Gold and Cannabis: Trading Strategies in the Coming Months

Description

As we continue on in the 11th year of economic expansion since the financial crisis, many investors (myself included) believe we may be headed toward difficult times in the next 12-24 months. If the market continues to roll along, I will be dead wrong, but the long-gold, short-cannabis trade is one that I think represents shifting sentiments in the markets. I think this trade will continue to perform well over the next 12-24 months.

Gold is perhaps the oldest hedge to anything based in flat currency. Gold represents a stable store of value and is global in nature. During the last financial crisis, the Federal Reserve in the U.S. printed a tonne of money via quantitative easing and pumped this liquidity into financial markets. The result was a devalued U.S. dollar. Since it would take more U.S. dollars to buy an ounce of gold with a weaker dollar (gold prices are based in U.S. dollars), the price of gold soared. Therefore, gold is an excellent hedge of overall market weakness. Gold is also an excellent hedge for U.S. dollar depreciation. This is important if you have a significant portion of your assets dominated in U.S. dollars.

I believe this economic expansion is getting long in the tooth. Therefore, I think gold still looks cheap, despite its slow and steady rise in recent years. I'd suggest investors look to one of the various gold exchange-traded funds (ETFs) or a large gold producer like **Barrick Gold** for exposure. The fact that the cannabis sector has been so weak over the past 12 months is indicative to me of the aforementioned shifting sentiment. This fuels my belief that we are nearing the end of this expansion. The key reason I believe this trend is likely to continue is poor supply-and-demand fundamentals in the cannabis sector. I'll use the example of the largest Canadian cannabis producer **Canopy Growth** (TSX:WEED)(NYSE:CGC).

Canopy Growth

Currently, Canopy Growth has approximately 20% of legal cannabis sales in Canada. This company also produces enough legal pot to service 50% of Canadian demand. This is based on the most recent financial statements released, indicating Canopy produced 183 tonnes of cannabis but only sold 70 tonnes. The fact that Canopy has enough weed on hand and in its production pipeline to last two-and-a-half years means the company is going to have to make some difficult decisions. These could include whether to destroy the product, cut its price drastically to sell inventory, cut jobs, incur writedowns, and/or close down production facilities.

With **Constellation Brands** having a massive stake in Canopy, I expect to see some serious cost-containment initiatives put in place in the coming quarters. This is a trend I expect will reverberate across the entire sector, as these supply-and-demand problems are not exclusive to Canopy.

Bottom line

When we start to see serious divestitures, plant closures, layoffs, and writedowns (it's only just begun), the reality will set in for many cannabis bulls that this is no longer an industry you want to be in. Invest in gold instead. This is what the market is saying after all, loud and clear.

Stay Foolish, my friends.

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3. Gold
4. recession

TICKERS GLOBAL

1. NASDAQ:CGC (Canopy Growth)
2. TSX:WEED (Canopy Growth)

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