Warren Buffett Indicator Hits Ominous Record High! What Now?

Description

The Warren Buffett Indicator has been on the minds of folks in the financial media of late. The popular indicator, which measures the U.S. stock market's market cap against America's GDP (gross domestic product), broke record highs recently, suggesting stocks may be the most overvalued they've been since the height that preceded the Great Financial Crisis and the ensuing market crash.

The worldwide Warren Buffett Indicator (global market cap versus GDP) is also at unprecedented heights, recently hitting 123%, breaking levels not seen since the dot-com bust. Undoubtedly, the gauge is startling, and given Warren Buffett appears to have been rather cautious with his investment moves in 2020, it's pretty easy to conclude that we're overdue for a mother of all market meltdowns.

Warren Buffett Indicator flashes red, but here's why I'm not worried

While the Warren Buffett Indicator does seem alarming on its own, investors must remember that context is everything, and that even the best economic indicators on the planet can have their share of limitations. While we've heard growing concerns over stock valuations ad nauseam of late, I think it's vital to remember that GDP figures were temporarily suppressed due to the COVID-19 pandemic.

Last week, we witnessed China posting blowout GDP growth numbers, as its economy bounced back from the coronavirus crisis in a massive way. The Chinese economy grew an unprecedented 18.3% in the first quarter. If the U.S. and Canadian economies are also due for record GDP growth, the Warren Buffett Indicator will stand to be compressed, as GDP numbers (the denominator of the Warren Buffett Indicator) could surge.

The Warren Buffett Indicator doesn't tell the full story

The stock market, as you may know, is forward looking. And market caps have likely already reflected the considerable GDP growth that'll likely be in the cards once COVID-19 is conquered. If U.S. stocks remain stagnant, the numerator of the Warren Buffett Indicator could stay put while the denominator (U.S. GDP) could take off, thus bringing the Buffett Indicator back down to levels that are likely to be less alarming than they are right now.

So, if you're at all startled about the Warren Buffett Indicator, it's important to remember that the indicator itself doesn't tell the full story, especially these days. As such, the fact that the U.S. and worldwide Warren Buffett indicators are at highs should not be a cause for concern as we spring into spring.

Should you sell in May and go away? No way. With the magnitude of stimulus being pumped into the economy, corporate earnings could explode, and if they surpass estimates, stocks could easily continue their ascent, despite the Warren Buffett Indicator.

But why has Warren Buffett been so cautious with his recent moves?

Warren Buffett was busy in 2020. The man loaded up on telecoms, beaten-down big oil stocks, and Japan's top trading companies while eliminating riskier positions such as his positions in airlines and bank stocks.

Is the Sage of Omaha truly worried? Probably not. The man said to "never bet against America," and he's taking his own advice. While he has been more defensive with his recent moves, he certainly isn't ready to liquidate his portfolio anytime soon. He's staying the course, and he's buying more of the stocks that nobody else wants to own right now.

In numerous pieces, I've urged investors to follow the man into big oil with **Suncor Energy** stock before the post-COVID economic expansion had a chance to fuel one last boom for oil prices. The Warren Buffett Indicator may be signaling severe overvaluation in stocks.

Foolish takeaway

Even if U.S. GDP numbers weren't to bounce back as fast as the market is anticipating, I still think it's wise to be a net buyer of stocks these days, especially of names, like Suncor, that nobody else wants to touch because of the nature of its industry.

I think the Warren Buffett Indicator is temporarily out of whack due to COVID-19's impact. As such, investors should take it with a very fine grain of salt as they continue to stay the course.

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