



## Why Marijuana Stocks Will Trigger the Next Recession

### Description

The recession of 2008/2009 was arguably the worst economic crisis since The Great Depression in 1929. I recently [wrote an article that predicted](#) Canopy Growth is worth only \$14.13 a share and from the time of writing, the stock has declined 17% to \$36.75.

My next prediction is that marijuana stocks will be the trigger to the next recession. With the subprime mortgage crisis, the market valuation of the subprime mortgage industry was much higher than its actual value. This is similar to the marijuana industry, where companies are grossly overvalued.

Canopy Growth recently reported a net loss of \$1.3 billion for Q2 2019. The company lost more money in Q2 2019 than Grenada made in GDP for an entire year yet its market capitalization is \$12 billion.

Marijuana stocks will trigger the next recession based on two factors: the fact the industry is grossly overvalued and the exposure of financial institutions to marijuana stocks.

### Grossly overvalued industry

The *Financial Post* wrote an article recently that pegs the value of the marijuana industry at \$5 billion by 2021. Assuming that Canopy Growth is the only marijuana company in existence (which is obviously not the case), its \$12 billion market capitalization makes it overvalued by 150%.

Unfortunately for investors, companies such as **Aurora Cannabis**, **Aphria** and **Cronos** have equally ludicrous values which mean that there will likely be a major correction in marijuana stock prices.

Another parallel between the 2008 recession and the current marijuana bubble is the fact that investors are overpaying. Subprime mortgages had inherently more risk because the borrowers taking on these mortgages had poor credit histories.

Thus, there were underlying weaknesses in the subprime mortgage industry which meant that it was being traded at multiples much higher than what it was worth.

The marijuana industry is also facing this issue with many companies reporting net losses despite having valuations in the billions of dollars.

As I had mentioned above, Canopy Growth lost \$1.3 billion in Q2 2019, yet it is still valued at \$12 billion, which means that there is a fundamental issue with the industry as a whole, similar to the subprime mortgage industry.

## Financial institution exposure

This is arguably the scariest feature of the marijuana industry. During the subprime mortgage crisis, the reason American banks were hit so hard is that all had massive exposure to subprime mortgages by trading with each other.

When borrowers started to default on their mortgage payments, [which drove down house prices](#) and led to more defaults, the banks held so much of each other's subprime mortgages that it created a domino effect. This subsequently led to the bankruptcy of Lehman Brothers and the bailout of financial institutions by the federal government.

As Canadian financial institutions become more comfortable with the marijuana industry, it exposes these companies to default risk. Take loans for example. If a marijuana company wanted to get a loan, it would need the services of a corporate bank such as TD Securities or RBC Capital Markets.

When these banks take on a client, they sometimes form a syndicate. This is where troubles can arise, as multiple financial institutions would be exposed to a marijuana company; in the event of a default, the effect will be widespread.

Now imagine several companies defaulting on payments; it's not a pretty picture.

## Bottom line

In my opinion, the marijuana industry is grossly overvalued.

There are many parallels between the 2008 subprime mortgage crisis and the current marijuana industry in Canada, which means that the likelihood of marijuana stocks triggering the next recession are high.

As financial institutions become more comfortable with the marijuana industry and exposing more transactions, defaults in payments could very well be the straw that broke recession's back.

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### TICKERS GLOBAL

1. NASDAQ:ACB (Aurora Cannabis)
2. TSX:CRON (Cronos Group)
3. TSX:WEED (Canopy Growth)

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