

When to get out of the stock market

The first major financial bubble took place in the 17th century. Investors began to madly purchase tulips, pushing their prices to unprecedented highs. The average price of a single flower exceeded the annual income of a skilled worker and cost more than some houses at the time. Recently this has happened with the GameStop shares.

How does this happen? Investors lose track of rational expectations where there is a massive, sustained upswing in the price of an asset. The 'Fear of Missing Out' hits them and they believe they have to be in on it. The earnings potential and the valuation of the company all become irrelevant as you are buying because you know that others will buy at even a higher price.

When investors wake up and realize that they are merely holding 'a tulip bulb' that is vastly overvalued they start a sell-off. Prices collapse within days, or a week at the outside as everyone else realizes what their asset is worth. As in the 17th century many investors lose most of the sums invested.

If you study the 'S&P 500 Index – 90 Year Historical Chart', you will see that there have been five major stock market declines which led to the collapse of a number of once great companies. The last major adjustment was in 2008/2009. If history were to repeat itself which it usually does, the next major stock market adjustment cannot be far away, especially based on some of the ratios that companies are trading at.

Whilst stocks over time will always go up, the major danger of a stock market crash is that hyped companies will fail as they are unable to obtain enough funding for the expansion plans they are already committed to.

Stock market crash checklist	Is it covered?
Is the Shiller P/E price earnings ratio for the S&P top 500 companies over 24	<input type="checkbox"/> Yes <input type="checkbox"/> No
Is the Wilshire 5000 Index over 1.15?	<input type="checkbox"/> Yes <input type="checkbox"/> No
People you know are investing heavily into financial instruments they do not understand E.g., bitcoin, shares, metals, futures.	<input type="checkbox"/> Yes <input type="checkbox"/> No
Shares such as GameStop hit the news because of their violent share price movements.	<input type="checkbox"/> Yes <input type="checkbox"/> No
Is there some major event that will affect many businesses negatively for a while (COVID 19)?	<input type="checkbox"/> Yes <input type="checkbox"/> No
Are shares rising in companies that have not yet made a profit or have a negative cashflow?	<input type="checkbox"/> Yes <input type="checkbox"/> No
Are young tech start-up companies getting huge backing based on an idea not the economics e.g., lime technologies e-scooter.	<input type="checkbox"/> Yes <input type="checkbox"/> No
Price to earnings ratios for popular stocks are flying over 30 times (the company is valued at 30 times last year's earnings).	<input type="checkbox"/> Yes <input type="checkbox"/> No

