Marijuana Investors: You Gotta Check Out This ETF

Description

Earnings season has not been kind to some of Canada's major marijuana stocks.

Canopy Growth Corporation (TSX:WEED) announced its earnings on Wednesday for the quarter that included the big legalization day in Canada. Results were disappointing because the company spent more than anticipated on marketing, among other factors.

Shares sank some 12% during Wednesday's trading, causing the stock to fall to levels not seen since August.

This highlights one of the big risks pot investors have to face. Just one piece of bad news can send shares reeling. A 10% decline in just a day or two is a common occurrence in the industry. These stocks really are that volatile.

There's one way for investors to at least minimize the crazy swings up and down while still getting access to the sector. This method also allows for greater diversification, which reduces the risk of one rogue company scuttling your whole portfolio. Yes, I'm talking about owning an ETF.

Here's why pot investors should swap out their individual company holdings for the **Horizons Life Sciences Marijuana ETF** (TSX:HMMJ).

A basket of pot stocks

The whole point of an ETF is to provide instant diversification at a reasonable price. The Horizons Marijuana ETF delivers just that.

The ETF has approximately 50 different holdings, ranging from the top companies in the sector to small players that trade on the **TSX Venture Exchange.** Approximately 50% of assets are invested in the top five companies. It seeks to replicate the **North American Marijuana Index**, which has 62 different holdings.

We can immediately see the positive impact the additional diversification brings. The ETF is only fell by about 6% during Wednesday's trading, despite owning a heavy Canopy Growth position. Yes, 6% is still a big drop, but the ETF did its job; it protected investor capital.

One potential disadvantage is the fund's management fee, which currently stands at 0.75%. That's a little aggressive, especially considering management fees of the most popular ETFs are closer to 0.10%. The average sector ETF has a management fee in the 0.5% range.

Overall a 0.75% management fee isn't that bad. If you had $1,000 invested in the fund, it would charge you $7.50 in annual fees. I think most investors can live with that.

A different perspective

Many investors are turned off at the marijuana sector because of excessively high valuations. Some of the leading pot companies trade at 100 times sales, for instance: no, not earnings. *Sales.*

This ETF has holdings some much more reasonably priced stocks. It has a large position in **Scott's Miracle-Gro**, for instance, which trades under 20 times forward earnings. It also has a smaller position in **Village Farms**, a reasonably-valued produce grower that's in the process of switching to marijuana.

The majority of the fund is still in stocks with valuations that would make a value investor blush, but it's nice to see a little diversification into mature companies with actual earnings.

Dividends

Yes, this ETF returns capital to shareholders periodically.

Through the first three quarters of 2018, 71.4 cents per unit has been returned to shareholders. This gives this ETF a yield in the 4-5% range, depending on what happens with the end of the year distribution.

The bottom line

I'd caution investors against trying to pick and choose one or two pot stocks, as we're only in the early innings of the marijuana boom here. Nobody really knows who'll end up winning. By spreading your bets, you'll ensure that you own at least a small part of the winners.

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