Stock Market Crash 2.0: Warren Buffett's Perfect Storm Is Here

Description

In the turbulent 2020 stock market, Warren Buffett has been playing it unusually safe. Selling more stocks that he's buying, he seems to think that cash is preferable to stocks right now.

In August, filings revealed that Buffett's cash pile had soared to $147 billion. That was partially due to accumulating dividends, but also due to the Oracle selling shares. In Q1, Buffett sold out of airline stocks entirely, shedding his positions in **Delta** and others. Other high profile sales included banks and restaurant stocks.

While Buffett hasn't come out and said it yet, his moves suggest he's bracing for a perfect storm that could crash the stock market. Selling stocks and hoarding cash, he's being decidedly bearish. Not only that, but you can read some *past* statements of his as indicating that the current market is overvalued. I'll explore those statements in just a minute. First, though, let's evaluate what Buffett has been up to this year.

Warren Buffett has been a net seller of stocks in 2020

In 2020 so far, Warren Buffett has been a net seller of stocks. That's significant because Buffett has been investing professionally since the 1950s, and until now had never been a net seller.

In the time Buffett has been managing money professionally, we've seen several huge crashes like those in 1987, 2001 and 2008. None of those crashes were enough to make Buffett sell out of his holdings. The 2020 crash, on the other hand, did. Earlier this year, Buffett sold his *entire* stake in airlines and most of his stake in banks. It was an uncharacteristic move for Buffett, but when we look at some of Buffett's past statements, it makes sense.

The Warren Buffett indicator

In the past, Warren Buffett has touted his support for an equity valuation metric now called the *Warren Buffett Indicator*. In 2001, he said *“it is probably the best single measure of where valuations stand at any given moment.”*

The Warren Buffett Indicator is equity market cap divided by GDP. It shows how expensive stocks are relative to economic output. If this ratio gets too high, then it indicates that stocks are overvalued. As of September 5, the ratio sat at 1.83, or 183%. That’s higher than the historical norm, which tends to suggest that stocks are overheated.

In fact, the *Warren Buffett Indicator* was getting high well before the COVID-19 market crash. Now, with stocks up and GDP still down, it’s presumably higher. Of course, GDP will climb back to pre-COVID levels eventually, but nobody knows when that will be.

In the meantime, we’ve got more problems on our hands than *just* an overheated stock market. At the same time as stocks are getting pricey, we’ve got other factors in the mix, like ballooning public debt, airlines running out of money, and still-high unemployment numbers. Take them all together, and you’ve got the makings of a “perfect storm” that could lead to another bear market.

What does all this mean for Canadian investors?

Well, if you follow Buffett, here’s one move to pay attention to:

Just recently, the Oracle sold out of the Canadian restaurant company **Restaurant Brands International Inc** (TSX:QSR)(NYSE:QSR) entirely. QSR is the holding company that owns Tim Horton’s, Burger King and Popeyes. Previously, Buffett was a huge bull on the stock, which had seen explosive growth in its Popeye’s subsidiary.

This year, Buffett abruptly reversed course on QSR–as he did with airlines and most banks. The move suggests that Buffett’s seeming bearishness toward U.S. stocks applies to Canadian stocks too. To put it simply, if you see Buffett as someone to emulate, *proceed with caution.* We’re not out of the woods yet.

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