Warren Buffett Indicator Signals a Stock Market Crash Is Coming

Description

As loud and confusing as 2020 is so far, Warren Buffett has been unnervingly quiet throughout the year. Warren Buffett's lack of significant activity in the stock market confused many investors, since most equities recovered valuations after bottoming out in March 2020. Investors who missed the dip lost plenty of potential profits.

In a market like that, everybody expected Warren Buffett to buy up whole companies at a bargain. His moves never came, and the market is almost back at pre-pandemic levels. Many argued that the Oracle of Omaha had lost his touch. I believe that he expects an imminent market crash. This Warren Buffett Indicator leans towards that possibility.

Warren Buffett Indicator

The Buffett Indicator is a model which follows Warren Buffett's value investing principles. It considers the combined market caps of publicly traded equities worldwide and divides it by the global gross domestic product (GDP). The mathematical equation has long been considered a Buffett Indicator of how the stock market fares relative to the world economy.

If the indicator has a reading of over 100%, it suggests that stock markets worldwide are overvalued compared to the global economy. In August, the indicator climbed to a 30-month high. Investors are increasingly on edge due to the high valuation of equities since the summer began. The indicator suggests a significant disparity between the struggling global economy and soaring stock markets.

While it is not the only indicator you should rely on to make your investment decisions, it is a significant sign that the market might soon become turbulent.

The Buffett strategy

If the indicator predicts what will happen, investors will need to brace themselves and reevaluate their portfolios to deal with the market crash. We might just see Buffett use his massive hoard of cash to acquire companies amid another market downturn that could be worse than the March crash.

Historically, Warren Buffett has been prolific with his selection of companies that belong to struggling sectors amid financial crises. He has a talent for picking industries that are facing temporary turbulence due to certain factors. Purchasing high-quality companies at a bargain, he increases his net worth as the economy recovers.

However, it's important to know not just when to buy stocks, but to sell them. The restaurant sector is one of the struggling industries due to the pandemic. Buffett just sold his shares of **Restaurant Brands International** (TSX:QSR)(NYSE:QSR). It is one of the two Canadian companies that the Oracle of Omaha had invested his capital in, but he recently decided to dump all his holdings of QSR.

QSR is the firm behind Tim Hortons, Popeyes, and Burger King chains. The company suffered significant losses due to the pandemic cutting down its operations and revenue.

At writing, Restaurant Brands is trading for $71.78 per share. The stock is already up by more than 77% from its March bottom, but it has a long way to go before it recovers to pre-pandemic pricing.

Foolish takeaway

As another market crash becomes more likely, it is time to consider reallocating the capital you might have invested in riskier stocks to more secure equities. Warren Buffett has shown he's no stranger to dumping stocks ahead of a potential market crash, so it might be wise to take a cue from the world's greatest investor.

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