

Investing in cannabis

The world's first pot-focused exchange-traded fund

Investors can gain exposure to a budding industry, set to profit from Canadian legalisation



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THE launch of the world's first cannabis-focused exchange-traded fund (ETF), on the Toronto Stock Exchange on April 5th, is welcome news to aficionados of marijuana. As with any ETF, the fund spares would-be investors the need to pick out their own favourite stocks, or indeed weed out dodgy ones, as it will simply replicate and track an index, in this case the North American Medical Marijuana Index.

The fund's home in Canada is no accident. Medical marijuana has been legal there since 2001, with growing and selling outsourced to licensed firms since 2013. (Justin Trudeau's administration has also announced plans to legalise recreational use by 2018.) In America, despite state-level legalisation, marijuana is still illegal under federal law, making it nigh-impossible for pot firms to even access the banking system, let alone seek a proper public listing.

As a result, the index itself ends up having a strong Canadian bent. Eleven of its 16 companies are based there, and all but three are licensed suppliers of medical marijuana in Canada, though a few also have American operations. Three of the others are American, though none of them deal directly with marijuana as such: one, Scotts Miracle-Gro, makes hydroponic systems popular among pot-growers, and two others make pharmaceuticals out of synthetic cannabinoids. (A British drug company listed in America and a Canadian-listed Uruguayan firm round out the list.)

Investors are likely to be attracted to the industry's mouth-watering returns. Shares in Toronto-based Aphria, the largest constituent of the index, are up by 89% in the last six months. Alberta-based Aurora Cannabis, the second-largest component of the index, are up by 50% in the same period. But this ETF is a highly concentrated bet on a very small sector. Many of these shares are very thinly traded, meaning that the prices of the underlying constituents of the ETF will move much more than is typical. Moreover, the ETF's exposure to America makes it vulnerable not just to exchange-rate risk, but also to the real possibility of a harsh crackdown by the new, dope-decrying attorney-general, Jeff Sessions.

The most important factor driving dreamy valuations of Canadian cannabis companies is the imminence of full legalisation, and the ensuing expectation of a vastly larger market. This means that companies in the sector are currently "trading like speculative tech stocks", says Khurram Malik of Jacob Capital Management, based on sometimes rosy projections of future recreational sales. Although the rest of 2017 may see further share-price rises, Mr Malik reckons 2018 will bring a market correction as actual hard figures show which companies are succeeding better than others. Investors in the sector should not expect a smooth roll, but a rough grind.