Buying Legalized-Marijuana Stocks: Just Say No!

BY JANE HODGES

MARIJUANA LEGALIZATION in multiple states has ushered in a variety of companies and funds that are selling shares.

But should you invest?

Marijuana-related securities have arrived in the form of over-the-counter or penny stocks and special funds for accredited or high-net-worth investors. Some investors have been playing this market for several years already.

But while marijuana has been legalized for medical and recreational use in a short list of states, at the federal level marijuana is still illegal.

"Unusual period"

"We're in an unusual period," says Bruce Barcott, author of "Weed the People," a book about marijuana's legalization. The federal government is standing by while states legalize marijuana, he says, "but the feds retain the right to come in and arrest any business that touches the leaf. That hasn't happened yet, but it is possible."

The Securities and Exchange Commission issued a May 2014 investor alert about marijuana-related investments in which it said "marijuana-related companies may be at risk of federal, and perhaps state, criminal prosecution." The SEC and the Financial Industry Regulatory Authority have cautioned investors about the risks of buying marijuana stocks, some of which they say are the subject of investor-fraud complaints or complaints that they are little more than pump-and-dump schemes.

In its 2014 alert, the SEC cited trading halts on several marijuana-related companies due to suspicious trading activity and investor complaints about their investments.

But, the alert also said, "Notwithstanding the federal ban, as of the date of this guidance, 20 states and the District of Columbia have legalized certain marijuana-related activity.

The SEC didn't return calls seeking comment.

There are funds, open only to wealthy investors, that specialize in marijuana-related securities, though they won't speak publicly, for fear of violating accredited-investor solicitation rules and rules about marijuana. High Times Growth Fund, for one, linked to the High Times media brand, has a website with little information other than email addresses and a cannabis leaf.

Marijuana Investment Co., also open only to accredited investors, focuses on providing investment access to an ETF-like portfolio of marijuana-related assets, says Alan Brochstein, a financial adviser who runs the newsletter 420 Investor and designs marijuana-based model portfolios for his subscribers. The company says it is planning to file for an initial public offering, and has invested in the Marijuana Index, which tracks listed companies in the sector. The index, launched by tracking six stocks just two years ago, but now tracks 200 with a combined market value of $6.9 billion.

Mr. Brochstein's own model portfolio of marijuana stocks provides a look at the many sub-sectors: a 19% allocation to Canadian licensed producers; 18% to vaporizer smoking devices; 14% to GW Pharmaceuticals, a listed British biopharmaceutical company that makes cannabis-based medication; 14% to grower supplies; 9% to cannabis concentrates; 7.5% to air-control and lighting for indoor cannabis growers; 4% to cannabis-based biotech; and the remainder in cash and technology.

**Mutual funds next?**

Inevitably, mutual funds and exchange-traded funds will look at opportunities in marijuana-related businesses. When that happens, investors who object to such businesses may want to look closely at the holdings of any funds they invest in, as investors do who don't want to own liquor or conventional-tobacco stocks.

"I don't think there will be funds and ETFs in the cannabis sector for at least a couple of years," says Mr. Brochstein. "Liquidity in this space is poor, so mostly you have over-the-counter stocks trading publicly."

Despite the lack of liquidity, investors are curious. Mr. Barcott says companies that help wealthy individuals invest in cannabis have gone from holding small seminars to "renting out hotel ballrooms."

Legal sales of marijuana are expected to quintuple to as much as $8 billion in 2019 from $1.6 billion in 2013, according to forecasts from trade publication Marijuana Business Daily. Founding editor Chris Walsh says his publication predicts that more states will move to major exchanges, where disclosure and company liquidity is more regulated, in the next two years.

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