

Marijuana ETFs: Good or Bad?

Description

It has now been almost a month since the “latest and greatest” exchange-traded fund (ETF) hit the market: **Horizons Medical Marijuana Life Sciences ETF** ([TSX:HMMJ](#)). Let’s do a “month in review” to see how the ETF has performed and look at which direction this ETF may be headed moving forward.

Risk management

With the rapid rise in the valuations of marijuana stocks over the past year, speculators and long-term investors alike have clamoured to get into many of these up-and-coming companies early. Private placements, and now venture stock market raises, have allowed these companies to continue to grow at breakneck speed, raising money along the way at higher and higher valuations.

We have now started to see, among some of the bigger and more established names in the Canadian medical marijuana business, that there appears to be a slowdown in terms of upward valuation adjustments. It appears that investors and the market have determined that much of the potential upside from legalization has been priced into most issues, resulting in a flattening out of valuations over the past month.

One of the selling points of this ETF, for investors who may be less excited than others about the short-term prospects of these cannabis companies but want long-term exposure, is that a lot of the speculative risk associated with buying one or two names is taken away by spreading out the risk across approximately two dozen stocks.

Heavily concentrated holdings

Interestingly, three of the top five holdings of the fund include (in this order) **Aurora Cannabis Inc.** (TSXV:ACB), **Aphria Inc.** (TSX:APH), and **Canopy Growth Corp.** ([TSX:WEED](#)). These three pot stocks account for 28.7% of the fund’s overall holdings, and we can see the high correlation when we look at each of these companies’ one-month stock charts and compare them to those of the ETF.

Some cannabis stocks have done better than others, as we can see with Canopy’s returns in April compared with most other stocks over the same time horizon; however, we can also see many similarities in how marijuana stocks tend to move in tandem over time. While not unexpected, this effect is seemingly exaggerated by the fact that the holdings of this ETF are so concentrated.

Looking at the top five holdings combined, we can see that over 47.8% of the ETF’s holdings are represented by these five picks alone.

Bottom line

Diversification is not the only reason that investors buy ETFs, but it is a pretty important selling point. With this ETF, I am unsure that buying a group of cannabis-related stocks will perform better over time

than selectively picking and choosing from the bunch.

In my opinion, not all marijuana stocks are created equal, and given the heavy concentration among the fund's top five holdings, I would rather create my own "mini-ETF" with picks I like rather than have someone else do it for me.

Stay Foolish, my friends.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:ACB (Aurora Cannabis)
2. TSX:HMMJ (Horizons Marijuana Life Sciences Index ETF)
3. TSX:WEED (Canopy Growth)

PARTNER-FEEDS

1. Msn
2. Newscred
3. Yahoo CA

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Date

2025/08/05

Date Created

2017/05/03

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