Warren Buffett: Avoid Losing Money in the Next Market Crash

Description

November was pretty optimistic for the global stock exchange, as **Pfizer** announced it had achieved 90% effectiveness in the third phase of COVID-19 vaccine trials. Many other pharma companies followed with positive news. This vaccine euphoria created optimism among investors, sending the **S&P/TSX Composite Index** up 10% in November. The most severely hit airlines, real estate, and oil stocks took flight. But is this stock market rally sustainable or a warning of another market crash?

The unpredictable nature of the stock market

The stock market has been unpredictable this year. It rallied when the pandemic was at its peak (April to July). It corrected and stabilized when the economy reopened (August to October) and rallied once again when the vaccine news came (November).

Many analysts have been adding a note of caution on this unpredictable behaviour of the market. The November rally was on the back of vaccine news. It is still not clear whether the vaccine will deliver the expected results.

The vaccine can make a difference in the economy and business only when it stops the virus spread. And for that, a significant portion of the population needs to be vaccinated. With vaccine close to being distributed, it is only a matter of time the pandemic crisis will end.

So, if the market rallied during the pandemic rally, does this mean it will crash when things normalize?

What does Warren Buffett's experience with a market crash say?

To answer that, we will look at the many lessons the stock market has taught the Oracle of Omaha. With over 70 years in the stock market, Warren Buffett has been through several market crashes. For a crash, his advice is, "Bad news is an investor's best friend." And there was more advice in his 2008 shareholders' letter: "If you wait for the robins, spring will be over."

By combining the two pieces of wisdom, we can take away that a market crash (bad news) is like spring for value investors, as many fundamentally strong stocks trade at heavy discounts. But the spring won't last long as the market corrects.

Historical data has shown that after a crash, the market recovers significantly. And that was true even for the March crash. The TSX Composite Index fell 33% in the March crash and surged 28% in the following month. The November rally of 10% also came after the index fell 6.7% in September and October.

Looking at this rally, it doesn't seem like another 30% crash is in the making. Even Buffett is not expecting another crash. Otherwise, he would have not sold a 40% stake in **Barrick Gold** in the third quarter after buying $500 million worth of gold stocks in August. He purchased gold stocks to hedge himself against a crash as gold rises when the market crashes.

How is Warren Buffett saving his money from a potential market crash?

As I said before, the market is unpredictable. Crash or no crash, you can save your portfolio from losing money by investing in stocks with strong fundamentals and less sensitivity to the pandemic. Buffett purchased energy stocks that have strong cash flows and no direct exposure to the pandemic.

The Toronto Stock Exchange has a similar stock: **Enbridge** (TSX:ENB)(NYSE:ENB). The pipeline operator transmits oil and natural gas to various populated cities of North America. During the pandemic, the stock fell 35% and gave dividend yields as high as 8.5-9%. In the November rally, the stock surged 19% and is still giving a dividend yield of 7.6%. When the stock returns to its normal growth, it will give a dividend yield of 6% and little stock price appreciation. Pandemic or no pandemic, it will give you returns.

Enbridge doesn't have direct exposure to oil price but is affected by low oil demand. Hence, its stock price fell in the pandemic. But the cash flow from transmitting natural gas partially offset weakness in oil demand, thereby protecting your money in a market crash by giving stable dividends. As the oil demand returns, its stock price will grow, giving you capital appreciation in a recovery.

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