Long-Term Investors: Should You Buy Tanking Cannabis Stocks?

Description

HEXO (TSX:HEXO)(NYSE:HEXO) was looking like a stock to buy on weakness Thursday morning after a management reshuffle — and then the situation got a whole lot worse. Is the cannabis company now a falling knife after not just a big shakeup in its management but also the shock withdrawal of its earnings outlook? Having ditched 33.76% over the last five days, it's starting to look that way.

Horizons Marijuana Life Sciences ETF is down 14% for the week in a clear indication of a cannabis bear market, while **Canopy Growth** (TSX:WEED)(NYSE:CGC) is down 12%, as the sector seems to be re-evaluating itself ahead of Cannabis 2.0. The cause of the mass dump of Canopy shares was fairly self-explanatory: The company had announced that it had named as its new chairman the CFO of **Constellation Brands**, David Klein.

Investors may be seeing this move as something of a corporate clampdown in a sector where profitability is king. Indeed, it's been quite the week for corporate maneuvers, with HEXO causing its own sell-off by withdrawing its earnings outlook along with a grim summation of the cannabis market that makes for sober reading.

HEXO's statement was decidedly bearish on the industry: "Slower-than-expected store rollouts, a delay in government approval for cannabis derivative products, and early signs of pricing pressure are being felt nationally." It added that "The delay in retail store openings in our major markets has meant that the access to a majority of the target customers has been limited."

Is the cannabis sector a contrarian wonderland?

One way to play the cannabis space when it's tanking is to back up the truck and hold onto affected stocks until they eventually recover. While this has its risks, if an investor can identify which companies exhibit the healthiest balance sheets, the canniest business models, and the clearest and most stable paths to profitability, then the sector could be a contrarian's candy store right now full of cheap, quality stocks.

Indeed, quality plays on weakness can still make cannabis a key part of a Canadian stock portfolio built around capital appreciation. As the old saying goes, the bleeding has to stop eventually. However, investors may also want to consider low-exposure routes to the cannabis space, such as **Shopify** — a potentially gravity-defying growth stock with in-built diversification across retail sectors, especially if its financial horizons are broad.

Compare cannabis with precision farming, renewable energy, and the nearly infinite potential of space commerce. Legal cannabis, by comparison with these industries that will likely dominate the future of the TSX, is perhaps no more a long-range play for growth than investing in alcohol, tobacco, or non-novel pharma stocks might be. While marijuana is a strong momentum play for the near future, it's arguably not an extreme long play.

The bottom line

HEXO's vulnerability to an uncertain market has offered a stark reminder that cannabis upside, while substantial, may be limited. Since consumer demand in any new industry is limited by eventual saturation, the overcrowded cannabis space is perhaps not stable enough in its current state for the long-range growth investor.

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