A Guide to Surviving the Cannabis Sector Carnage

Description

Investors who chose to jump into some of the top cannabis stocks immediately following legalization have been greeted with a violent pullback. It will come as no consolation for newcomers to learn that they are not alone, as indexes in North America, Europe, and Asia have all suffered sharp declines in October. The **S&P/TSX Composite Index** shed 127 points on October 23.

Still, volatility in the cannabis sector has been the most notable takeaway since recreational use was legalized on October 17. The top producers have all been battered since trading opened on that same day.

Aphria (TSX:APH) stock is down 15% over the past week. The sharp drop has put the stock into negative territory for 2018. For patient investors, Aphria certainly looks like a buy-low opportunity right now. It is quickly expanding into international markets and production is slated to ramp up to an annual output of 255,000 kilograms annually by May 2019. Last week Aphria also filed for a **New York Stock Exchange** listing, which should boost volumes and interest going forward.

Canopy Growth (TSX:WEED)(NYSE:CGC) stock has plunged 21.9% week over week. A Canopy-owned store was the first to sell legal cannabis just after midnight on October 17. Even after its most recent drop, Canopy stock has climbed 58% over a three-month span. CEO Bruce Linton predicted that the gap between supply and demand will lessen in the coming weeks, which should result in more stability for the industry and for stock valuations in the sector.

Aurora Cannabis (TSX:ACB)(NYSE:ACB) stock suffered an 11.7% drop on the same day of its NYSE listing. Shares have plunged 27.9% over the past week. The sharp sell-off for the cannabis sector will be disappointing for Aurora investors, especially considering its NYSE listing. However, Aurora remains a heavyweight producer and will be relied upon to meet the supply pressures of the industry over the coming year.

On the day before legalization, I'd discussed why investors should be prepared for volatility in the weeks and months following the big day. Unfortunately, rotating strikes from Canada Post workers has put additional pressure on the young industry during what was already expected to be a chaotic rollout.

The Ontario Cannabis Store (OSC) has said that the strike has put additional pressure on its operations combined with unexpectedly high and lasting demand.

Canopy CEO Bruce Linton has predicted that supply should catch up to demand in the coming weeks, but investors should be prepared for a longer wait. The C.D. Howe Institute recently released a report that predicted that supply would only be able to meet 30% to 60% of demand in 2018 and the first half of 2019. Several of the top producers, including Aurora and Aphria, will see production ramp up to much higher levels by the middle of next year.

Cannabis investors will be forced to stomach major volatility in this sector until the industry is able to adequately meet demand. It is possible this may not be until mid-to-late 2019, however. For long-term investors, the top producers we have covered today are still attractive buy-and-hold options. Small-to-medium sized producers will be subject to higher pressures in the current environment and could face serious complications over the next year.

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1. Investing

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2. NASDAQ:CGC (Canopy Growth)
3. TSX:ACB (Aurora Cannabis)
4. TSX:WEED (Canopy Growth)

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