Market Crash 2020: Prepare for Another Bear Market

Description

Jeremy Grantham is a legend in the investing world. He's the co-founder and chief investment strategist at Grantham, Mayo, & Van Otterloo, which controls $120 billion in assets. If you want to avoid the next market crash, heed his wisdom.

Grantham recently revealed some startling opinions regarding the market's valuation. He thinks you should be nervous.

Pay attention to Grantham

Grantham is best known for market crash predictions, which have been surprisingly prescient.

For example, his firm completely exited Japan in 1987 at 45 times earnings. The call appeared wrong over the short term, with valuations rising to 65 times earnings. Before long, however, the country began a three-decade downward spiral.

In 1998, Grantham was early again, warning of the impending tech bubble. His firm exited the market at 21 times earnings, just before the market zoomed to 35 times earnings. Of course, the popping of the tech bubble ultimately vindicated the call.

He went on to navigate the 2008 financial crisis with relative ease. According to Grantham, these weren't very difficult predictions.

"The 2008 event also was [easy] if you focused on the U.S. housing euphoria, which was a three-sigma, 100-year event or, simply, unique. We calculated that a return trip to the old price trend and a typical overrun in those extreme house prices would remove $10 trillion of perceived wealth from U.S. consumers and guarantee the worst recession for decades."

Grantham is a master at predicting market crashes. Unfortunately, he sees another downturn right around the corner.

“It is totally new and there can be no near certainties, merely strong possibilities,” he wrote in a recent investor letter, referencing current economic conditions. “This is why … you are nervous, or should be.”

Another market crash?

Here’s the thing: Grantham never predicts market crashes with perfect timing. Just look at the aforementioned examples. He saved his clients from some of the most destructive bear markets in history, but in almost all cases, he was *early* to the party.

Why can’t Grantham time the market perfectly? It’s the same reason why he’s able to exit the market in the first place. All he does is pay attention to historical valuation trends.

When markets enter a period of jubilation, causing valuations to spike to two-sigma levels or higher, Grantham begins to scale back. When valuations swing the other way, he re-enters the market, assuming more risk.

This strategy isn’t perfect, as valuations can stay in an abnormal range for years at a time. History has proven, however, that they nearly always revert.

How likely is another market crash based on valuation ranges? The news isn’t good.

“We are in the top 10% of historical price earnings ratio for the S&P on prior earnings and simultaneously are in the worst 10% of economic situations, arguably even the worst 1%,” writes Grantham.

“The market’s P/E level typically reflects current conditions (please see Appendix). Markets have historically loved fat margins, low inflation, stability and, by inference, low levels of uncertainty. This is apparently one of the most impressive mismatches in history,” he concludes.

There’s no telling when the next market crash will occur, but looking at valuations, it can happen at any moment. Whether it takes weeks, months, or years, make sure your portfolio can withstand another downturn.

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