This Long/Short Cannabis Investing Strategy Can Help Your Portfolio Get High Without the Hangover

Description

Not only do pot stocks have questionable valuations, but they could also blow up and wipe out your wealth very suddenly. Depending on the actionable negative development, you may not even have the chance to dump your shares if shareholders are stampeding to the exits, thereby overwhelming and potentially bringing down various discount brokerages that can't handle massive trading volume surges.

You're essentially risking your entire principal on a security that may or may not surge in price. For many, the risks are just too high to get involved in the Canadian "green rush," but for those who smell opportunity and not just marijuana smoke, here are a few strategies that may mitigate the risk you'll end up taking on.

Consider the following long/short strategy:

With recent the recent series of developments, I think now is a great time to buy **Canopy Growth Corp.** (TSX:WEED) while you take a short position in **Aurora Cannabis Inc.** (TSX:ACB).

Why?

Not only will you be hedged from downside from negative developments that affect the broader industry, but you'll also be able to capitalize on what I believe will be a widening of the market cap gap between Canopy and Aurora.

Aurora's shareholder-dilutive M&A spree is short-worthy!

You've probably noticed that Aurora Cannabis stock has been making up for lost time in its 2017 end-year rally, where shares nearly quintupled over the course of a few months after going parabolic. Aurora was the hottest pot stock out there, but since hitting the peak, shares have fallen over 40% thanks in part to questionable M&A activities.

Many pundits are calling for the industry to consolidate, but I believe Aurora is jumping into the pool without checking to see if it's been filled with water yet. Aurora made multiple acquisitions at absurd multiples when the industry was trading near all-time highs.

Sure, the industry will eventually consolidate, but it's going to be over the course of many years, not a few months. And the firms that pick up targets at a fair value will be the ones that will come out on top when all is said and done, not the ones that are the quickest to act and are willing to pay up hand over fist.

It looks to me like Aurora's management team is failing to consider the real value that acquisitions will add relative to their hefty price tags. Shareholders are getting severely diluted in the process, and after the recent $3.2 billion all-stock deal for **MedReleaf Corp.** (TSX:LEAF), many analysts and investors are becoming increasingly skeptical over management's strategy, which looks to be drawing comparisons to the reckless "pay any price" M&A spree exhibited by **Valeant Pharmaceuticals Intl Inc.** (TSX:VRX)(NYSE:VRX) during the Michael Pearson era.

Canopy CEO takes shots at acquisition-hungry peers

In a televised interview conducted by *BNN Bloomberg,* Canopy CEO Bruce Linton also noted that such M&A activities are like "paying a dollar to get a dime." Canopy hasn't been incredibly active on the acquisition lately, and has instead focused on organic growth initiatives. I praised Canopy for its M&A inactivity recently in a previous piece published on April 20, 2018.

While many pundits would agree that the first year of legalization will experience a marijuana shortage, I think the magnitude of the shortage touted by the public is exaggerated and fails to consider the role of a grow-it-yourself black market with personal growth regulations easing in conjunction with higher legal pot prices.

Today, Canadians pay $6.83 per gram of marijuana on average.

Finance Minister Bill Morneau estimated that the cost will rise to about $10 per gram with taxes slapped on, so with little evidence suggesting a rise in recreational usage, I think Aurora's rushed capacity ramp-up may be in jeopardy. As such, I think shares of Aurora could continue to fall, even after dipping over 40% from its peak.

Given that Canopy possesses the more conservative strategy, I believe its shares will stand to get hit to a lesser degree than that of Aurora shares, which could absolutely implode come the next industry-wide downturn.

I think Aurora really shot themselves in the foot with its recent barrage of expensive deals, and would thus encourage investors to short Aurora while going long Canopy.

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2. TSX:ACB (Aurora Cannabis)
3. TSX:BHC (Bausch Health Companies Inc.)
4. TSX:WEED (Canopy Growth)

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