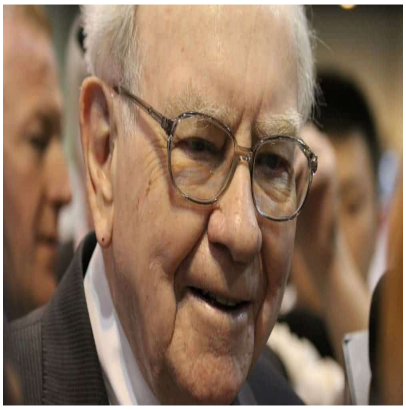

Forget Gold. I’d Use Warren Buffett’s Advice to Beat the Stock Market

Description

Warren Buffett has generally held a negative viewpoint of gold over recent decades. While some investors have sought refuge in the precious metal during periods of economic uncertainty, he has instead purchased high-quality companies when they trade at low prices.

His strategy has been hugely successful. It has easily outperformed the stock market over the long run, and could continue to do so in future.

Therefore, rather than investing money in gold while the economy currently faces a challenging near-term future, purchasing undervalued stocks could be a more profitable move.

The risks of investing in gold

Warren Buffett’s avoidance of gold may be partly due to the track record of the stock market. Even though it has experienced numerous downturns in the past, it has always recovered from them. Therefore, a strategy that seeks to buy cheap stocks and hold them in the long run has generally been a sound means of taking advantage of the market cycle.

By contrast, many investors buy gold when economic uncertainty is high. Its defensive qualities mean that it is usually less correlated to the prospects for global GDP growth. However, buying gold at such times can mean paying a high price that limits capital growth opportunities. Furthermore, investor sentiment has always improved following even the very worst market downturns. As such, Buffett’s strategy of banking on a recovery via cheap stocks could be far more profitable than buying gold ahead of a likely reduction in risk aversion among investors.

Warren Buffett’s focus on quality

Of course, Warren Buffett does not only seek to buy cheap stocks. He focuses on the quality of a company above all else. For him, this means identifying businesses with wide economic moats. For example, this may be a unique product, strong brand loyalty or a cost base that is significantly lower than sector peers. A wide economic moat can produce higher margins, more resilient financial performance, and faster-growing profitability in the long run.

Buffett seeks to identify high-quality companies when they temporarily trade at low prices. This may be caused by economic weakness, but could also be prompted by weak industry operating conditions. Where a company has a wide economic moat, a sound strategy to overcome short-term difficulties, and the financial means to put its plan into action, Buffett has often invested.

A long-term view

A strategy that seeks to buy high-quality companies at low prices requires a long time horizon. While the economy has always returned to growth following recessions, and the stock market has made gains following every previous downturn, it can take time for these events to take place.

Warren Buffett has an extremely long time horizon. This provides scope for all of his purchases to recover from their short-term challenges. In doing so, they have often outperformed the wider stock market and produced returns that are significantly higher than those of gold.

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