Cannabis Stocks Are Down: Here's Why That's Great for ETF Investors

Description

It seems the excitement over marijuana stocks is finally subsiding.

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Canopy Growth, still the largest marijuana company in the world, has lost 55% of its value since early May this year. Its closest rivals, **Aurora Cannabis** and **Cronos Group** have both lost 50% and 47.2%, respectively, over the same period. Year to date, nearly every listed marijuana stock has lost market value.

Legal issues at **CannTrust Holdings** and the ouster of Canopy's founder severely dented the industry's appeal for investors. Meanwhile, the rollout of legal cannabis and explosive growth in the industry hasn't been as smooth as some may have expected. As optimism turned to suspicion and anxiety this year, investors ran for the exits.

Now it seems the pendulum of investor sentiment could be swinging to the other extreme. Canopy's current market value, for example, is just three times the estimated worth of its cash and cash equivalents at the end of the last quarter. Meanwhile, cash represents 58% of Cronos Group's current stock price.

Besides cash, both Canopy and Cronos are backed by handsomely profitable mega-corporations with significant stakes in the businesses. This improves their chances of surviving this storm and gaining market share as smaller, underfunded rivals fall apart and the market consolidates.

Let's not forget that the global medical and recreational marijuana industry is still worth an estimated US$200 billion. Australia's capital city Canberra legalized marijuana last month, Mexico is exploring the same, and the U.S. recently passed the *SAFE (Secure and Fair Enforcement) Banking Act of 2019,* which brings marijuana legalization at a federal level one step closer.

As the world moves toward legalization, some corporate winners have to emerge and spearhead the industry. Picking this eventual winner isn't easy, but Canadian investors don't have to. Instead, betting on an exchange-traded fund with exposure to the industry's largest companies seems far more practical.

Horizons Medical Marijuana Life Sci ETF (TSX:HMMJ) is probably your best bet for such exposure. There are two key reasons why I believe this ETF is a better bet than any of its individual holdings.

Diversification

HMMJ's portfolio currently consists of 63 stocks that are all exposed to the nascent legal marijuana sector. The largest holding, Canopy Growth, contributes only 10.4% of the total portfolio. Meanwhile, the portfolio is re-balanced every quarter to account for changes in market value of the underlying companies.

In other words, individual marijuana producers failing or contracting will have minimal impact on the overall portfolio so long as the broader industry keeps expanding.

Income

Another surprising reason HMMJ stands out is its hefty dividend yield. Despite the fact that nearly all the listed marijuana producers are losing money, HMMJ offers a forward dividend yield of over 8%.

The company manages this through a savvy maneuver — lending out its holdings to option traders. Traders placing short-term bullish or bearish bets against individual marijuana companies must pay interest on the stocks they borrow. Because the sector is relatively illiquid and highly volatile, the interest rate on borrowing marijuana stocks is higher than average.

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Foolish takeaway

Investment legend John Bogle once said that investors should stop looking for a needle in the haystack when they can simply buy the whole haystack and reap the rewards. In the unpredictable and unconventional legal marijuana sector, HMMJ could be the ideal haystack for long-term passive investors.

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