LAKE PLACID, N.Y. -- Jack Bogle, founder of Vanguard, has earned his fame as the man who taught the small investor how to make the stock market work for him. He'll also be remembered as the guy who left $20 billion on the table.

The story has been told of how, as the young president of Wellington Management Co., he lost a power struggle and was relegated to running the back end of one of the early mutual fund companies. It was ordained that he would have charge of record keeping, shareholder communications and other paperwork functions; his ex-colleagues would be in charge of investment management and distribution. He was obliged to sign a legal paper promising to honor this division of labor. "I knew I had to expand the mandate for this to be any fun," he recalls today. His solution was to seek the directors' permission to start an index fund, arguing that it didn't violate the taboos because it was "unmanaged" and because it would carry no sales charge, or "load." "I persuaded the directors we weren't taking over distribution, we were eliminating distribution," he says, recalling the triumph.

Now this was corporate warfare of a very high form, I suggest. You might even call it devious. "Would you mind using 'disingenuous' instead of 'devious,'" he says with a small smile. "I confess to wanting to achieve what I can achieve. I would never, I don't think, do it by foul means. But I would give a broad interpretation of what is fair."

An index fund seeks simply to hold the stocks of a given market index, in this case the Standard & Poor's 500, and mimic its performance. But here's where umpteen billion in Bogle dynastic wealth went up in smoke. He set up the new Vanguard Group as a "mutual" company -- i.e., investors in the individual funds would also own the parent company. He didn't take Vanguard public or make himself its dominant shareholder. As a result, today he's introduced to countless speaking audiences as Vanguard founder Jack Bogle -- not billionaire Vanguard founder Jack Bogle.

In my shallowness, I have traveled to the lakeside retreat where he and his family have spent their summers for many decades partly to ask how he feels about this. Mr. Bogle fields the impertinent question with the same thoughtfulness that he fields all the others. "First of all, I'm an honest guy. If you told me the rewards I was relinquishing by structuring the company the way I did in 1974, I might have thought about it a little bit. I had no idea that we'd have this greatest bull market in the recorded history of modern man."

He continues: "Every once in a while, I think, God, have you really been stupid? On the other hand, not all the rewards in this life are financial. Compared to any normal person, I've had a staggering financial award. But am I worth one tenth of 1% as much as [Fidelity founder] Ned Johnson and his $25 billion? No. But I'm doing fine. And I have no complaints."
He adds: "I have, I might as well tell you, a large ego and it needs a lot of feeding. Whenever I go out, strangers accost me to say nice things. Strangers will walk up to me, including this morning, about half a dozen of them, to say, 'You know you're my hero.' What is that worth in dollars and cents?"

Some of those strangers call them themselves "Bogleheads," and for all his frustrations (which you'll hear about shortly), the wisdom of indexing has penetrated far and wide and gained millions of adherents: Buy the market. Hold for the long term. Keep costs low. Don't chase fads. Cough up as little as possible to keep Wall Street's army of helpers in Hermès and Heineken.

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Mr. Bogle, a scion of a wealthy family that hit hard times in the depression, had to make his way with scholarships and hard work, and he considers himself doubly blessed for this. "It was a great way to grow up," he says. "We had a community standing, one might even say a social standing, yet having no money and knowing you had to work for what you get."

His health is another story in itself. A bad heart, misdiagnosed when he was 30, almost killed him many times over. In 1996, he received a heart transplant and, after a rough recovery, has become an energetically walking advertisement for the miracles of American health care. In four hours of heavy conversation, a boat ride with Mr. Bogle at the helm and lunch at a public golf club, he displays a nearly youthful vigor in prosecuting an old man's deep concern for his legacy and life's work.

On his mind these days are challenges to the indexing paradigm, most recently in the form of Wisdom Tree, promoted by Wharton Professor Jeremy Siegel and retired fund manager Michael Steinhardt. Its founders believe they have a formula superior to conventional, capitalization-weighted indexing. Their index weights companies by the dividends they pay, which the promoters argue the market has historically undervalued compared to the S&P 500.

Mr. Bogle finds the case implausible. He questions their data and, more to the point, believes the market is efficient enough that it would have corrected any undervaluation of dividend-paying companies once the fact was credibly pointed out. He recalls telling one advocate: "Don't you see? If you're right, you're wrong."

To Mr. Bogle, Wisdom Tree is just another episode in Wall Street's endless peddling of the illusion that "we can all be above average." In theory, an investor could beat the market and grow rich doing so. But, on average, all an investor can expect is the market return, minus his costs. That's why indexing aims to give investors the market return at the lowest possible cost. He has no patience with critics who say indexing is a surrender to mediocrity or that it misallocates capital by directing funds to companies on an autopilot strategy. Index funds may account for nearly 10% of the stock market, but they
account for a mere 0.4% of trading. He says the stock market would still be as efficient even if half of all investor dollars went into index funds.

By his estimate, the tax imposed by traditional Wall Street fund managers and brokers impose amounts to fully 2.5 percentage points a year -- which is likely to become increasingly hard for investors to swallow if Mr. Bogle is right in expecting that market returns will decline to their historical average of 7% in coming decades. "I'm rational enough to believe that no system in which the interests of the client are 180 degrees different from the interests of the suppliers [i.e. Wall Street] can persist in that mode forever," he says.

Yet he admits to serious disappointment that events seem to be heading in the opposite direction. Classic index funds have been frozen at under 10% of the market since the late 1990s. New money has flowed instead into exchange traded index funds, or ETFs, which he says "defy every single principle of classic indexing." Instead of "buy, hold and keep costs low," they encourage trading. One of the most popular ETFs, Spyders, which mimics the Standard & Poor's 500, has turnover of 3000% a year.

He puts some of the blame on investors -- "We are greedy, we are emotional, we think we're smarter." But he directs much of his critique at a financial industry built on telling everyone that they can do better than average, even after paying fees and transactions costs to support the lavish incomes of brokers and fund managers. The Wisdom Tree experiment is just the latest example. "Sure, the ETF business is a great business for entrepreneurs," Mr. Bogle says. "They're drawing scads of money. It's a great business for those who want to create their own wealth in this flawed financial system. Isn't it time that somebody sat back and said, is it good for the clients?"

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Mr. Bogle takes a certain sorrowful satisfaction in the fact that the views that make him a hero to small investors have rendered him persona non grata at fund industry get-togethers. He expresses greater perplexity that he's also persona non grata on the executive floors of Vanguard, run by his handpicked successor, John Brennan.

In 1999, the coldness spilled into the press when Mr. Brennan insisted that Mr. Bogle step down as a director of the company he founded at the mandatory retirement age of 70, despite the vocal protests of many Vanguard investors. Finally, face was saved all around when Mr. Bogle was invited to stay and he declined. Instead he receives a six-figure annual stipend and a small staff to run the Bogle Financial Markets Research Center out of Vanguard's headquarters in suburban Philadelphia.

"There's just no communication. There hasn't been for five or six or seven years," he says. Ego clashes and oedipal issues leap to mind. But so does the possibility that Mr. Bogle, with his outspokenness, is simply perceived as a potential liability to the company.
I put this possibility to him. "I can't imagine a rational human being would see me as a liability for the business," he responds, but then seems to take up the other side: "I think they know I'm wise enough not to [say anything that would hurt Vanguard]. I won't say my record is perfect, but I'm batting about .990. It's hard for someone with my temperament and disposition who started the company to not speak my version of the truth. I'm not particularly good at fudging things or temporizing. As a matter of fact I'm terrible."

Later, he adds: "I stake out my positions. I have no idea what their position is on anything. Nobody tells me. Nor do they need to. They shouldn't expect me to endorse their position when I don't know what it is."

It occurs to me that it can't be easy for a company to know how to handle a living legend like Mr. Bogle, founder of one of the world's great businesses, a man with strong opinions and strong ethical judgments that are not exactly favorable to the industry that Vanguard finds itself playing a leading role in. It also occurs to me that this is why other companies lavish jet planes, homes, living expenses and lots and lots of stock on their celebrated retiring CEOs. To their successors, it must be a source of comfort to know there are golden fences to keep them on the reservation.

Mr. Bogle is not oblivious to the irony that it was his own deft playing of corporate politics that partly led him to the index fund and the low-cost model as the founding strategy of Vanguard. Yet the truth remains that his brainchild has given average investors their most reliable means of sharing in the prosperity of American business over the long run.

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