Why Warren Buffett Is Right to Think a Market Crash Is Always Coming

Description

Warren Buffett's investment strategy seeks to use the market cycle to maximise returns. He has historically purchased high-quality companies when they trade at low prices during a market crash. He then holds them over the long run, during which time they often benefit from a subsequent market rally that propels their share prices higher.

Buffett has repeatedly been able to use this strategy because the market cycle is omnipresent. As such, the next market crash is never far away. Through following the Oracle of Omaha's lead and using a patient approach that builds a cash balance, it is possible to outperform the stock market over the long run.

A market crash is always on the horizon

Even though many shares have surged higher following the 2020 market crash, history suggests they are very unlikely to rise in perpetuity. After all, no previous market rally has ever lasted indefinitely. They have always come to an end, with rapidly-falling stock prices usually following periods of high growth.

As such, it makes sense to always plan ahead for the next market downturn. Warren Buffett achieves this goal through only purchasing high-quality companies when they offer wide margins of safety. In doing so, he avoids overvalued businesses that may be negatively impacted to the largest extent by a market downturn. He also holds large amounts of cash at all times that can be deployed quickly should share prices temporarily fall to extremely low levels.

Warren Buffett is also able to use a market crash to his advantage because he takes a long-term view of his portfolio. A sudden market decline is only likely to be of major concern to an investor who has a short time horizon. For long-term investors who are concerned about their portfolio's performance over the next decade, several months of paper losses are unlikely to cause issues for their financial future.

Implementing Warren Buffett's strategy today

Clearly, when the next market crash will occur is a known unknown. However, history shows that it will occur at some point over the coming weeks, months or years. Therefore, following Warren Buffett's strategy could be a sound move.

At the present time, this may mean avoiding overvalued companies that have soared as a result of improving investor sentiment. Instead, buying businesses that are underappreciated by investors, or that have wide margins of safety due to temporary operating disruption, could be a less risky move. They may offer greater return potential over the long run, as well as being less susceptible to the next market downturn.

Furthermore, holding some cash at the present time could be a shrewd move. Even though it means obtaining a low return due to low interest rates, cash allows an investor to capitalise on the next market crash. Over the long run, this strategy may be more profitable versus buying shares after they have already risen in value.

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