



Horizons Marijuana ETF (TSX:HMMJ): Best Way to Bet on a Cannabis Rebound?

Description

Cannabis stocks have had a rough year. Investors in the sector have collectively lost billions of dollars, while the stocks are trading at their lowest valuations since 2017. Market sentiment has turned decisively pessimistic, which makes the sector fertile ground for contrarian investors.

Value-oriented investors probably understand that the top players in this sector are gearing up for a better year ahead. The roll-out of Cannabis 2.0 products, the relaxation of licensing rules in Ontario, along with ongoing involvement of major established corporations like **Constellation Brands** and **Altria**, all indicate that the market could bounce back in 2020.

However, I still believe it is way too risky to bet on any individual stock in this sector. Even the largest marijuana producers could face cash flow issues or debt-repayment problems that could drag them down, while the rest of the sector recovers and snatches away their market share. It's simply too difficult to pick stocks with conviction here.

Instead, I believe investors should take a pragmatic approach and invest in the broader market through an exchange-traded fund (ETF) like **Horizons Marijuana Life Sciences ETF (TSX:HMMJ)**. Here are three reasons why betting on this ETF is better than trying to pick winners or losers in the [Canadian marijuana sector in 2020](#).

Diversification

The most obvious benefit of investing in an ETF rather than stock picking is the way risk is mitigated through diversification. HMMJ owns a stake in the top 55 publicly listed marijuana stocks. The exposure to these holdings is weighted by market capitalization, which means the industry leaders account for the biggest portion of the overall portfolio.

This level of diversification also means that the downside is limited when any one company fails. **CannTrust**, for example, was a larger part of the portfolio at the start of 2019 but now accounts for a smaller fraction since its stock price plummeted. Meanwhile, the larger stocks that performed relatively better offset the losers.

This makes the HMMJ ETF a barometre for the entire industry. In other words, it's a bet on consumer demand for marijuana rather than the success of any individual company.

Steady income

Another reason HMMJ is an ideal bet is the fact that it offers a dividend to shareholders. Admittedly, it's surprising that a portfolio of money-losing companies pays a dividend, yet that seems to be the case. In fact, the trailing dividend yield is impressively high at 12.4%.

Here's the secret: HMMJ isn't paying a dividend from the profits of its underlying stocks. Instead, the ETF management company generates income *by lending the stocks to short-sellers and daily traders*. The interest earned on this short-selling activity is passed onto investors in the form of dividends.

In other words, HMMJ benefits from the market collapse as well.

Fair value

Like any other ETF, HMMJ's market price is usually misaligned with the net value of its underlying holdings. Generally, the ETF has traded at a discount to net asset value (NAV). However, at the moment it is trading at par with NAV.

In other words, the ETF is fairly valued. However, you could wait for another discount to emerge to add exposure if you're feeling adventurous.

CATEGORY

1. Cannabis Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:MO (Altria Group, Inc.)
2. NYSE:STZ (Constellation Brands Inc.)
3. TSX:HMMJ (Horizons Marijuana Life Sciences Index ETF)

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Date

2025/08/16

Date Created

2020/01/12

Author

vraisinghani

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