

A Case Study on Cannabis and Bitcoin Mania

A new investment mania is always just around the corner. All you need are the right ingredients of hope, unquantifiable potential and greed. Cannabis stocks and Bitcoin qualify for this distinction as we observe them both dominating the headlines. So, we thought we would take this quarter's Case Study to discuss why a speculative craze *does not* fit with Avenue's strategy of investing in consistent and profitable businesses.

As a refresher, at the core of Avenue's investment philosophy is the idea that we invest in businesses. We ask ourselves, does the company have a good product or service which can be sold to earn a consistent profit margin. Then can we invest in this business at a fair price. Sticking to this plan is the best way we know to avoid big investment losses. If we own a diversified portfolio of businesses which all have about an 8% profit margin, we should compound at about 8% over time, with more consistency than the overall stock market.

So now let's look at Cannabis stocks with this filter. The business should be easy to analyze because it is simply a traditional agriculture commodity turned into a consumer product. Why it is exciting is because the market is expected to be large. The argument goes that whichever company can get market share early will be able to make a killing. Likely there will emerge a few dominate players. But at the start it is hard to tell which ones they will be. There is no track record or financial data to analyze. You are making an investment decision based on proposed business plans run by people who have never done this before.

Now, when we look at the financials we see they are already pretty crazy and don't come anywhere near Avenue's criteria. The largest company, Canopy (Ticker symbol: WEED) has a \$6 billion market capitalization and this year they are expected to have revenue of \$40 million, negative operating profit, and no earning for years to come. Disregarding any moral or legal challenges, a potential outcome will likely be that too much money will get thrown at the investment opportunity. This will result in overcapacity and an industry where there is a lot of cannabis but not much profit.

So far Bitcoin, the world's first and most successful cryptocurrency, is not in any way a traditional investment. Straight out, it is not a business. Also, it is not really a currency because it has limited uses at this point. It is being characterized as an asset class, similar to gold. However, from Avenue's perspective, gold is still a business where we look for companies where the mining costs are less than the price the gold can be sold at, and where we can generate a healthy profit margin in the business of mining gold. We will mention that there is such a thing as mining Bitcoin and it is a very technical, high capital cost, and energy intensive exercise with low profit margins.

The key ingredient to an investment mania or craze is that, whatever the opportunity is, it is new and very few people own it at the start. The upside seems to offer unlimited potential. Speculators feel they are going to be left behind if they don't get on the band wagon. We have no idea how much higher in value Cannabis stocks and Bitcoin can go. What Avenue's discipline requires is that until such time where we can identify a good business, we will ignore the mayhem. The get-rich-quick payoff will elude us but we will also avoid the possibility of catastrophic failure.