

Original Article

A Critical Exploratory Study on the Method of Value Investing (Warren Buffett's Portfolio Management Strategy) as Opposed to Diversified Quantitative Models of Modern Portfolio Theory

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Abstract - Modern Portfolio Theory and Value Investing are widely treated as competing investment frameworks, with debate centering on which delivers superior risk-adjusted returns. This paper challenges that framing, arguing that the two are not rival frameworks, but complementary tools applied at different stages of the investment process. It compares how each framework defines risk, diversification, and portfolio construction, drawing on a conceptual review of the literature and case studies of leading practitioners — Warren Buffett and Peter Lynch as value investors, and Ray Dalio's Bridgewater and Dimensional Fund Advisors as quantitative, MPT-based managers. To test whether this complementarity holds in practice, the study conducts a primary survey on Indian investment practitioners, including individual investors, fund managers, and wealth advisors. The findings indicate that pure forms of either framework are rarely practiced: institutional approaches retain MPT's mathematical framework while building on it with factor models and risk parity. Most surveyed practitioners reported using a combination of both philosophies — MPT to guide portfolio construction and diversification, and value investing's margin-of-safety concept to select individual securities. Practitioners tilt towards the value investing definition of risk as permanent loss of capital rather than volatility, as in MPT, and most consider markets to be only moderately efficient. The study concludes that an optimal approach for investors lies not in choosing between the frameworks but in pragmatic diversification using the two, offering insights highly relevant to retail and emerging-market investors navigating between these methods themselves.

Keywords - Diversification, Modern Portfolio Theory, Risk, Portfolio Construction, Value Investing.

1. Introduction

There are many approaches to portfolio management, using both traditional and alternative assets to achieve optimal risk-adjusted returns. Research suggests that investors need to adapt their strategies according to the complexities of today's financial markets effectively, staying agile and proactive in managing risks while seizing opportunities. [1]

There is often a wide divergent view between academic and practitioner risk, return, and portfolio construction. For example, academics focus primarily on purely quantitative measures or factors. Initially, the focus is on standard deviation, beta, and factors such as size, style, liquidity, momentum, and quality. Value investing practitioners, in contrast, often focus on a company's products, its history, free cash flow, and the competitive dynamics of its industry. Furthermore, they have "discovered" anomalies, such as momentum, decades before they were rigorously analyzed and published by academics. The current distinction between the

two groups is not merely quantitative versus qualitative, but between putting into perspective the intuitional aspect of stock selection. [2]

MPT (Modern Portfolio Theory) relies on a number of unrealistic assumptions, including an inaccurate definition of risk. Yet this characterization of risk sets the rules for comparing active and passive strategies, often causing active strategies to appear more risky and less efficient than their index counterparts. The same logic is used to risk-adjust returns, biasing them downward for more active, concentrated managers.

Furthermore, reliance on MPT's measure of risk often leads active managers to super-diversify. [3] Finding securities with gaps between price and value is the foundation of generating excess returns in active investment management. The difference between price and value, also known as "edge," comes from having a view of a security that



diverges from what the market reflects. One of the most challenging aspects of understanding expected value is that excess returns can be the product of high probability events with relatively low payoffs, or low probability events with relatively high payoffs. “In other words, how often you are right is not all that matters. What is vital is how much money you make when you are right versus how much you lose when you are wrong.” [4]

Work on these two frameworks has developed along two separate lines. One approach compares their theoretical claims and concludes that this framework cannot reconcile, since they cannot agree on what risk is and how it is defined [6]. The other reconciles them statistically, demonstrating that the returns of sophisticated value investors can be reproduced through factor exposures drawn from asset pricing research [7]. The reconciliation work is, however, retrospective, accounting for realized returns rather than the reasoning that produced them, and is drawn almost entirely from developed markets. What has not been established is which framework a working investor applies at which stage of the investment process, on what basis that division is made, and whether the same pattern holds outside the United States.

This paper addresses that gap in three ways. It specifies the level at which each framework operates and why the two are not competing to perform the same function. It examines how leading practitioners of each approach depart from the pure form of both frameworks. And it collects primary evidence from investment practitioners in India on how the two are combined in practice.

Value investing has one key distinguishing feature, which is, margin of safety, which suggests that all value investing decisions lie on buying an asset only when it is significantly undervalued. This is one of the ways that value investors try to avoid losing money. The other key characteristic of value investing is that the security is analyzed as a business. Thorough analysis of the company’s operations and financials, along with a significant margin of safety are used by value investors to handle risk.

1.1. Research Questions

(1) How do value investing and Modern Portfolio Theory differ in their treatment of risk, diversification and portfolio construction? (2) At which stage of the investment process does each framework apply, and do the two conflict at that stage or operate on different segments? (3) What combination of the two do practicing investors in an emerging market use, and what does that practice suggest about the ideal mix?

2. Literature Review

2.1. The Development of Modern Portfolio Theory

Knight (1921), as discussed in [5], classified risk as a situation where the outcomes are random but the probability distribution governing the outcome is known, and therefore

expectations (for example, expected returns) can be quantified.

Financial market participants are not a uniform group of rational investors. Instead, they are an amalgamation of very different investors with varying goals. In fact, not every financial market participant is an investor. Investors in the market often operate in a way that a lot of decisions may not be considered rational. Thus, using Modern Portfolio Theory to represent the activities of market participants as rational investors leads to predictions that may, in certain scenarios, not fit what is observed in financial markets. [5]

The empirical record of CAPM has been weak. Fama and French found that beta alone has little power to explain the cross-section of average returns, and that two additional variables, company size and the ratio of book value to market value, capture much of the variation that beta misses [8]. This led to the three-factor model and later to a five-factor model, adding profitability and investment [9]. The direction of this research is important for the present paper. Each extension moves further away from CAPM's claim that the market portfolio is optimal, and towards the position that systematically tilting a portfolio away from market weights earns higher returns.

A second body of work questions MPT at the level of implementation rather than theory. Michaud demonstrated that mean-variance optimization behaves as an estimation error maximiser, because the assets they assign the largest weights to are precisely those whose expected returns have been most overestimated, whose variances have been most underestimated, and whose correlations appear most favorable [10]. The output of the optimization is therefore highly unstable with respect to small changes in its inputs. DeMiguel, Garlappi and Uppal extended this finding by comparing a range of optimization models against dividing capital equally across available assets, and found that none of the optimization models consistently outperformed equal division [11].

The above establishes a point that is central to this paper's argument. MPT in practice already departs considerably from MPT as it was originally written. Practitioners applying the framework do not hold the market portfolio, do not rely on beta alone to estimate expected returns, and frequently constrain or override the outputs generated through mean-variance optimization.

2.2. The Development of Value Investing

Empirical support for value strategies emerged well before the framework was formally recognized by asset pricing research. Basu sorted US stocks by their price to earnings ratios and found that portfolios of low price to earnings stocks earned higher returns than portfolios of high price to earnings stocks, and that the difference persisted after

adjusting for risk in the CAPM sense [12]. Fama and French subsequently incorporated the effect into the three-factor model through the book-to-market ratio [8].

The reason for the value premium remains disputed, which is vital to this paper. Fama and French treat the premium as compensation for a risk that beta fails to capture, which places value investing inside the efficient market's framework rather than in opposition to it [8]. Lakonishok, Shleifer and Vishny reach the opposite conclusion, arguing that value strategies outperform because investors extrapolate past growth too far into the future and therefore overprice glamour stocks and underprice value stocks, and they present evidence that value portfolios were not in fact riskier by conventional measures [13]. The first explanation is compatible with market efficiency, while the second directly contradicts it.

2.3. Research Reconciling the Two Frameworks

Another work has treated the two frameworks as combinable rather than opposed.

Black and Litterman addressed the instability identified by Michaud by starting from the returns implied by market equilibrium and then allowing the investor to state subjective views on specific securities or asset classes, with each view weighted according to the confidence attached to it [14]. The resulting portfolio departs from market weights only to the extent of the investors view and the confidence attached with it, and within this model, investors are no longer required to estimate expected returns for securities where they do not hold views and lack confidence. The significance of this for the present paper is that the model is a formal framework for creating value-based judgements as inputs into the mean-variance framework.

Frazzini, Kabiller and Pedersen provide the most direct evidence that value investing and quantitative factor investing draw on overlapping sources of return. Examining Berkshire Hathaway's returns from 1976 to 2017, they find an average annual return of 18.6% in excess of the Treasury bill rate against 7.5% for the market, and a Sharpe Ratio of 0.79, roughly 1.6 times that of the market [7]. Berkshire's alpha is significant against the standard academic factors, which is why earlier work treated the record as unexplained [15]. Once exposure to the Betting-Against-Beta factor [16] and the Quality-Minus-Junk factor [17] is controlled for, the alpha becomes statistically insignificant, and leverage is estimated at about 1.7 to 1, financed largely through insurance float. Their conclusion is that Buffett's returns are a reward for applying leverage to cheap, safe and high-quality stocks [7]. The characteristics value investors describe qualitatively, therefore correspond closely to factor exposures that asset pricing research has since formalized. The authors do not interpret this as an absence of skill; instead, they attribute Buffett's success to identifying and consistently applying these

characteristics decades before they were formalized [7]. The judgement involved in value investing and the systematic measurement used in quantitative models thus address the same return sources from different directions, which supports treating the two as complementary rather than competing.

Ang generalizes this position, treating factors as the underlying units of risk and return that assets are composed of, and arguing that investment styles which appear distinct at the level of security selection are often similar at the level of factor exposure [18].

2.4. Evidence from the Indian Market

As the primary data in this study is collected from Indian practitioners, the Indian evidence is relevant to whether their stated preferences are representative of the situation in Indian markets.

Agarwalla, Jacob and Varma constructed Fama-French and momentum factor returns for the Indian equity market using data from CMIE Prowess, excluding illiquid firms and correcting for survivorship bias [19]. Over January 1994 to December 2014, they report an average annual return on the value factor of 15.3%, against an average annual excess return on the market factor of 11.5%, with the size factor at close to zero [19]. The value premium in India over this period was therefore larger than the equity risk premium itself.

Earlier Indian studies reach similar conclusions. Sehgal and Tripathi found a significant value effect across several alternative valuation measures [20], and Saji and Harikumar found that stocks identified as undervalued on the basis of earnings to price ratios produced persistently better returns than overvalued stocks [21].

The evidence is not uniform, however. Harshita, Singh and Yadav report that the Indian value premium, measured using the price to book ratio, has nearly ceased to exist in the period following the global financial crisis. [22]. The Indian value premium is therefore well documented historically, but may not be stable, which is a relevant consideration when interpreting practitioner preferences reported in section 5.4.

2.5. Research Gap

The literature above establishes three things. MPT as applied in practice departs substantially from MPT as originally specified. Value investing has empirical support, though the reason for that support remains disputed. And the returns of a leading value investor can be largely reproduced using factors drawn from the asset pricing tradition, meaning the two frameworks are not describing separate phenomena. What the literature does not address is how the two are combined in the decisions of working investors. The reconciliation research is quantitative and retrospective, explaining past returns and is drawn almost entirely from developed markets, specifically the United States. The

question of which framework an investor applies to which decision, and on what basis, has not been examined directly. Existing work on MPT's practical implications is also non-committal on the role of active fund managers [23].

3. Methodology

3.1. Research Design

This study combines conceptual analysis, case study analysis and primary data collection. The conceptual comparison examines how each framework defines risk, diversification and portfolio construction. The case studies examine how each framework is applied by leading practitioners, and the primary data shows how a set of investors in India define risk, construct portfolios and select frameworks in practice.

The first two strands are based on published and verifiable evidence, and hence carry significantly more weight. The primary data strand is included to record how practitioners describe their own decisions in an area where the existing literature is almost entirely quantitative and retrospective, and its findings are not generalizable beyond the investors surveyed.

3.2. Primary Data Collection

The survey was designed to record how practicing investors define risk, how they diversify, which framework they apply to which decision, and whether they regard markets as efficient. These four areas correspond to the points of comparison examined in sections 5.1 to 5.3.

Participants chosen were required to be experienced in the investment markets, and were selected to span a range of roles, including fund managers, analysts, wealth advisors and individual investors, so that respondents with different objectives, time horizons and approaches to investing were represented. The intention was breadth of perspective rather than statistical representativeness. Participants were approached through personal and professional networks and through referrals from initial contacts. Nine responses were received between 31 January 2026 and 2 June 2026, and none were excluded from analysis. Not every respondent answered every question.

The survey was conducted through Google Forms and consisted of closed questions with single-select or multi-select response options, along with open-ended questions allowing respondents to explain their reasoning. A link to the full questionnaire is reproduced in Appendix 1.

Participation was voluntary, and no incentive was offered. Respondents were informed that their responses would be used in a research paper intended for publication, and were given the option to be identified by name and role or to remain anonymous. Where anonymity was requested, respondents are described by role and scale only.

Closed responses are reported as counts alongside percentages. No inferential statistical testing has been conducted, as a sample of this size would produce confidence intervals too wide to be informative and reporting them would lend the findings a precision the data cannot support.

3.3. Case Study Selection

Four cases were selected, two for each framework: Warren Buffett at Berkshire Hathaway and Peter Lynch at the Magellan Fund as value investors, and Ray Dalio's Bridgewater and Dimensional Fund Advisors as managers working from MPT.

Cases were selected based on four criteria. Each practitioner has a track record long enough to span multiple market cycles, which excludes performance attributable to a single favorable period. Each has performance data that is publicly available and independently verifiable.

Each has set out an investment philosophy explicitly in published writing, which allows stated method to be compared against observed practice rather than inferred from returns alone. And each operates at an institutional scale, which is necessary to measure whether the frameworks act as working systems.

Within each pair, the two cases were chosen to differ. Buffett and Lynch both select securities on fundamentals but diverge in holding period, portfolio breadth and their treatment of growth, which shows that value investing cannot be reduced to a single method.

Bridgewater and DFA both build on MPT but extend it in different directions, with Bridgewater implementing risk parity and leverage at the asset class level and DFA through factor tilts at the security level.

The limitation of this approach includes survivorship bias, due to all four cases being selected because they are well-known and have been successful. The cases can therefore only show how each framework is applied by practitioners who have succeeded with it, and how far their practice departs from the framework in its pure form, discussed in sections 5.3 and 5.4.

They cannot show whether either framework produces success on average, since practitioners who applied the same frameworks and failed are not included in the study.

Moreover, Lynch's record at Magellan ended in 1990 and is therefore from a different market environment than the other three, and Bridgewater and DFA are institutions rather than individuals, so their published philosophies represent the firm's broad, stated approach compared to Buffett and Lynch's independent philosophies.

Table 1. Respondent profile

Respondent	Role	Experience	Investment horizon	Portfolio size / AUM	Holdings	Stated philosophy
R1	Analyst / Associate	7–15 yrs	Medium (1–3 yrs)	Not disclosed	10–30	A combination of both
R2	Portfolio / Fund Manager	15+ yrs	Long (3–10 yrs)	Not disclosed	10–30	A combination of both
R3	Portfolio / Fund Manager	3–7 yrs	Long (3–10 yrs)	Not disclosed	10–30	A combination of both
R4	Individual Investor	15+ yrs	Long (3–10 yrs)	₹1 crore	30	Value investing
R5	Individual Investor	15+ yrs	Long (3–10 yrs)	Not disclosed	10–30	A combination of both
R6	Investment Advisor / Wealth Manager	15+ yrs	Very long (10+ yrs)	₹2,400 crore	10–30	A combination of both
R7	Individual Investor	7–15 yrs	Long (3–10 yrs)	₹100 crore	10–30	A combination of both
R8	Individual Investor	15+ yrs	Long (3–10 yrs)	Above ₹1 crore	10–30	No specific framework
R9	Individual Investor	15+ yrs	Long (3–10 yrs)	Not disclosed	30	Modern Portfolio Theory

4. Definition and Understanding of Base Concepts

This section sets out the mechanics of the two frameworks the paper compares: Buffett-style value investing and MPT-based quantitative portfolio optimization. Each framework is defined here before the two are compared in Section 5.

4.1. MPT

MPT really means “mean-variance” analysis because it focuses on optimizing the mean (expected return) and variance (risk) of portfolio returns. It is a framework to construct and select portfolios based on the expected performance of the investments and the risk appetite of the investor, ranging from

risk-averse to risk-loving. [24] MPT modifies the statistical definition of variance by shifting its use from measuring a single asset’s volatility to calculating the volatility of an entire portfolio by incorporating weightage and covariance to accurately measure total risk by accounting for the proportion of each asset held and how their returns move together [25]. This was Markowitz’s central result: the risk of a portfolio is not the average of the risks of the securities held within it, which turned diversification from a matter of prudence into a quantifiable input to portfolio design [25]

An example of the portfolio variance formula is given below by Equation 1:

$$\text{Portfolio variance} = w_1^2 \sigma_1^2 + w_2^2 \sigma_2^2 + 2w_1 w_2 \text{Cov}_{1,2} \quad (1)$$

Where:

w_1 = the portfolio weight of the first asset

w_2 = the portfolio weight of the second asset

σ_1 = the standard deviation of the first asset

σ_2 = the standard deviation of the second asset

$\text{Cov}_{1,2}$ = the covariance of the two assets, which can thus be expressed as $p_{(1,2)} \sigma_1 \sigma_2$
where $p_{(1,2)}$ is the correlation coefficient between the two assets

It is a normative theory that describes a standard or norm of behavior that investors should pursue in constructing a portfolio. In reality, this serves as a guideline for investors where the actual investment decisions are dependent on

various factors over and above the statistical estimates". Portfolios are constructed using the efficient portfolio frontier in MPT, which is depicted in the diagram in Figure 1. [24]

Investment Opportunities

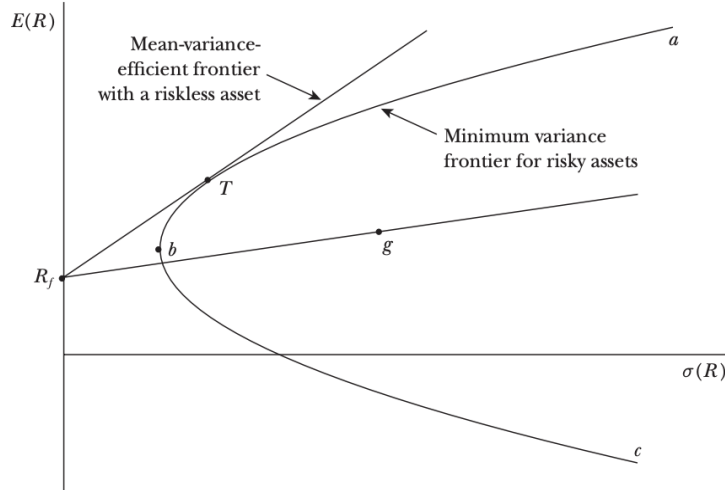


Fig. 1 The efficient portfolio frontier. Source: Fama and French [8]

The efficient portfolio frontier is the set of portfolios that offer the highest expected return for a given level of risk, or equivalently, the lowest risk for a given level of expected return; any portfolio not on this frontier is inefficient because another portfolio exists that dominates it in terms of both risk and return. Any point on the concave curve represents these optimal, “efficient portfolios”. The x-axis represents risk in the form of standard deviation, and the y-axis represents expected return.

The MPT theory dictates that given estimates of the returns, volatilities, and correlations of a set of investments and constraints on investment choices, it is possible to perform an optimization that results in the risk/return or mean-variance efficient frontier. MPT’s core innovation is the use of statistical analysis in the quantification of diversification by introducing the statistical notions of covariance and correlation into finance [24]. In defining various factors that impact portfolio construction, risk plays an important role. Risk equals volatility, as volatility indicates the unreliability of an investment. [26]

Volatility is measured by the variance (σ^2) or standard deviation (σ) of returns. [24]. It reflects the unreliability or uncertainty of an investment’s outcomes [26]. Within MPT, an investment is considered “risky” not because it threatens permanent loss of capital, but because its future returns are statistically uncertain. Risk is therefore redefined from an economic concept into a probabilistic one—measured entirely by the dispersion of outcomes around an expected mean [24, 26]. Further, risk depends on the volatility of each asset and how strongly these assets move together. Risk in MPT is not

an intrinsic property of an individual asset; it is a portfolio-level characteristic that emerges from how assets interact with one another through their correlation [24].

In MPT, return is defined as the expected value of an investment’s future payoff, and is a statistical mean, rather than a realized outcome [24]. Return is a payment for unavoidable risk. Portfolio construction in MPT is based on optimizing the trade-off between expected return and risk measured by variance. An asset is attractive in MPT only relative to its contribution to portfolio risk; high return alone is meaningless without the calculations of its variance and covariance [24].

MPT itself does not specify where expected returns come from. The Capital Asset Pricing Model (CAPM), developed independently by Sharpe and Lintner, is the tool most widely used to supply them, completing Markowitz’s mean-variance framework by relating an asset’s expected return to its covariance with the market portfolio [27, 28].

$$ER_i = R_f + \beta_i(ER_m - R_f) \quad (2)$$

Where:

ER_i = expected return on investment

R_f = risk free rate

β_i = beta of the investment

$(ER_m - R_f)$ = market risk premium

Expected return is determined by systematic risk—the portion of volatility that cannot be diversified away [8].

$ER_m - R_f$ The market risk premium—the reward for bearing aggregate uncertainty.

β_i measures how much an asset contributes to portfolio risk through covariance with the market [8].

Expected return is therefore proportional not to total volatility, but to systematic covariance risk. Risk is a portfolio concept, and return is the compensation for bearing un-diversifiable variance [24, 26].

4.2. Value Investing

The above involves buying securities that, based on fundamental analysis (studying financial statements or business positioning), are trading below their intrinsic worth or at a discount to the market or their peers. [29] It is a style of investing set out by Benjamin Graham and David Dodd in *Security Analysis* in 1934 and developed by Graham through his teaching at Columbia University [6, 30].

“An investment operation is one which, upon thorough analysis, promises safety of principal and an adequate return. Operations not meeting these requirements are speculative.” [31]

Graham viewed stock purchases as purchasing a piece of the underlying business.

Warren Buffett, one of the best practitioners of value investing [32], buys common stocks by approaching the transaction as if he were buying into a private business. He looks at the economic prospects of the business, the management, and the price he must pay. “When investing, we view ourselves as business analysts.”, says Buffet [33]. According to him, “The intrinsic value of any stock today is determined by the underlying business’s cash inflows and outflows - discounted at an appropriate interest rate - that can be expected to occur during the remaining life of the asset” [33]. Value investors are concerned mainly with valuation risk, the risk of paying too much relative to the intrinsic value.[6] To avoid this, they use a margin of safety. Graham believed that “in investment, the preferred way to handle risk is to avoid it.” [5] Risk is framed as the possibility of permanent loss of capital, mitigated by buying with a margin of safety. [34] Investment risk is measured by the danger of a loss of quality and earnings power through economic changes or deterioration in management, according to Graham as paraphrased by Montier [35].

An important distinction is that value investors do not view volatility as risk. Defining volatility as risk, as MPT does, obscures the definition of investment risk as the possibility of losing money. Value investors believe volatility is measurable, but uncertainty is not. Beta is used primarily by those who are looking at the whole market or a large number of stocks within it and who don’t look in detail at the

fundamentals of specific companies. As for value investors, this concept is irrelevant and downright dangerous at worst.[36] Value investors believe that, from time to time, the market systematically overreacts or underreacts to company and market events, leading to undervalued or overvalued securities, respectively. Discussing risk in the context of value investing, it is important to note that value investors do not view financial markets as always efficient. [5] Margin of safety is the difference between an estimate of a company’s underlying, fundamental value and its stock price. Sometimes, the value of a business and its stock price will be in close proximity. At other times, there may be a considerable difference between the two measures. [37] The margin of safety is always dependent on the price paid. For any security, it will be large at one price, small at some higher price, nonexistent at some even higher price. By applying sound security analysis methods and insisting on a significant margin of safety, the value investor protects his portfolio against losses. [5] Value investors look for opportunities to buy undervalued securities at a good discount (margin of safety) and either hold forever or sell as the asset price approaches its intrinsic value. [5]

5. Comparison of Value Investing & MPT-Based Approach

5.1. On Risk

Academicians define risk as the relative volatility of a stock or portfolio compared to a large universe of stocks. Beta (β), according to this definition, is the relative volatility of a stock and for analysis, it has to be computed with precision, and subsequently, building investment theories around this statistic. However, for value investors, Buffett states that additional factors such as the likelihood of losing money or receiving an unacceptably low return, which are assessed through thorough analysis of business fundamentals and protection against through a margin of safety, are important considerations [5, 26, 33]. According to Howard Marks of Oaktree Capital, volatility is likely to be the least relevant risk. He also states that there are structural flaws in equating volatility as risk: a stock that rises from \$50 to \$80 may show the same statistical volatility as one that falls from \$50 to \$20, yet the two outcomes are fundamentally different. [26]

5.2. On Diversification

MPT requires broad mathematical diversification across low-correlation assets to minimize portfolio variance. [24] This is considered “protection against ignorance”, according to Buffett, diversification “makes very little sense if you know what you are doing.” [33] He uses this in practice, as seen by the top five holdings in Berkshire Hathaway’s portfolio, averaging 73% of portfolio value in 2013 and have continued to represent between 60–70% of total portfolio value. [38] Buffett’s portfolio, due to its high concentration, is normally associated with higher volatility. Over the years, it has shown large positive returns rather than downside risk. [15]

5.3. Comparison of MPT and Value Investing Investment Decisions

Table 2. Value Investing

Investors	Warren Buffett (Berkshire Hathaway)	Peter Lynch
Track Record	From 1965-2024, Berkshire Hathaway's book value (value of investments) compounded at 18.1% annually, compared to the S&P 500 TR Index's 10.5%. [39]	Managed the Magellan Fund from 1977-1990, achieving a 29.2% annualized return and outperforming the S&P 500 in 11 of 13 years. [40]
Investing Philosophy	Buy high-quality (great) businesses with strong moats at reasonable prices	Lynch's approach combined elements of value and growth investing — buying companies at reasonable prices with strong earnings growth potential, emphasizing "buy what you know" and circle of competence. [40, 41, 42]
Famous Investments	Buffett invested when the Salad Oil scandal halved the share price, as he saw the core credit card business was unaffected, and cardholder usage continued. [43]	Taco Bell: It was a simple repeatable business that was scalable by replicating stores across states. Began buying at \$7 and held through declined till \$1 as he viewed the business model and fundamentals as unchanged. In 1978, Taco Bell bought out by PepsiCo for \$42 per share. [44]
	Washington Post: The bear market of 1973-74 dragged down its market capitalization to \$80 million. With \$75 million in net cash and owners' earnings calculated of \$10 million a year, Buffett estimated the true value to be around \$400 million. Buffett continued to hold as stock fell 50% from buy price. Eventually, in 2013, stake worth \$1 Billion. [45]	Dunkin' Donuts: Based on his buy what you know philosophy. Was a customer himself and noticed the long lines at the local shop. Simple business model, did not face external threats - stable, predictable business. He made 10-15 times his investment in Dunkin' Donuts. [46]

5.3.1. Key Patterns Across Value Investing Examples

Across Value investing examples, investments were chosen in businesses generating predictable cash flows and holding a durable competitive advantage, allowing a reasonable estimate for the intrinsic value. Purchases were also made during periods of distress, firm-specific at American Express and market-wide at the Washington Post, which allows purchases at a margin of safety [45]. Additionally, in each case, the business was within the

investor's circle of competence and was simple enough to be understood without specialist knowledge, then held long enough for the gap between price and value to close [33].

In practice, MPT is not used in isolation. Rather, it is used as a theoretical framework to build upon by several practitioners. These cases show how MPT is built upon and evolved.

Table 3. MPT-Based Investing

Investor	Ray Dalio	DFA
What they do	A passive investment strategy designed to perform consistently through economic cycles and be indifferent to shifts in economic conditions. Aims to minimize the impact of economic surprises, providing attractive, relatively stable returns. [47]	Uses a 5-Factor Model as a filter to identify stocks to tilt their portfolios towards higher expected returns. Portfolios are over-weight on stocks with these factor traits (Market Risk Premium, Size, Value, Profitability, and Investment Factor). [9]
How they built on MPT	Instead of capital-weight allocation, assets are allocated to achieve risk parity, ensuring that all asset classes contribute equally to portfolio volatility. [47] Finds the efficient frontier of risk-to-return, but because portfolios with balanced risk profiles generate less returns, leverage is used to bring up return level	While MPT's core pricing model (CAPM) assumed a stock's beta as the only factor influencing expected returns, this approach expands on the CAPM using the Fama-French 5 factor model, adding size and value risk factors, along with investment and profitability as factors. [9]
Results	During the 2008 financial crisis, while the S&P 500 declined by 37%, the All-Weather strategy generated positive returns. The portfolio has generated a 6.80% annual return in the past 21 years. [48]	DFA US Small Cap Value Portfolio (DFSVX) has annualized returns of 11.5% since inception in 1993, outperforming the S&P 500 by 1.5% annually. [49]

5.4. Primary Data: Survey of Indian Investors

A primary survey on 9 Indian investors was conducted to understand 4 things: *How they define risk, how they diversify, what frameworks do they actually use while investing, and do they believe markets are efficient?* Results are reported as counts as well as percentages.

5.4.1. Definition of Risk

6 out of 9 (66.7%) respondents defined risk as

“Probability of Permanent Loss”, whereas 4 of 9 (44.4%) in addition added “Volatility of Returns”. 3 of the 4 respondents in institutional roles included “Volatility of Returns”, compared with 1 of the 5 individual investors, who laid greater emphasis on permanent loss.

This shows how individual investors tend towards Ben Graham’s definition of risk, whereas those with institutional involvement towards MPT.

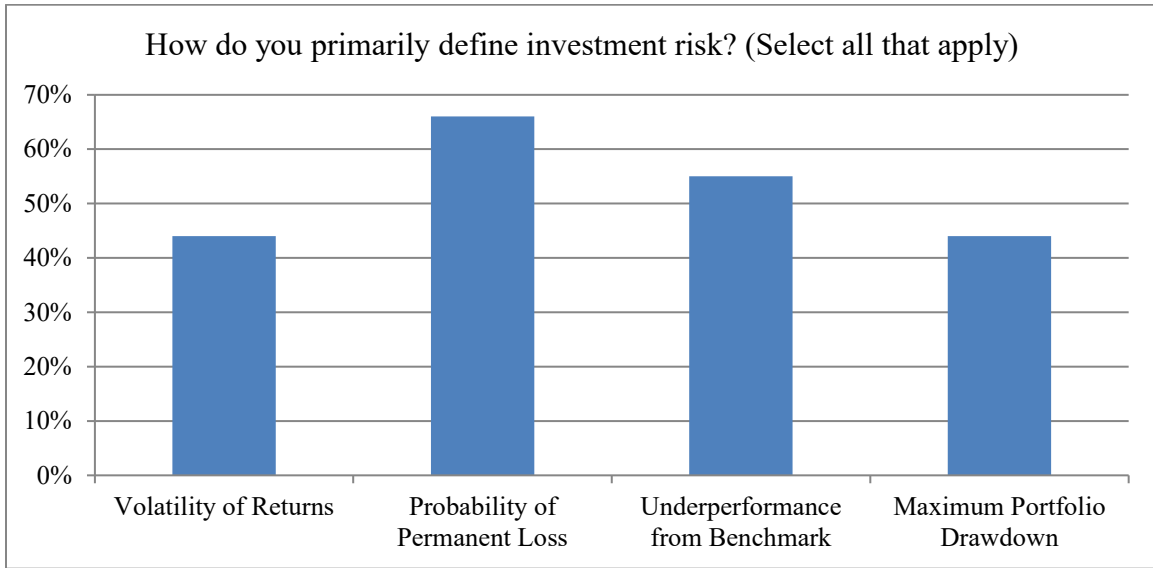


Fig. 2 Definition of investment risk (n = 9, multi selection allowed, hence total exceeds 100%)

5.4.2. Frameworks used in Practice

6 out of 9 (66.7%) respondents described their investing philosophy as a mix of both Value Investing and MPT. As mentioned by Udit Gadia (Analyst), “Value Investing for

stock picking, and MPT for portfolio construction” and a wealth manager with an AUM of ₹2,400cr stated, “MPT decided asset allocation, Value investing for identifying mispriced securities.”, requesting to remain anonymous.

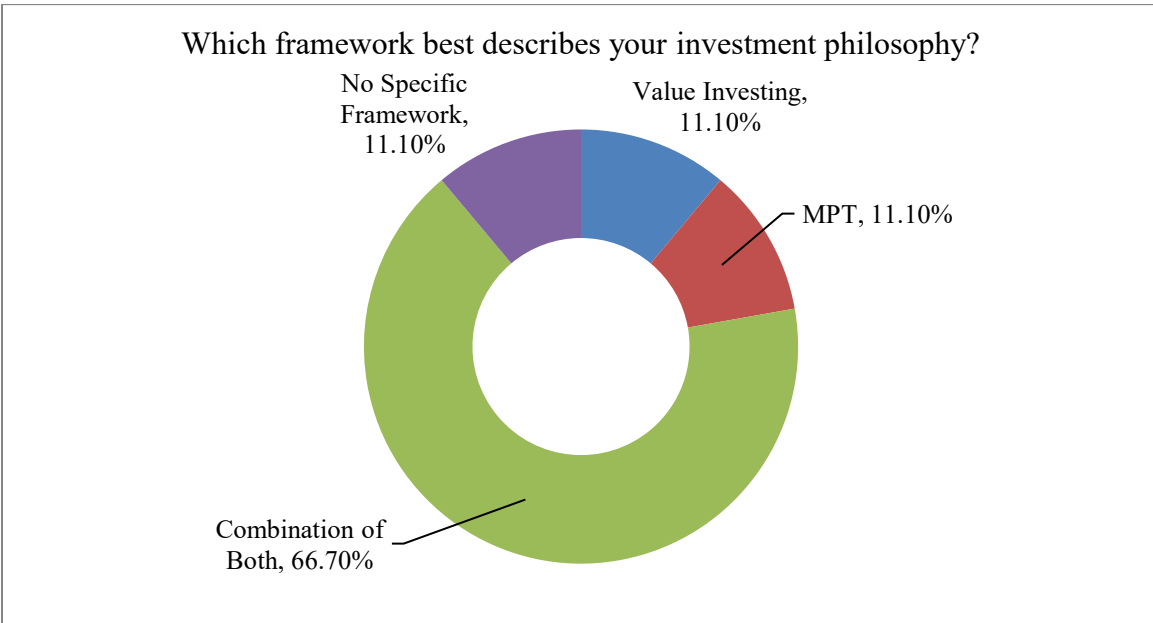


Fig. 3 The framework best describing investment philosophy

“Value investing works well for very active market participants as it requires a lot of analysis to be done in identifying value opportunities. For retail investors, that becomes difficult, so she felt that MPT framework works better as this framework needs a very passive approach, as there are multiple kinds of mutual funds and investment instruments available that could be used to create ‘alpha ’in the portfolio.” The above was mentioned by an Accredited Investor.

5.4.3. How they Diversify

7 out of 9 respondents (78%) held moderately diversified portfolios (10-30 holdings), neither leaning towards extreme

concentration such as Warren Buffett’s (Top 5 holdings = 70% portfolio) nor broad diversification across hundreds of stocks as proposed by MPT. 5 out of 9 respondents (55%) treated diversification as central risk management tool and 3 out of 9 (33%) saw it as secondary to security selection.

This shows the general consensus that while diversification is vital to manage risk, it does not overrule stock selection. 5 out of 9 respondents recognized their position sizing approach as “conviction and margin of safety based”, while 4 said “Risk contribution along with volatility” played a role.

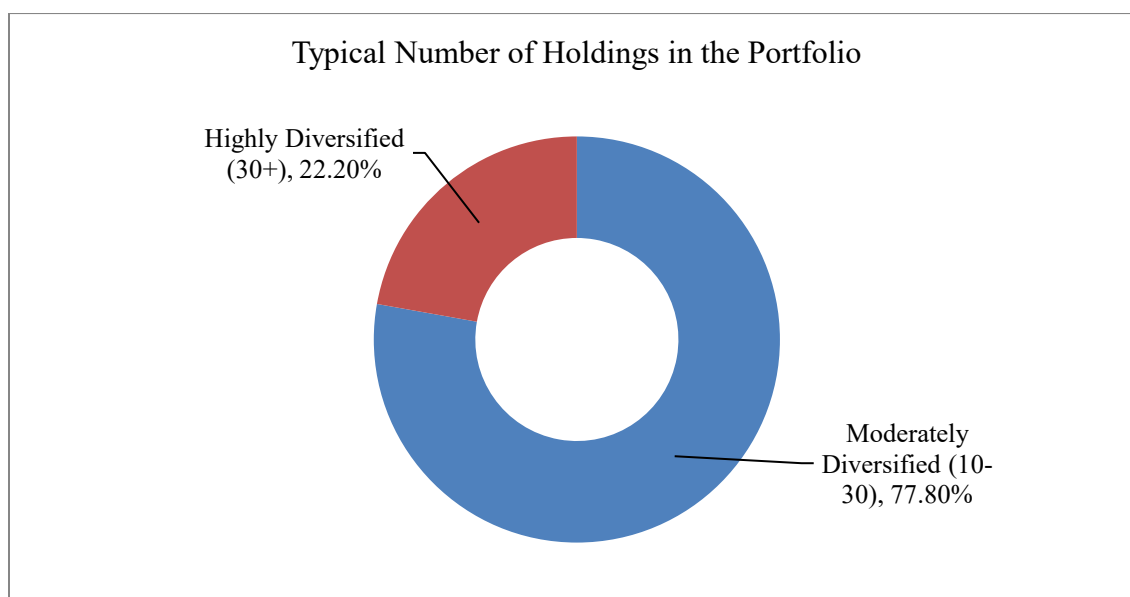


Fig. 4 Typical number of holdings in portfolios

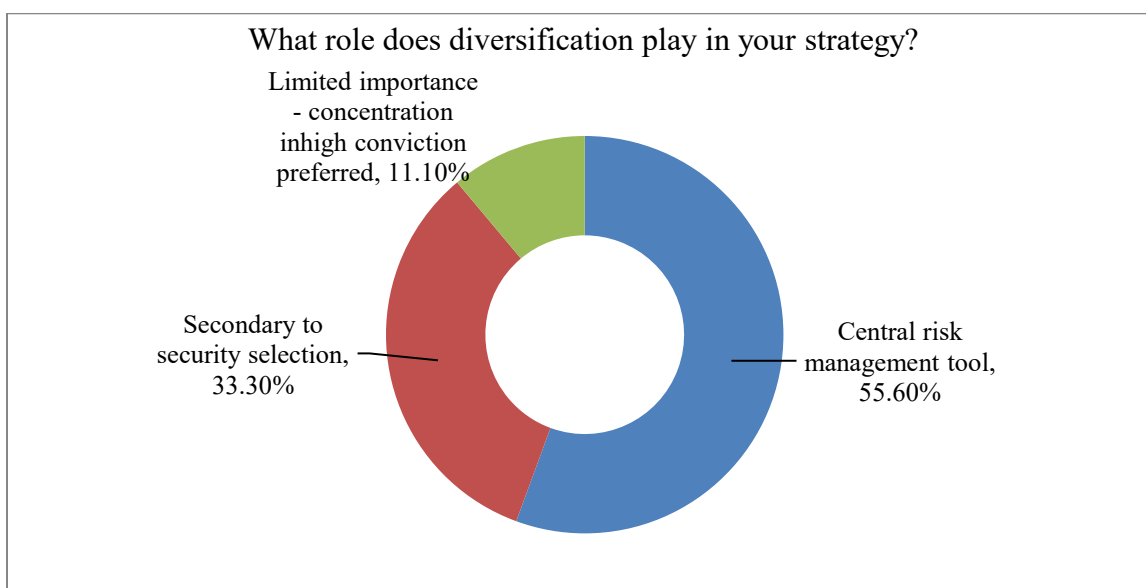


Fig. 5 Role of diversification in investment strategy

5.4.4. Do they believe Markets are efficient?

5 out of the 8 respondents who answered this question (62.5%) of respondents described the markets as “moderately efficient”. This shows that investors prefer taking a middle ground, neither perceiving markets are completely efficient and that market prices are always accurate (Core assumption of “pure” MPT) nor as extremely inefficient, pointing to how

investors believe neither framework works for all market scenarios (Value investing requires prices to deviate from intrinsic value, i.e. mis-pricing). Additionally, 4 out of 9 respondents (44.4%) viewed macroeconomic and geopolitical events as creating mispricing opportunities, and 5 out of 9 (55%) felt it adds to short-term volatility.

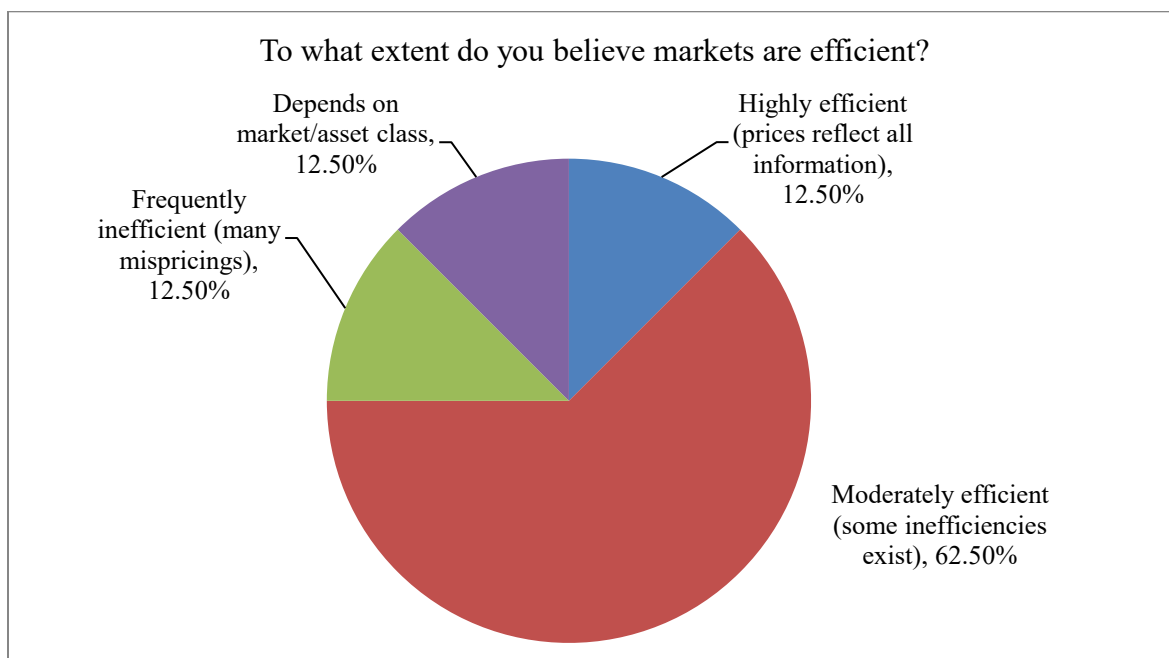


Fig. 6 Percieved Market Efficiency (n = 8)

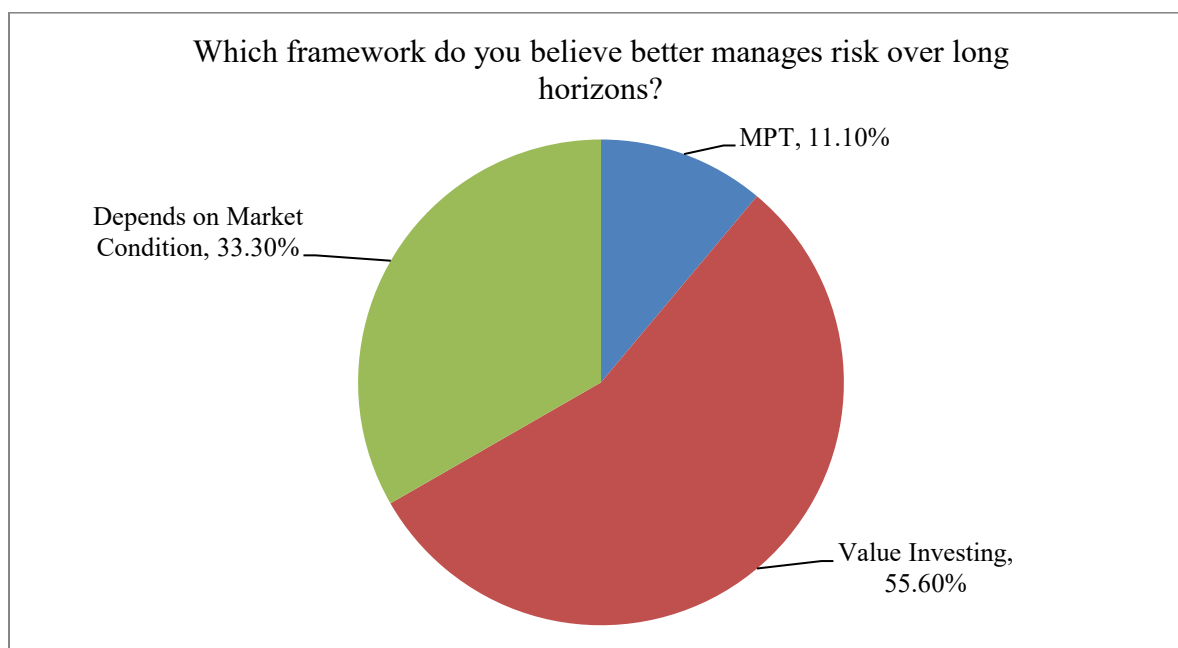


Fig. 7 Framework suitable for long-term risk management

5 out of 9 (55%) investors felt value investing manages risk better over long horizons, while 3 of 9 (33%) felt it depends on market conditions instead of any particular framework.

Table 4. Key Insights from Comparing Both Approaches:

	MPT	Value Investing
Returns	MPT funds aim for lower volatility and more predictable returns, over large returns (As seen in Ray Dalio's All Weather Portfolio)	Successful practitioners generate large returns, significantly outperforming the market (Buffett's 18.1% annualized Book Value gain, Lynch outperformance)
Success Measure	Success is measured by risk-adjusted returns (Sharpe Ratio), portfolio volatility and maximum drawdowns.	They measure success by beating the market and purchasing stocks below their intrinsic value.
Scale	MPT Frameworks can be used to manage huge amounts.	Value Investing, though practiced by Buffett and others at scale, is easier to implement with smaller amounts. Buffett himself has said that his returns would be significantly higher with smaller amounts of capital.
Underlying Philosophy	Construct portfolios based on the expected performance of the investments and the risk appetite of the investor, optimizing expected return and risk of portfolio returns.	Aim to purchase stocks with a margin of safety, for less than their intrinsic value. Believe that from time to time the market systematically overreacts or underreacts to company and market events, leading to undervalued or overvalued securities, respectively. Hold stocks forever, or sell as it approached intrinsic value.

6. A Framework for Combining the Two Approaches

Sections 4 and 5 established that the two frameworks define risk differently, treat diversification differently, and are applied differently by their leading practitioners. They also established that neither is applied in its pure form. This section will illustrate how the two fit together, on what basis, and where the fit breaks down.

6.1. The Two Frameworks Operate on Different Objects

The MPT and Value Investing may not be treated as competing frameworks, as they are not attempting to perform the same task. As Section 4.1 established, MPT requires expected returns as an input but contains no theory of where they come from.

Value investing produces this input through an estimate of a single security's intrinsic value, from which an expected return can be derived through comparison to current prices [30, 31]. It does not, however, contain any rule for combining these securities into a portfolio.

Graham's margin of safety offers protection at the level of the individual holding, and Buffett suggests concentration in businesses within the circle of competence [33], but neither provides a method for determining how holdings should be weighed against one another.

The two frameworks, therefore, supply precisely what the other lacks. Value analysis generates the expected return estimates that MPT requires but cannot produce. MPT supplies the aggregation and risk budgeting rule that value investing does not provide.

6.2. Points of Conflict

Treating the two frameworks as layers does not dissolve every disagreement between them. The three conflicts between them are stated below, out of which two resolve and one does not.

6.2.1. The Definition of Risk

The two definitions of risk set out in Sections 4.1 and 4.2 conflict directly.

This conflict resolves once the level and the horizon are specified. Volatility is measured as a portfolio-level quantity measured over short intervals, while the permanent loss of capital is specific to individual securities assessed over the life of the holding. The two measures apply to different decisions and can be held together by investors.

The evidence in this study also supports this, with section 5.4 shows that respondents did not choose between the two definitions but selected several simultaneously, and that respondents in institutional roles, who face redemption and mandate constraints, were more likely to include volatility.

6.2.2. Concentration and Breadth

As Section 5.2 established, MPT favors breadth while Buffett treats diversification as protection against ignorance. This conflict is a genuine trade-off rather than a disagreement, and it can be stated quantitatively. According to Grinold's fundamental law of active management [50],

$$IR = IC * \sqrt{BR} \quad (3)$$

IR=Information Ratio (ability to consistently beat a benchmark per unit of extra risk taken)

IC=Information Coefficient (measures managers forecasting accuracy)

BR=Breadth (measures number of individual investment decisions)

Concentration raises the information coefficient because the analyst's attention is divided fewer ways, and lowers breadth, while diversification does the opposite. Hence, both frameworks can be used to maximize returns, depending on how far a given investor's forecasting accuracy can be pushed. The survey evidence points to practitioners resolving this in the middle rather than at either extreme. As reported in section 5.4, no respondent held a concentrated portfolio of fewer than ten securities, and none reported the broad diversification across hundreds of holdings that pure MPT would imply.

6.2.3. Market Efficiency

The third conflict remains unresolved, with CAPM's pricing rule assuming that prices reflect all available

information [27, 28]. Value investing requires that prices deviate from intrinsic value, since without such deviation, there is no margin of safety to obtain [5, 31]. These two positions cannot both be held together, and neither can they be made compatible.

As Table 3 shows, neither Bridgewater nor DFA holds the market portfolio - one tilts towards factor characteristics, the other allocates by risk contribution. The practitioner evidence takes the same position with section 5.4, showing most respondents describing markets as moderately efficient.

6.3. The Layered Framework and the Evidence for It

This can be expressed as two stages in the decision-making process, each with its own inputs, its own analytical tools and its own output. Sections 6.1 and 6.2 established that the frameworks disagree about risk, breadth and efficiency, but that they do not compete to produce the same thing. Separating the decision into stages shows where each one operates.

Table 5. The Stages of the Approach

	Stage 1: Security selection	Stage 2: Portfolio construction
Question answered	What is worth owning?	How much of each should be held?
Inputs	Financial statements, competitive position, management quality, the gap between price and the estimated intrinsic value	Conviction levels from Stage 1, the covariance matrix of candidate holdings, the investor's risk budget
Tools	Discounted cash flow valuation, intrinsic value estimation, margin of safety	Mean–variance optimisation, risk contribution, position limits.
Output	Candidate holdings, each carrying a level of conviction	Final portfolio weights
Framework	Value investing	Modern Portfolio Theory

Stage 1 provides expected return estimates for Stage 2, supplying the inputs required by MPT, which are poorly supplied by CAPM [8]. Stage 2 creates a risk budget for the holdings produced in Stage 1, supplying the aggregation discipline that value investing does not provide — Graham offers margin of safety on a single position, and Buffett offers

conviction within a circle of competence [31, 33], but neither determines what proportion of a portfolio a position should occupy. Without the first connection, the optimizer has no reliable estimate of expected return. Without the second, security analysis produces a list of holdings but no portfolio.

Table 6. The 2 stages and layers of each

Stage	Behaviour predicted if the structure holds	Case study evidence (5.3)	Practitioner evidence (5.4)
Security selection	Value criteria govern the decision, with risk assessed as permanent loss rather than volatility	Buffett and Lynch select on business fundamentals and margin of safety; DFSVX selects on value and profitability characteristics	8 of 9 describe their construction approach as fundamental-based stock selection; 7 of 9 cite qualitative business fundamentals as determining attractiveness; 6 of 9 define risk as probability of permanent loss, while only 2 of 9 use statistical models such as CAPM to estimate expected returns
Portfolio construction	MPT tools govern the decision, applied without reliance on CAPM pricing	Berkshire concentrates in high-conviction holdings, while DFA holds breadth across its factor tilt	5 of 9 treat diversification as a central risk management tool; 7 of 9 hold 10–30 securities, and none holds fewer than ten; sizing is determined by conviction and margin of safety in 5 of 9 responses and by risk contribution or volatility in 4 of 9

6.4. Contribution

This paper identifies the level at which each framework operates and shows why the two are not competing to perform the same function, with MPT supplying the broad portfolio construction and portfolio level risk management that requires expected returns it cannot generate, and value investing providing the expected return estimates for which it does not have a portfolio construction approach. Second, it shows that the leading practitioners of each approach depart from the pure form of their stated framework. Third, it collects primary evidence from practitioners in an emerging market on how the two are combined in practice.

The paper does not, however, demonstrate that a layered approach outperforms either pure framework, and recognizes that the practitioner evidence, drawn from a small sample, indicates that the layered pattern is present among the investors surveyed rather than that it is representative of Indian investors generally.

7. Limitations

This study has clear limitations. The sample size for the primary research was 9 respondents due to the lack of access to enough professionals and respondents. This could result in the data possibly being biased or skewed. The sample does, however, contain a mix of individual retail investors, fund managers, and analysts, which helps reduce the possibility of bias. A larger sample would allow a better trend to be noticed, as findings would be more representative. The availability of Authentic, Audited, Data was also a constraint. Time and financial constraints were also present, which limited the study from being conducted in far greater detail.

The survey instrument was purpose-built for this study and has not been formally validated, so the response options, while derived from the definitions identified in the literature,

have not been tested for reliability. The four cases examined in Section 5.3 were selected on the basis of long and well-documented records, which introduces survivorship bias: they show how each framework is applied by practitioners who have succeeded with it, not whether either framework produces success on average.

8. Conclusion

Both the secondary sources, real-life practitioners in the form of famous value investors and MPT practitioners, along with the primary survey data obtained from Indian investors, point at the conclusion that neither pure MPT nor pure Value Investing is practiced by sophisticated investors. Real-world applications of MPT involve using the diversification logic, however, they have built on it by using tools such as factor models and risk parity, as shown in section 5.3. The prevalent real-world approach involves using the MPT framework for portfolio-level diversification to manage overall portfolio volatility and risk, while the value investing framework is used for individual stock selection and managing stock specific risk (margin of safety, business fundamentals, intrinsic value). 6 out of the 9 Indian investors from the primary survey data used a combination of both frameworks. The institutional evidence, in the form of renowned practitioners of both frameworks, along with the data collected from the survey, point at a mix between both frameworks, rather than choosing one: MPT for portfolio construction and risk management, and value investing for stock picking.

9. Conflict of Interest

There was no conflict of interest regarding the publishing of this paper.

10. Funding Statement

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Appendix 1. Survey Questionnaire

<https://forms.gle/YghxNiah9GLkCzBG6>

Appendix 2. Survey Responses

<https://docs.google.com/spreadsheets/d/1-Y-j3Z4bfwlBr0aGM3QKr2228svX7h4zwTalZFFQomH0/edit?usp=sharing>