Stock Market Crash 2.0: Warren Buffett Is Ready. Are You?

Description

The year 2020 will be etched in public memory for several decades. It has been a crazy year for the global populace due to the COVID-19 pandemic, and even more so for Wall Street and equity investors.

The dreaded coronavirus sent the S&P 500 lower by 36% in just over a month earlier this year. Indexes slumped into a bear market territory in record time; however, the recovery was just as swift. The S&P 500 took just over four months to erase losses and reclaim its record high.

At the time of writing, the S&P 500 is trading 4% higher year to date, which is 5.5% below its all-time high. However, several experts believe the market recovery is not in sync with the economy. Global economies are in a recession and grappling with high unemployment rates, lower consumer spending, and falling GDP.

Even Warren Buffett has been a net seller of equities in 2020, as he believes the markets are trading at a premium. The Buffett Indicator, which is the market cap-to-GDP ratio, indicates the U.S. markets are overvalued by at least 70%.

Buffett-owned **Berkshire Hathaway** ended Q2 with a record $146 billion in cash, which means the Oracle of Omaha is patiently waiting for another stock market crash to buy quality companies at a discount.

A perfect storm is brewing for equities

Several experts are wary of sky-high stock valuations in an environment that is extremely uncertain and volatile. Further, the Shiller price-to-earnings multiple, which accounts for inflation-adjusted earnings in the last 10 years, is above 30. The last three times this multiple soared above 30 were just before the Great Depression, prior to the dot-com bubble, and before the equity sell-off in Q4 of 2018.

Alternatively, valuations have not really mattered much for growth stocks, including **Shopify**, **Amazon**, **Roku**, and **Zoom Video**. The COVID-19 pandemic has acted as a tailwind for these companies thatare trading just below record highs.

Another indicator of a market crash is the temporary suspension in share buybacks — a key driver of earnings growth in the past decade — by some companies. As enterprises are looking to boost liquidity, some companies have also suspended or cut their dividend payouts.

Energy giant **Suncor** cut its dividends by 55% in March, and the absence of shareholder perks might drive demand for equities lower, as we inch close to the end of 2020.

Further, most developed economies run on consumption; approximately 70% of the U.S. GDP relies on it. The federal governments are likely to end their domestic stimulus programs, and with unemployment rates at multi-year highs, discretionary spending is expected to take a massive hit.

How do you play a stock market crash?

It is difficult to predict when the markets will crash again due to a multitude of variables, including investor sentiment, quantitative easing measures, and federal benefits. However, you can be prepared for it and have some cash on hand to buy companies at lower valuations.

Investors need to avoid bank stocks at a time when interest rates are low and unemployment rates are high. Pure-play oil producers also remain vulnerable, as crude demand is unlikely to rebound in the near term.

Investors can instead look to buy growth stocks at a discount and hold them for the long term. Utility stocks such as **Fortis**, **Emera**, and **Algonquin Power & Utilities** are also solid bets given their recession-proof businesses and stable cash flows. Alternatively, gold mining companies such as **Barrick Gold** and **Kirkland Gold** should also be on your radar, as these stocks have an inverse relationship with the stock market.

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Date
2025/09/10
Date Created
2020/09/17
Author
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