Is it Time to Buy Marijuana Stocks Like Canopy Growth Corp (TSX:WEED)?

Description

Canopy Growth (TSX:WEED)(NYSE:CGC) is currently trading back at levels last seen in August, which, in isolation, is nothing to write about. But if we consider that the stock is down 43% since mid-October highs, the volatility behind this stock becomes clear.

What's changing here?

Well, it all comes down to expectations, sentiment, and multiples. This is why I have not been focusing on the fundamentals of these marijuana stocks. When a stock is trading on sentiment, as these stocks have been doing, this is what matters and will matter in the short term, at least.

So, right now, investors are hopefully adjusting from a euphoric state to a more realistic, down-to-earth state, where price paid for a stock matters.

"The act of surrendering"

At this point in time, capitulation, or "the act of surrendering," is the point that investors must come to before a sustained rally in these stocks can be realized. Before I can even think about piling into marijuana stocks, I will look for signs that this has happened — signs that the market understands that we need to temper our expectations and consider risks as well as opportunities, and that we can't pay "infinity" for any stock.

But a bubble doesn't burst in a day, or a week, or even a month. It takes time.

Technicals breaking down

Yes, marijuana stocks are rallying at the time of writing, but can this be sustained?

Canopy Growth stock price decisively broke through its 50-day moving average and is hovering above its 200-day moving average, testing it.

Aurora Cannabis's (TSX:ACB)(NYSE:ACB) stock price broke through both its 50-day and 200-day moving averages, as it has given up almost half its value since October highs.

Aphria's (TSX:APH) stock price has also broken through both its 50-day and 200-day moving averages.

I don't really make it a habit to look at technicals, but it is useful here, as marijuana stock prices have been disconnected from fundamentals.

Speaking of fundamentals, the marijuana industry is still an industry that is essentially at its infancy, so we must bear in mind that market conditions and companies involved in it are all subject to heightened risk.

At this point in time, consensus analyst estimates need to be taken with a grain of salt, but for Canopy stock, they are for a loss of $0.34 in 2019 and EPS of $0.28 in 2020.

The company will need to invest dollars into its growth plan, which will eat away at earnings and profitability, and we are already pricing the stock at these levels which translate into almost 200 times earnings.

Aurora Cannabis and Aphria have had a very busy year of acquisitions and expansion at a cost to current shareholders, as this growth was largely funded by issuing shares, bringing on significant dilution.

In fact, we have seen industry-wide dilution, we are still seeing volatile and overvalued stocks, and we can expect to see continued big spending on growth.

So, after the carnage in marijuana stock prices, is this the best time to jump in?

Not yet.

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