Canopy Growth Corp. Has Entered a New Realm: Investors, Rejoice With Caution

Description

Canopy Growth Corp. (TSX:WEED) is to be added to the broad **S&P TSX Composite** index on March 20, 2017. A lot of hype has come with the news, and management at Canopy is celebrating another "first." There is indeed a reason to celebrate the achievement, but what could the inclusion on the index mean for individual investors?

There are a number of big institutions, including mutual funds, pension funds, and investment banks, that use the TSX Composite and its sub-indices as performance benchmarks for their portfolios. The addition of Canopy to the index will introduce some new dimensions to the index's performance.

Canopy is currently the only listed marijuana stock trading on the main Toronto Stock Exchange. All those funds that track the TSX Composite or its sub-indexes may be mandated to buy into Canopy as there is currently no other substitute. There will likely be a swarming of institutional investors into the company's stock.

These institutions will come with complications, blessings, and curses to Canopy's stock.

The good news

Firstly, institutional investors are smart money managers who could further improve the valuation of Canopy's stock. They have a vast number of trained analysts, access to a host of corporate and market data that retail investors may not afford, and they can perform a more in-depth analysis than individual investors. Canopy may be more fairly valued going forward.

Secondly, these big investors could further lift Canopy's stock price. Not only will they increase demand and improve liquidity in the stock, but once they establish a position, they usually closely engage with management on how best value can be created in the company going forward. Usually, investors who buy in to a stock with the initial wave of institutional buyers make good money.

Moreover, institutional investors may dampen the volatility in the stock going forward. The stock is currently likely being held by many traders and speculators with short-term holding periods who overreact even to the most trivial information. Institutions usually have a long-term perspective in a stock as they incur high due diligence and transaction costs when entering a position.

Rather than selling whenever there is some negative market noise, institutions usually choose to have a dialogue with firm directorship. They can even suggest hiring new management, promote value-driven decisions, and create more shareholder wealth by better monitoring of management.

The downside

There could be some few complication with increased institutional shareholder concentration in Canopy.

Institutions may hold millions of shares in a stock. With the high uncertainty surrounding the marijuana industry, especially the critical recreational legalization, something could go wrong in the sector. These big guys could decide to offload their stocks all at once. With such big stock volumes coming on to the market all at once, Canopy shares could massively drop in a matter of minutes, and recovery could take years.

Foolish bottom line

Great times are likely coming for marijuana investors and to Canopy in particular. An increase in institutional investors in the stock may boost shareholder confidence and bring price stability, but the uncertainty with recreational legalization is a huge factor that could be magnified.

Invest with caution!

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