Is the Cannabis Bubble Finally About to Burst?

Description

The sentiment that cannabis stocks have reached "bubble-territory" are "wildly overvalued," or "due for a major correction" would be at this point anything but a novel concept.

As a matter of fact, many skeptics have been saying exactly these things for what seems like forever.

Circumstances in the cannabis industry have begun to catch up to themselves, which could lead to a sharp downturn in valuations for legal cannabis producers.

All good things must come to an end

Even if a disastrous collapse in the valuation of cannabis stocks isn't the outcome that eventually befalls the industry and its investors, there's still very good reason to believe that incredible momentum that has been enjoyed by cannabis companies and their shareholders over the past two or so years simply can't be sustained for much longer.

Take Canada's largest cannabis producer by market capitalization, **Canopy** ([TSX:WEED](#))(NYSE:CGC), for example. At present, Canopy is trading at a valuation just north of $20 billion.

Most experts agree that the size of Canada's legal cannabis market will end up somewhere near $6-8 billion annually — comparable to the size of this country's beer market, which would suggest that Canopy is being valued at nearly three times the size of the entire domestic market.

There is the possibility that Canadian licensed producers will be able to tap into emergent export markets like Germany, Australia, Israel, and perhaps one day the United States. But there is still a lot that needs to be decided in these cases, and there is certainly reason to believe that beyond the likelihood that cannabis imports will end up being a tightly controlled and highly regulated export market, these governments may be more than a little wary to allow foreign-controlled mind-altering substances to cross into their borders.

Momentum in cannabis stocks appears to be waning

It's more than just "rich" valuations that suggest perhaps an overly optimistic outcome for the majority of Canada's licensed cannabis producers; there are also some more technical signs that the supply and demand for cannabis stocks may be falling out of balance as of late.

Sticking with the example of Canopy, its shares have gained 64% since the start of 2017, which, obviously, is no small feat.

However, despite that impressive surge, in recent trading WEED stock has failed to surpass its previous all-time high of $74 from October 15, which, by the way, is not such a coincidence that it occurred just two days prior to the day recreational pot officially became legal in Canada.

Buy the rumour, sell the news?

The time-honoured strategy of "buying the rumour and selling the news" may not make a lot of intuitive sense, but it's a pattern that has persisted in the markets for about as long as they've been around.

Not only has the price of WEED stock failed to make fresh new highs this year, but technical supply and demand indicators are also suggesting that the shares be on the verge of further declines.

Canopy stock, not to mention shares in **Aurora**, **Aphria**, and even the cannabis-focused ETF **HORIZNS MARIJUNA** have all begun to see investor confidence begin to fade since legalization last October.

Bottom line

With more countries adopting a more liberal stance towards marijuana legalization, including now more than 21 countries where the drug has obtained official legal status, I'm still remaining bullish on the industry's long-term prospects.

But I think that, on the heels of such a historic surge in investor confidence over the last couple of years, cannabis stocks as whole might find that they're about to experience a minor comedown before this story resumes its course.

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Date
2025/07/21
Date Created
2019/02/16
Author
jphillips

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