



Why Cannabis Investors Should Avoid ETFs Right Now

Description

Investors looking to put some money to work in the cannabis sector may be considering buying an exchange-traded fund (ETF) to do so. By spreading one's bets across a number of different companies, the thought is that investors are able to gain diversification and maximize returns.

In this context, **Horizons Medical Marijuana Life Sciences ETF** ([TSX:HMMJ](#)) is a top choice for Canadian investors right now.

I'm going to discuss why I think investing in an ETF is not a good approach right now. Furthermore, I believe a targeted approach to the cannabis sector will ultimately win the day.

Quality far from uniform in this sector

Diversification is generally a good thing. Investors get access to a broad group of companies and (hopefully) maximize their risk-adjusted returns over time.

Unfortunately, I think the cannabis sector is one which is problematic right now in that I see real potential in only a few names. Of these, I've been [pounding the table](#) on **Curaleaf** (TSXV:CURA) of late as the best way to play the cannabis space. I think Curaleaf has a real shot at capitalizing on U.S. legalization, as opposed to its peers. This is a fully integrated business model that is well developed from coast to coast in the United States. There's really no comparison on the TSX right now.

As such, every other company appears to me to be overvalued and of worse quality right now. When you like one stock in a sector and don't really like the other options, over-diversifying with an ETF could lower one's long-term returns, if one is right about that particular company being the best in its class.

Risks in this sector remain elevated

Every cannabis company is trading at an astronomically high valuation multiple right now. With so much growth priced into these stocks, I find it hard to believe the entire sector will be able to meet

these targets. Rather, I believe a handful of companies will ultimately win out. The rest are likely to be acquired or perish.

Thus, I think there's a tremendous amount of value in picking stocks correctly in this sector. That goes for any sector, for that matter. I think investors seeking diversification as a risk-management tool could actually be shooting themselves in the foot. Indeed, a targeted approach to the cannabis sector seems more prudent to me.

Finally, HMMJ has a very high management expense ratio (annual fee). Investors pay 0.75% to own this basket of companies. That's just far too high of a fee and eats away at one's long-term returns. If there ever was a sector in which stock picking should outperform, cannabis is it.

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1. Cannabis Stocks
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TICKERS GLOBAL

1. CNSX:CURA (Curaleaf Holdings, Inc.)
2. TSX:HMMJ (Horizons Marijuana Life Sciences Index ETF)

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