Can Marijuana Stocks Beat the Market This Year?

Description

After seeing the performance of marijuana stocks so far this year, it's very tough to predict whether or not Canada's top producers will beat the market again.

During the past three months, the Canadian marijuana index, which tracks the performance of leading cannabis stocks operating in the country, was up just 7% at the time of writing, following a very volatile start to the year.

And if you look at the performance of the top three producers, **Canopy Growth Corp.** (TSX:WEED), **Aphria Inc.** (TSX:APH), and **Aurora Cannabis Inc.** (TSX:ACB), you will get a very mixed picture; Aphria and Aurora are down more than 20%, and Canopy is up slightly so far this year.

To put things in perspective, these top leading marijuana stocks produced triple-digit gains last year, becoming the most profitable trade amid the deal frenzy and on investors' excitement about the scheduled legalization of recreational pot consumption in Canada this summer

This year, however, investors have become very cautious about the rich valuations of these companies, which still have to prove their worth and show profitability once the recreational market opens.

You can guess the market's changing mood about these players from the latest deals, which have failed to fuel any excitement.

Aphria stock, for example, is down more than 7% during the past five trading days, despite the fact that the company closed its $430 million purchase of Nuuvera Inc. successfully today.

Short sellers

One potential reason of this weak performance when compared to the last year is that cautious investors don't want to bet heavily just before the major event (the legalization of recreational use in Canada). There are also signs that short sellers are targeting Canada's cannabis sector, betting on the negative surprises from producers with little to no revenue, while their valuations touch the ceiling.

Most marijuana producers have little sales history and remain unprofitable. In anticipation of legalization, investors have built in high expectations to cannabis stock prices, and it won't take much to wipe out these valuations if these companies fail to produce results.

A recent report in the *The Globe and Mail* shows that investors have to pay the highest cost to borrow shares of cannabis companies (based on data obtained from Interactive Brokers). When short sellers are willing to pay higher borrowing costs for shares, it is usually a sign of rising bearish sentiment.

The bottom line

Staying on the sidelines is a much better strategy for 2018 when it comes to Canada's marijuana stocks. Investors who are looking to beat the market with this speculative trade have probably missed the boat. Going forward, it's all about sales and profitability.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:ACB (Aurora Cannabis)
2. TSX:WEED (Canopy Growth)

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Date
2025/07/03
Date Created
2018/03/23
Author
hanwar