



Growth Investors: What to Do Before Bubbles Burst

Description

For more than a year, several Foolish writers (including me) have been advocating caution when it comes to cannabis stocks. The height of enthusiasm back in the summer and fall of 2018 has subsided substantially, with many stocks down more than 50% from their highs.

A little over a year ago, I began promoting the need to halve certain positions that had accelerated to enormous heights. Valuations became stretched, as the companies' stocks appeared to climb without end, regardless of their non-existent earnings. At this point, I began to promote the strategy of halving your position with each double.

I would rarely recommend selling everything, even if that might have been the best course of action in hindsight. Take **Canopy Growth** ([TSX:WEED](#))(NYSE:CGC), for example. I first recommended selling half the stock at a share price of about \$40 a share when the company hit that level for the first time.

If you had sold everything at that point, you would have missed out on the ride, as the stock continued to accelerate above \$70 a share. You would have regretted your decision and very likely would have stepped back into the stock at a higher level.

By selling half, you get the comfort, thanks to the benefits of a mental bias known as mental accounting, to get your original investment back and then "play with the house's money," in gambling terms.

Should you get in now?

Honestly, the fact that these companies have yet to make any real money to justify their valuations makes it very difficult to pull the trigger on buying shares. Even at these much lower share prices, it is hard to imagine that they command the valuations they currently represent.

The one great thing I can argue about these companies is the fact that they have frequently sold one of their most valuable assets: their shares. When these companies were at sky-high valuations, they made a wise choice by issuing shares to get cash. Of course, this diluted the shareholders, but it was a good way for the company to make money by selling its overpriced assets.

Canopy Growth had a massive net loss in its June results, another in a long line of negative earnings. Much of it was due to capital spending, which could be argued as an important mechanism to drive future growth, but all the same, it would be nice to see the company making money.

It's not all bad

I am not a fan of many of these growth stocks, especially cannabis stocks, due to the fact that they do not make any real [amounts of money](#). Nevertheless, there are some positive attributes that could be attractive in the future.

Canopy, for one, has a lot of cash on the balance sheet and relatively little debt. This should help to cushion the blow and even eventually put a floor under the shares. It also has the government at its back trying to stop its biggest competitor: black-market producers. If the government is able to get the basement operations to stop, legitimate operators like Canopy might be better able to make money.

The bottom line

It is very difficult, impossible even, to pick the top on any individual growth stock. The best you can do is get [your money back](#) as quickly as possible. This is doubly true if these growth stocks, as was the case for Canopy and others, do not actually make any money. Stocks can go up quickly on dreams and rainbows, but watch out if the dreams die and the rainbows fade away.

I use gambling analogies to discuss these stocks frequently because buying growth stocks is very much akin to gambling. This is doubly true when the companies do not have earnings or dividends to support share appreciation. Use effective mitigation strategies, like getting your money back quick, and you will be able to weather growth stock storms.

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1. Cannabis Stocks
2. Investing

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1. Cannabis

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Date

2025/08/22

Date Created

2019/10/27

Author

krisknutson

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