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SPECIALREPORT

Financial Planning and investing

HAZE OVER POT MARKET

Don’t invest in cannabis space now, advisers say

BY GINO FANELLI

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Advisers say investing in cannabis business too risky right now

No doubt there's money to be made but pitfalls are prominent

By GINO FANELLI

Quite a few people are going to make a lot of money in the legal marijuana market.

In fact, quite a few people already have made a lot of money in the legal marijuana market. Hamilton, Ontario's Canopy Growth Corp. posted a quarter-over-quarter growth of 250 percent in the quarter ending Dec. 31, with a share price of $43.37 on March 29. That about doubles where the company stood last year preceding a $4 billion investment by Victor-based Constellation Brands in August.

Canopy was far and away the largest grower in that quarter, while Tilray Inc., a cannabis and pharmaceutical company based in Nanaimo, British Columbia, leads the pack in market value at $63.94 as of April 2. And those numbers are likely to grow as the Canadian cannabis market opens up.

Ontario's recreational marijuana market began on April 1 with the first dispensary, The Hunny Pot, opening in downtown Toronto. Meanwhile celebrities such as Willie Nelson and Martha Stewart have taken steps into the marijuana industry. Stewart in particular will be partnering with Canopy on a non-psychoactive CBD line of products, while Canopy is poised to develop a $150 million hemp facility near Binghamton.

Legal marijuana is a sexy investment option. It provides the possibility of huge returns and opportunities for diversification and is expected to hit $146.4 billion as an industry by 2024 at a staggering 34.6 percent compound annual growth rate, according to Grandview Research. Which is why it's no surprise that a quick Google search will provide you with an endless array of options promising to make you a marijuana millionaire.

But local financial advisers are calling for investors to pump the brakes.

"There's a large number of investable opportunities in Canada, but the question is how many of those are things you actually want to invest in," said Jeff McCormack, senior equity analyst at QCI Asset Management. "The major guys are capturing the majority share of the recreational markets. Canopy, in the markets that it's serving, is capturing about 30 percent of the flower market, largely because they had production capacity in place before anybody else."

Canopy, Tilray and medical marijuana provider Columbia Care LLC are among the big players in the market. They have the means, the resources and the actual product to back up their economic prospects that most proposed marijuana companies do not have.

"Tilray and the Cronos Group are examples of two companies that are still ramping up, whereas Canopy was in a good place already to meet early demands," McCormack said. "Albeit, there are still supply constraints in the Canadian market, and that problem is only going to become more acute in fourth quarter of 2019 when the edibles and beverage market opens up."

Due to the legal status of cannabis, Brighton Securities does not work in the industry, but chief sales officer Doug Hendee nonetheless has some strong feelings. He borrows the software term "vaporware" to describe the majority of companies he expects to pop up in the legal market. Vaporware is a software product that is announced, advertised and usually draws plenty of investment despite never actually coming to fruition.

"The reality is, many of these could be scams," Hendee said. "So there's a storefront and on the backend of it there is no true business —it's just a security that is trading. People go out and they pump them up —they're like penny stock schemes. Everybody that invests have heard of those before, and they're just not legit."

Investing in small cannabis companies at this point is akin to a gamble in Hendee's view. It's plopping down money into a stock that might not have a viable product, business model or growth plan. The company could vanish in a few years' time.

At this stage Hendee advises against buying stock in firms solely involved in marijuana. Instead, he suggests investing in companies that are diversified, so even if the marijuana portion of their business plummets there's still a chance to make a return.

"From an investment standpoint, it's hard to pick who is going to be the winner," Hendee said. "Since we're at such an early stage of this industry, I agree it will boom at some point, but I think it's still to be determined, it still needs to be vetted out...the way I've been telling folks is if you want to be involved with marijuana and that industry, you don't need to pick a company that is going to be a winner. You can easily invest in Constellation Brands and if marijuana and marijuana-infused beverages catch on you benefit from that."

Hendee said that in the case of an investment in Constellation, one is protected by the beer, wine and spirits

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CANNABIS

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market in case marijuana turns out to be a bust. It's far too early in the game to know whether the cannabis business will thrive.

Investing in small businesses is a subject of particular interest to Jason Klimek, an attorney specializing in cannabis law at Boylan Code LLP.

Business investments are "a difficult thing to navigate in any context, and then if we throw the cannabis layer on top of it, we're looking now at investing in what is a federally illegal business," Klimek said. "That could start to potentially limit some of your rights. Technically, you're involved in a federal criminal enterprise."

This can put an investor in a complicated legal spot. The days of DEA agents raiding dispensaries in legal states have more or less ended, but the dangers are still there. Last year, Los Angeles city attorney Mike Feuer announced criminal cases against 105 illegal marijuana businesses. Even if

you're just an outside investor, you could still be in legal trouble if for instance the operation you're invested in ends up distributing into the black market.

"Companies are selling into the illegal markets and that will trigger the feds to come in, and if they do, and you're an investor, are you on the hook?" Klimek said. "You can say you're just an outside investor, but honestly, I don't know if that's enough to shield you from the criminal activity."

New York did not include a plan to legalize marijuana in its just-passed budget as some had expected, but the door is still open for a bill to be considered by the end of this year's legislative session in June.

What the industry will look like five years from now is hazy. As federal prohibition continues, it still will be a problematic industry for investing. Section 280E of the tax code eliminates all deductibles for businesses dealing in a federally controlled substance, a potential cash drain for many investors. And many of the businesses people are investing into right now may be gone tomorrow.

For Hendee, there's one thing he knows for sure.

"You can look at all of the other states that have done this and all of the revenue it's created," Hendee said. "The genie is out of the bottle, and it's not going back in."

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RETIREMENT

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Midcareer in your 40s and early 50s: You may have residual college debt. You also may have your own family and be starting to care for aging parents. Friday called these the tweener years, and they can be financially demanding. However, they also can be peak earning years and can give you momentum. One adviser suggested that in addition to fully funding a company-matched 401(k), put money into investment vehicles that won't ding you for withdrawals before a certain age.

Vosburgh said that business owners should be thinking of how they will fund their retirement and assess their savings plan. "It's most likely that they put so much time and effort into the business that they haven't saved elsewhere. … My broader point is that things can become more sophisticated and people might have some big assets they have to plan around, and you want to account for that in your retirement planning."

Countdown to retirement in 50s and 60s: Friday said that around age 55, people seriously start thinking about retirement and what those years will look like. This is when your plan picks up nuances, and you adjust specific investments as goals get closer to reality. If you have various accounts and insurance policies, it may be time to get organized. It also helps to have a continuity plan in case something happens to you and your spouse or children need the paperwork.

If you haven't been much of a saver until this point, you still can plan and budget for a retirement that's within reach.

Besides figuring out the finances in your 50s and 60s, you also have to come to terms with the notion and emotion of retirement. "It's where you start to have a new concept," Vosburgh said. "You're moving from a period of time where you're saving and you're moving into a period of time where you're using all that money you saved. It's a hard transition."

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BUY-AND-REBALANCE

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uncorrelated investments, including domestic and international stocks, high-quality bonds, real estate, and other alternative asset classes could help reduce the pain when stocks next decline.

They say death and taxes are inevitable. I would add economic and stock market downturns to that list. Short-term losses are part of investing. Without risk we wouldn't have any return. So, if you are in the market, take an honest look at your emotional state as it relates to your investments. How did you respond in the past when stocks went down? With the market still at relatively high levels, there is time to reposition your portfolio to better correspond to your state of mind.

For those willing to endure short-term risk and employ a few smart tactics to take advantage of downturns, there can be significant long-term rewards. However, if you are prone to emotional decisions, and can't resist the urge to sell in down markets, it would be better to get more conservative now.

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