

## The Cannabis Market: Year End Recap of 2019 and Discussion for 2020

In the following commentary, Portfolio Manager Korey Bauer of the Cannabis Growth Fund (CANNX/CANIX) discusses how the cannabis sector performed in 2019 and how the Fund is positioned heading into an exciting 2020.



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8 years of experience

### Would you please discuss the volatility in the cannabis industry over the past year?

The cannabis sector in 2019 started out on a positive note. Cannabis stocks rallied by 75% from the lows in December 2018 to a high in March 2019 (Cannabis World Index). The sector quickly took a turn from the March highs and, through December 31, 2019, the Index was down roughly 60%. The Index was down 37.54% for 2019.

### Why did this happen?

There are several reasons why cannabis stocks have gone down so significantly over the past year. We believe these are the most impactful issues to the sector in 2019: 1) The illicit market is still much more affordable than the legal market. As of the 3rd Quarter 2019, the legal average price per gram was around \$10.23 relative to the illegal market with an average price of \$5.59. This is a 45% premium for legal cannabis. 2) Ease of access to legal cannabis for consumers has been a significant issue. Recent data has shown that Ontario, Canada (the largest province in Canada) has less than 100 cannabis stores. If we take the population density of Ontario and compare it to Colorado, which has 1 store per 10,000 inhabitants, Ontario would need roughly 1,400 stores to match the same store build out as a mature market like Colorado. 3) Cannabis companies' access to capital has become extremely difficult. Bankruptcy is a real issue for a number of companies. Companies are being forced to issue more shares to raise capital which has resulted in share dilution and, in some cases, been a strain on the share price. 4) The rules and regulations

surrounding the Canadian Cannabis Act are very restrictive in terms of packaging, labeling, branding and marketing. Companies are having issues developing brand recognition with the consumers. 5) The vaping issue in the U.S. was very detrimental to consumer sentiment. There were over 2,000 probable cases of vaping related illnesses reported in the U.S. The CDC has recently come out and said that the illnesses were most likely caused by a specific additive that was included in illegally produced vape cartridges.

### What is being done to combat these issues and how is the Cannabis Growth Fund positioned as we head into 2020?

Cannabis 2.0, launched in October 2019, will allow the sale of cannabis derivatives in Canada (e.g. vapes, edibles, beverages, etc.) U.S. data has shown that in California and Colorado concentrates and edibles account for roughly 50% of all cannabis related sales. These products began hitting the shelves on December 15, 2019. Cannabis 2.0 products carry higher price margins when compared to pure flower.

Ontario, Canada is expected to double the number of stores in the province by the end of 2020 and will continue to add more in the coming years. Store increases are being seen throughout all the Canadian provinces.

As of December 31, 2019, the Fund held 24 positions. Over the quarter, we reduced our overall holdings as we are focusing on a core group of companies we believe possess key criteria for success in the ever-changing environment. To compete with the illicit market, companies will need to reduce the prices they charge for cannabis. We see this as an opportunity for companies that are producing higher quality cannabis. Higher quality cannabis allows the company to charge higher prices and we have seen that the consumer is willing to pay a premium for this. Quality and consistency

are extremely important and we are focusing on companies that are doing this rather than focusing on the overall amount they can produce.

The Fund is focusing on companies that are producing unique products and are positioned to be successful in Canada and eventually the U.S. In particular, there is a lot of excitement surrounding CBD only and CBD and THC combined cannabis beverages. Currently, this is a very small market in the U.S and Canada but has the potential to be a very sought after product in both countries. We are keeping a close eye on this development.

The Fund favors companies that are taking a conservative approach to furthering the size and scale of their grow operations. Current projections show the market as being fully supplied. We are favoring cash rich companies that may be able to take advantage of companies that start to default and whose assets become distressed. There may be an opportunity for these cash rich companies to pick up those distressed assets at a discounted price.

Product branding and distribution will be extremely important. What brands will lead the way and which will the consumer choose? This is still in its infancy and yet to be determined, but the Fund is actively honing in on those

companies that are producing and selling the most sought-after brands.

Another area of the market we are focused on is extraction. Extracting the cannabinoids from the plant is a capital-intensive process and we think there is significant upside to those companies that are focusing on this part of the industry.

The Fund also has exposure to the U.S. CBD market and we believe there is still an opportunity for companies to gain significant market share.

Lastly, we are very bullish on the science of cannabis as there is still a lot to learn. We have exposure to biotechnology companies using cannabis medicinally to combat specific diseases and ailments. This remains a very exciting segment of the cannabis industry.

### About Foothill Capital Management

Foothill Capital Management is a specialized asset manager focused on markets they view as innovative, fast-growing or emerging to provide investors with an aggressive growth component in their equity portfolios.

**Of Special Note:** Statements, estimates and forecasts are subject to significant legal, business, economic, and competitive uncertainties, including competition, limited access to bank services, litigation, enforcement actions, and the receipt of government authorizations. This includes differences in, among other things, laws, regulations and guidelines relating to the manufacture, transportation, and storage of cannabis, and the conduct of operations, which vary among the U.S. federal government, various states, and foreign jurisdictions. There can be no assurance that such estimates and/or forecasts will be realized, and these are not indicative of future investment performance. Historical data is not indicative of future performance.

**Carefully consider the Fund's investment objectives, risk factors, charges, and expenses before investing. This and additional information can be found in the Fund's prospectus. Read the prospectus carefully before investing. To obtain a prospectus please visit [www.cannabisgrowthfunds.com](http://www.cannabisgrowthfunds.com).**

Investing involves risk, including possible loss of principal. The cannabis industry is subject to rapidly evolving laws, rules and regulations, and increasing competition which may cause such companies to change business model, shrink or suddenly close. These may limit access to banks, and create significant burdens on company resources due to litigation, enforcement actions, receipt of necessary permits and authorizations to engage in medical cannabis research or to otherwise cultivate, possess or distribute cannabis. Possession and use of cannabis is illegal under federal and certain states' laws, which may negatively impact the value of Fund investments. Where legalized by states, cannabis possession and use remains a violation of federal law. The companies in which the Fund invests are subject to various laws and regulations relating to the manufacture, management, transportation, storage and disposal of cannabis, including health and safety, conduct of operations, and environmental protection. Even if a company's operations are permitted under current law, they may not be permitted in the future, and a company may not be able to continue operations in its current location. Controlled substance legislation differs significantly between countries and may limit a company's ability to sell products.

Foreign investing involves social and political instability, market illiquidity, exchange-rate fluctuation, high volatility and limited regulation risks. Emerging markets involve different and greater risks, as they are smaller, less liquid and more volatile than more developed countries. Investments made in small, mid-capitalization and micro-capitalization companies may be more volatile and less liquid due to limited resources or product lines and more sensitive to economic factors. Fund investments will be concentrated in an industry or group of industries, and the value of Fund shares may rise and fall more than more diversified funds. Purchasing and writing put and call options entails greater than ordinary investment risks. Options ownership involves the payment of premiums, which may negatively impact Fund performance. Please see the prospectus for details of these and other risks.

For more information regarding current fund holdings, please see the [fact sheet](#). Fund holdings and sector allocations are subject to change and should not be considered recommendations to buy or sell any security. The views expressed represent the opinion of Foothill Capital Management which are subject to change and are not intended as a forecast or guarantee of future results.

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