett's infinity.