Warren Buffett: 3 Ways to Prepare for a Market Crash

Description

Over the course of his six-decade-long career, Warren Buffett has lived through multiple stock market crashes. His investment company has lost roughly 50% of its market value in previous market crashes.

Nevertheless, Buffett has relentlessly accumulated wealth over that period. He's still the fourth-richest person on the planet. That means Buffett's market crash strategy could help regular investors like us, too.

If the frothiness in the stock market is making you cautious, here's how the investment legend is preparing for a potential crash.

Hold cash

Buffett is notoriously conservative. He likes to hold a significant portion of his portfolio in cash. However, the proportion of cash rises steadily when he finds that the market is overvalued and opportunities are rare.

See, holding cash lowers risk and raises optionality. When or if the market crashes, Buffett's portfolio will be buffered by the cash. He will also have enough dry powder to add new stocks to his portfolio when prices are significantly lower. That boosts his long-term performance.

At the moment, the Oracle of Omaha holds a record-breaking US$140 billion (CA$178 billion) in cash. That's nearly enough to acquire Canada's most valuable company: **Shopify**.

Of course, Buffett won't buy Shopify. But regular investors should consider lowering their exposure to stocks and holding pure cash for a while.

Offload overvalued winners

The cash mentioned above is derived from selling stocks that have had an incredible runup during the market boom. Buffett regularly trims his stake in companies that he's held for decades if he believes the price has overshot the fundamentals.

For instance, Buffett has been reducing his stake in the iPhone maker over the past year, as its stock surged 70%. It's still his largest holding, but Buffett has been booking profits as the stock touches record highs.

Canadian investors can consider doing the same with their overvalued winners. Shopify, for instance, is up 147% over the past year. It's now trading at 56 times sales per share. There's no doubt that its long-term prospects are as bright as ever. But the stock is priced to perfection. Perhaps it's time to offload a little.

Invest in value

Some sectors and stocks are undervalued, even in a market boom. For instance, Buffett has been adding exposure to pharma stocks. Last year, he also entered the gold market for the first time by betting on Canada's largest gold miner, **Barrick Gold**.

Considering the market value of gold and Barrick's profitability, the stock seems undervalued. Investors could consider it a safe haven if the market crashes in the near term.

Bottom line

Investment legend Warren Buffett has built his wealth over decades, despite market crashes. He prepares for these crashes by trimming his winners, holding cash, and investing in undervalued sectors. Non-billionaire investors like us could consider this strategy, too.

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