Can Cannabis Give Your Portfolio a High

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Over the last couple of weeks we have noticed renewed interest in the Cannabis space. Much of this was triggered by Constellation Brands Inc. (STZ) disclosing on October 30th that the company was taking a 9.9% stake in Canopy Growth Corp. (WEED), who is widely regarded as a leader in medicinal and recreational sales of cannabis products. This was one of the first examples of a major company taking significant financial action to gain exposure to the space, and this type of interest from larger and more well-known companies can go a long way towards legitimizing the industry in the eyes of many investors who have remained skeptical up until this point.

Since the announcement, Canopy Growth Corp. (WEED) shares are up approximately 35% as of the time of this writing, and many other smaller names are up sharply as well. In our view, the industry as a whole is pricing in very favourable results from the legislative process currently in progress to legalize and regulate the recreational sale and use of cannabis products. As is often the case with these processes, there remains a fair amount of uncertainty surrounding production regulation, taxation, and distribution of cannabis products. Our concern is that any unanticipated negative developments coming to light over the next few months could have drastic consequences for these stocks, given their current valuations. We are always very wary of investing in companies which are too closely tied to decisions being made by governments or other regulatory bodies.

One potential opportunity we are anticipating is eventual consolidation occurring within the industry. Building the types of facilities needed for cannabis production is both time consuming and expensive, and once there is additional clarity on various supply and demand factors, we think it is likely that smaller players with production facilities in operation or under construction may become acquisition targets for major players looking to rapidly increase their production capacities. Despite all of our current misgivings about the near-term risks in the industry, it will remain an area we pay close attention to in search of potential opportunities.

Sincerely,
Di Iorio Family Wealth