The Motley Fool

Warren Buffett's Advice for a Stock Market Crash

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Why you should heed Buffett's advice

If you could only listen to one person's advice during a stock market crash, let that person be famed investor, Warren Buffett. Not only will the **Berkshire Hathaway** (NYSE: BRK-B) (NYSE: BRK-A) chairman and CEO's advice serve you well, but his knack for keeping a clear head -- and even getting a bit greedy (more on that later) -- when everyone else is selling, may make his the only advice you need to navigate uncertain times.

Indeed, Buffett's ability to tune out the noise and remain optimistic amid these downturns has played a vital role in his unrivaled performance over decades. Between 1965 and the end of 2017, Berkshire's market value has increased at an annualized rate of 20.9%, more than doubling the **S&P 500**'s average annual growth of 9.9% during this same period. This 20.9% annualized growth rate for Berkshire's market value translates to a total return of 2,404,748%, obliterating the S&P 500's 15,508% gain during the same timeframe.

Notably, this performance was achieved amid a number tumultuous financial periods, the 1973-74 stock market crash, Black Monday, the bursting of the dot-com bubble, a sharp pullback after the September 11 attacks, and the more recent Great Recession between December 2007 and June 2009.

Suffice to say, Buffett knows a thing or two about stock market crashes. So, without further ado, here's some advice from the Oracle of Omaha regarding inevitable market downturns.

Source: Getty Images

1. Stocks can fall far -- and they can fall fast

When investing in stocks, there's always a risk that a major downturn is right around the corner. In fact, stocks not only fall often, but they're totally unpredictable. As Buffett said in his most recent shareholder letter, "There is simply no telling how far stocks can fall in a short period."

Consider some of this data from Capital Research and Management Company on the frequency of large declines in the **Dow Jones Industrial Average** between 1948 and December 2017.

Percentage Decline	Average Frequency	Average Length
5% or more	About 3 times per year	46 days
10% or more	About once a year	117 days
15% or more	About every 3 years	275 days
20% or more	About once every 6 years	425 days

Data source: Capital Research and Management Company (via American Funds). Table by author.

A similar study of the period between 1945 and July 2016 showed that the S&P 500 fell 5% to 9.9% 56 times, 10% to 19.9% 21 times, 20% to 39.9% nine times, and 40% or more three times, according to CFRA Research (via American Association of Individual Investors).

Stock market declines are inevitable -- and they will come in all shapes and sizes.

Be prepared.

Source: Getty Images

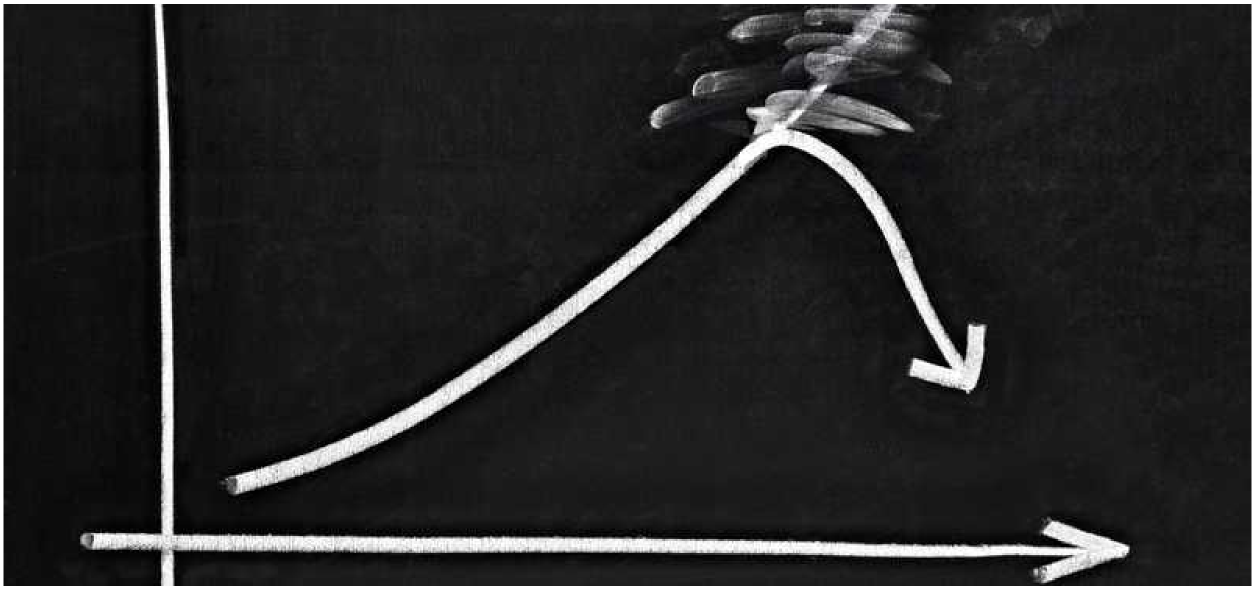
2. Avoiding leverage will give you greater clarity

To be able to make good decisions amid a stock market crash, investors will need to be able to remain calm. As Buffett has said, "Investing is not a game where the guy with the 160 IQ beats the guy with the 130 IQ. Once you have ordinary intelligence, what you need is the temperament to control the urges that get other people into trouble in investing."

While there's no guarantee investors will be able to resist irrational and emotional urges that could lead to bad decisions during a downturn, there's one way that makes poor judgment a near certainty when things go awry: trade on margin. Debt distorts all decision making in investing -- especially during a stock market crash.

Buffett explained this in his most recent shareholder letter:

"Even if your borrowings are small and your positions aren't immediately threatened by the plunging market, your mind may well become rattled by scary headlines and breathless commentary. And an unsettled mind will not make good decisions."



Source: Getty Images

3. Don't try to time the market

Don't try to forecast when stock market crashes will occur. Just know they will come.

In Berkshire's 2017 shareholder letter, Buffett outlined four times when Berkshire stock fell 37% or more, representing what he called "truly major dips." The biggest decline occurred from March 1973 to January 1975, when Berkshire stock declined a whopping 59%. "In the next 53 years our shares (and others) will experience declines resembling those in the table," Buffett said about these four major declines. "*No one* can tell you when these will happen. The light can at *any time* go from green to red without pausing at yellow.

These pullbacks, which were all accompanied by broader drops in the stock market, are undoubtedly painful for investors. But no matter how much you wish to avoid them, trying to time them is a fool's errand.

Source: Getty Images

4. Don't view stocks as ticker symbols

To help maintain a clear head during stock market crashes, investors should remember that they are business owners -- not ticker symbol owners. While stock prices may plummet, the majority of companies with good business models and strong competitive advantages will likely see a far smaller negative impact to their underlying businesses during these periods. So, be sure to detach stock price performance from business performance.

Buffett elaborated on this concept in Berkshire's most recent shareholder letter:

"Charlie and I view the marketable common stocks that Berkshire owns as interests in *businesses*, not as ticker symbols to be bought or sold based on their 'chart' patterns, the 'target' prices of analysts or the opinions of media pundits. Instead, we simply believe that if the businesses of the investees are successful (as we believe most will be) our investments will be successful as well."

Source: Getty Images

5. Stay invested

While stock market crashes and major downturns have proven to resurface time and time again throughout history, an even stronger trend has been the powerful wealth-building returns of stocks over time. The Dow Jones Industrial Average, for instance, has risen an average of 10.3% annually over the last 100 years when including reinvested dividends.

Don't be that person that liquidates their portfolio during a recession. In fact, be the person that is keeping most -- if not *all* -- of their portfolio invested.

Buffett explained the [importance of staying invested] in Berkshire's 2012 shareholder letter:

"Since the basic game is so favorable, Charlie and I believe it's a terrible mistake to try to dance in and out of it based upon the turn of tarot cards, the predictions of 'experts,' or the ebb and flow of business activity. The risks of being out of the game are huge compared to the risks of being in it."

Source: Getty Images

6. Go shopping

Even better than not selling stocks during a recession is to actually go on the offense. In bull markets, investors can occasionally find reasonably priced, wonderful businesses. But they can rarely find wonderful businesses trading at a significant discount to their fair value. Stock market crashes are the rare times when high-quality businesses can be found in the clearance aisle. Go shopping!

As Buffett has famously said, "Be fearful when others are greedy and greedy when others are fearful."

Or consider a more recent quote from Buffett: "When major declines occur, … they offer extraordinary opportunities to those who are not handicapped by debt."

Source: Getty Images

7. Stay focused on the long haul

Don't get caught up in near-term economic forecasts or the popular headlines of the time, whether those are ones of sheer optimism or gloom and doom. Investors are not traders. They are business owners with long-term views. So, remain focused on the long haul during downturns.

Buffett explained this concept in Berkshire's 2017 shareholder letter.

"Stocks surge and swoon, seemingly untethered to any year-to-year buildup in their underlying value. Over time, however, Ben Graham's oft-quoted maxim proves true: 'In the short run, the market is a voting machine; in the long run, however, it becomes a weighing machine.'"

Source: Getty Images

In a nutshell: Remain calm and be patient

Last but not least, embrace some of Buffett's optimism, exemplified in a quote from Berkshire's 2012 shareholder letter:

"American business will do fine over time. And stocks will do well just as certainly, since their fate is tied to business performance. Periodic setbacks will occur, yes, but investors and managers are in a game that is heavily stacked in their favor. (The Dow Jones Industrials advanced from 66 to 11,497 in the 20th Century, a staggering 17,320% increase that materialized despite four costly wars, a Great Depression and many recessions. And don't forget that shareholders received substantial dividends throughout the century as well.)"

Stocks have survived depressions, recessions, and corrections in the past, and they will survive them in the future. So, if you find yourself amid a stock market crash, stay out of debt, stay focused on the long-term, and take advantage of buying opportunities. Every downturn will eventually turn back upward.

Daniel Sparks has no position in any of the stocks mentioned. The Motley Fool owns shares of and recommends Berkshire Hathaway (B shares). The Motley Fool has a disclosure policy.