



Warning: 3 Things All Cannabis Investors Should Be Aware of

Description

The idea of high-return investments is intriguing to all investors. The cannabis sector is a perfect example. Fortunes have been made in the industry, but now that legalization has come and gone, are there any opportunities left in the space?

Horizons Marijuana Life Sciences Index ETF ([TSX:HMMJ](#)) is the ideal way for investors to gain exposure to the cannabis industry without taking on specific business and execution risk. The fund consists of all the top companies in the marijuana space and is just over two years old.

It is of fair size with a net asset value just under \$1 billion. While the ETF will still be exposed to the industry risk, it's a good option for investors, as it is more stable than owning some of the individual stocks. Before investing in the space, though, it is important to consider these three important factors.

Marijuana is a commodity

Although the industry may be recently legalized, it's important to understand that in general it is a pretty mature industry. The black market has been serving the demand for years. Since legalization, it's been reported that cannabis use has increased; however, the numbers are negligible. This suggests that the majority of demand comes from existing users.

Cannabis products are mostly commodities, as there is very little differentiation between products. Since most of the more frequent users are also existing users, these consumers are more likely to value price as their main concern.

Pricing issues

The main issue that is currently plaguing the industry is pricing. The legal cannabis industry has product-quality requirements the black market doesn't have. This naturally increases costs in the legal industry. Additionally, issues with supply have also been pushing costs up. The national average suggests legal cannabis is almost 57% higher than black market cannabis.

Considering that most illegal prices haven't changed, it is no wonder that existing consumers aren't willing to pay an almost 60% markup for the same cannabis they were buying prior to legalization. This has been a continuous problem, as consumers seem to be very price sensitive.

Going forward, as evidenced by data out of numerous American states, as other problems sort themselves out and the legal industry evolves, prices will begin to decline. This will manifest even more competitiveness in the industry as producers fight to produce the lowest-cost products.

Supply and demand

The supply issue story has also been highly talked about. A lack of supply when cannabis was first legalized caused a lot of problems for the legal market. Ontario, for example, had to limit its number of retail stores to just 25 for the entire province. Quebec has had to change its store hours to only open four days a week. A private retailer in Newfoundland even had to close its doors because of the lack of supply.

Undersupply may seem like a relatively easy problem to fix. Producers have been ramping up production to meet this undersupply; however, the undersupply issue could soon switch to the problem of oversupply.

At the moment, the total output production of the top 13 licensed producers (LPs) totals around two million kg of cannabis each year. Currently, Health Canada estimates that demand for cannabis both recreational and medical is 926,000 kg a year. This implies that just the top 13 LPs growing at maximum capacity would produce more than two times estimated demand, and that doesn't even account for black market supply.

The bottom line

Due to the highly competitive market and growing pains the legal industry is going through, an investment today in the cannabis space is not worth the risk to reward. Although, if investors are keen to [gain some exposure](#) to the industry, a small position in the ETF would be the best way to play it.

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