



Be Warned: Marijuana Stocks Could Burn Investors

Description

The cannabis market is in full euphoria mode. After a mid-year lull, the sector has once again exploded. The Canadian Marijuana Index has risen 23% in the last month. Some of the more notable players have seen incredible gains.

HEXO Corp leads the group with a 53% gain, while **Aphria** and **Aurora Cannabis** ([TSX:ACB](#)) are both up approximately 42%. I'm not even going to talk about **Tilray's** unjustified run.

The cannabis [sector is a momentum play](#). Investors beware: you may get burned.

Unjustified valuations

Many analysts have sounded the alarm bells. Valuations are getting out of hand. Bulls will point to **Constellation Brands's** \$5 billion investment in **Canopy** as justification for current valuations.

However, even the best-managed companies can get caught up in the hype. History is full of ill-advised investments or takeovers.

Here is the bottom line: pot stocks are the most expensive stocks on the TSX. It's not even close. On average, they are trading at triple-digit price-to-sales ratios. Canopy and Aurora Cannabis have market caps greater than the likes of **Canadian Tire** and **Saputo**.

Let's put this into perspective. The Canadian medical marijuana market is expected to reach \$2.5 billion by 2022. Using the most bullish case, the Canadian recreational marijuana is expected to reach approximately \$10 billion in sales.

In 2017, Canadian Tire had \$13.4 billion in sales, which tops the combined expected Canadian marijuana markets (medical and recreational). Yet, as of writing, the top five Canadian-listed marijuana stocks have a combined market cap of \$36 billion. Yes, \$36 billion. There are about a dozen other publicly listed pot stocks as well.

I know, bulls are going to argue that the international markets provide access to significant growth. At

the moment, however, international sales account for but a sliver of company revenues. The reality is that all eyes are on Canada.

Make no mistake, the recent run-up is being fueled by the Canadian legalization of recreational marijuana. The recent tide as propped up all stocks, but not all can succeed. It's a numbers game.

Lock in your profits

A word to the wise: Lock in your profits. It is only a matter of time before sales and profits take centre stage. When that time comes, retail investors will quickly realize that very few of these stocks deserve such valuations.

I am not crazy enough to short the sector, but I also can't justify initiating a position at these levels. I've booked my profits in Aurora Cannabis and will wait for another pullback before re-entry.

Given the expected market size, just how much higher can the sector justifiably rise? The combined market caps of the major players in Canada already far exceeds that of the expected market size. At this point, [the risks](#) far exceed the potential rewards. Something has to give.

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Date

2025/08/27

Date Created

2018/09/25

Author

mlitalien

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