



Will Cannabis Stocks Prove Defensive in a COVID-19-Induced Recession?

Description

Cannabis stocks took a beating during a coronavirus-induced market crash that deepened in March amid heightened and legitimate investor fears of a near-term economic recession. My prior proposition was that the marijuana industry could prove resilient during economic down turns. [Will cannabis stocks prove defensive?](#)

Cannabis-resilient... like alcohol?

Beer and alcohol demand usually remains strong during economic downturns, which makes sense. People drink a lot when merry making, in celebration of the good times. They also indulge to drown their sorrows and forget their problems during the bad times.

The same narrative was extended to the nascent marijuana industry in [my October 2019 article](#). Cannabis provides a competing offering to alcohol in the form of high potency tetrahydrocannabinol (THC).

THC is the principal psychoactive cannabinoid in marijuana and its demand patterns could naturally follow those of beer and alcohol.

I'm not very concerned about medical cannabis sales, however. Pharmaceutical products' demand usually remains stable during recessions. But recreational pot is likely more exposed to demand swings during the coronavirus pandemic.

High potency attracts high demand

It's safe to say that recreational marijuana sales are highly skewed toward high potency psychoactive strains today. Cannabis strains high in THC sold better last year, prompting some management teams to shift more production spaces towards such strains.

The big question is: Will demand for high potency pot remain strong during the coming recession?

Sales could reflect alcohol traits if consumers increasingly want to pull a smoke during these stressful times.

Will cannabis stocks prove defensive in coronavirus times?

The Ontario government declared cannabis retail stores and licensed producers as essential workplaces on March 23, 2020. These essential workplaces will remain open as the COVID-19 forced business shutdowns across the province. This nascent industry has power enough to remain operational during crises.

The pot industry may continue growing its revenue base during the downturn, albeit at a slow pace.

Further, new products like edibles and vapes could drive new sales growth numbers this year. The newly legalized marijuana edibles market presents a new growth frontier even during the ongoing market crash.

But I'm concerned about the wartime nature of the coming recession.

Challenges to the defensive thesis

A coronavirus induced economic collapse in 2020 would be different from the great recession of 2008-09. In the previous recession, citizens lost incomes, but they still had freedom of movement and social interaction.

This time, a pandemic threatens us with empty streets and deserted shopping malls. It has decimated global supply chains and forced workers to work from home, shaking up both economic demand and supply.

Online marijuana stores remain open, which is good. But consumers may not be so eager to visit retail stores for daily purchases during the coronavirus outbreak.

Analysts and corporate managers in the cannabis space acknowledged the inadequacy of the online and physical retail networks in Canada to serve the consumer market. That was during normal economic times without any logistical nightmares.

Limited distribution networks may increasingly disappoint if the target consumer wants to avoid unnecessary travel during community lockdowns. The fact that some retail stores operators like **Fire & Flower** are limiting store time for patrons could also result in lost sales.

It's reasonable to expect that pot consumers want to buy from the nearest retail outlet in their neighbourhoods to limit travel during community lockdowns. Fewer and far between legal retail stores may not fare any better against illegal pot runners.

Moreover, marijuana regulars enjoy the sharing of joints; it's part of their culture. They aren't free to do

that anymore during the COVID-19 pandemic. This takes away consumption pleasure and camaraderie. Perhaps consumption appetite might suffer too.

Foolish bottom line

Marijuana industry firms have yet to be tested against recessions. We're waiting to see if they will pass the initial defensive industry test in Canada.

That said, the yet-to-confirmed recession has come at a time when firms' balance sheets are weakest, when they still needed financial support from the capital markets. Bankruptcies may happen earlier before the defensive test results come out over the next six to nine months.

Extra caution is therefore needed when picking potential recession-proof names in this industry.

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brianparadza

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