



4 Reasons Your Marijuana Investment Could End in Tears

Description

Marijuana has quickly become the next “can’t miss” investing idea for investors across North America.

This has led many investors looking to make a quick buck to the Canadian markets, where the largest and most liquid marijuana stocks trade. In addition, the Canadian government is expected to pass legislation at some point in 2017, which would make it the first North American nation to fully legalize the drug.

Estimates vary, but the size of a legal marijuana market in Canada will be huge. The consensus seems to be that Canadians will buy between \$15 and \$25 billion worth of legal weed each year. The only wild card is that we don’t know how many Canadians will begin to consume cannabis once it’s legal.

Despite this huge potential market, I’m reluctant to put any of my cash into this market. Here are four reasons why.

Excessive valuations

Canopy Growth Corp. ([TSX:WEED](#)), which has a market cap of \$1.8 billion on a fully diluted basis, is Canada’s largest pot stock. It was just added to the TSX Composite Index — an action bulls feel will only add to its lustre.

But Canopy is an incredibly expensive stock. Over its last four quarters, the company did \$30 million in sales. That gives it a price-to-sales ratio of nearly 60 times. It also lost \$0.03 per share in that same period with analysts predicting more red ink over its next two fiscal years.

Shares are trading on nothing but potential and hype. If the expected result doesn’t happen, it can work out very badly. Do you want to take that chance with your retirement savings?

Uncertain winners

There's a Warren Buffett story that nicely encapsulates what's going on with the marijuana market today.

Back in 1999, when talking about the tech bubble, Buffett asked his audience to imagine investing in cars in 1910. It was obvious the sector was going to be a winner. But with hundreds of fledgling auto makers, which one should they choose?

It was much easier to look at it from a different perspective. Instead of going long cars, the obvious trade was to short horses.

The same thing applies today. Everyone is crowding into marijuana stocks. But industrial REITs such as **Pure Industrial Real Estate Trust** (TSX:AAR.UN) are poised to be winners no matter which producer comes out on top. You need to grow the product somewhere, and renting space makes more sense than buying it.

Short-term resistance

There's an old expression in finance that tells investors to "buy the rumour and sell the news." I've seen it play out hundreds of times.

It's likely the same thing happens with Canada's largest marijuana stocks. When the Trudeau government finally announces a legalization date, many investors will sell the news, which could cause these stocks to crash.

U.S. resistance

Although President Trump seems ambivalent towards marijuana, and eight U.S. states have now legalized the drug for recreational purposes, the fact of the matter is, the United States will continue to be tough on marijuana for as long as the Republicans are in charge.

Many marijuana investors are banking on the fact that these Canadian producers will soon be able to sell their product to the United States. Meanwhile, U.S. producers in states like California, Washington, and Colorado are gearing themselves up for a potential nationwide expansion, whenever that happens.

The bottom line

It comes down to this: legal marijuana will be a very big thing in Canada, but that doesn't mean any of Canada's top pot stocks will necessarily be good investments. Their valuations are every bit as high as tech stocks were in the Dot Com era.

Weed stocks could go higher. Or they could fall. When a sector trades at such a lofty valuation, it's hard to predict what will happen. I'm content to wait out this opportunity from the sidelines without any of my money at stake.

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