

# Addressing Questions on the U.S. Marijuana Market

## HEALTH CARE AND CONSUMER STAPLES SECTOR REPORT

### Buy-Rated:

- Johnson & Johnson (JNJ - \$154.26)
- Merck (MRK - \$129.90)
- Pfizer (PFE - \$27.22)
- General Mills (GIS - \$68.99)
- Mondelez (MDLZ - \$67.97)

### Hold-Rated:

- Altria (MO - \$42.12)
- Molson Coors (TAP - \$68.14)

Prices and opinions ratings are as of market close on 4/3/24 and subject to change.

Source: Reuters.

### Key Marijuana Market Risks:

- Federally illegal in the U.S.
- Political and regulatory uncertainty
- Highly competitive market
- Price uncertainty
- Unpredictable consumer behavior
- Health & safety risks
- Stock volatility
- Stock prices implying expanding legalization

### For more information:

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Attention on the marijuana industry has grown over time as most U.S. states and many countries have legalized marijuana in some form. While excitement can build in any start-up industry, we believe there are many risks and uncertainties in both the medical and recreational marijuana markets, and all forms of marijuana remain illegal under U.S. federal law. **We believe that any investment in the marijuana industry should be viewed as speculative.**

**Marijuana Remains Illegal Under Federal Law** - Public sentiment toward marijuana has relaxed over the years, and most U.S. states have legalized marijuana in some form. However, marijuana use remains illegal under U.S. federal law, which creates uncertainties for companies participating in the market.

**Investments in Medical Marijuana Market Carry Risk** - While many states have legalized access to marijuana for medical purposes, marijuana itself, and CBD oil, have not been approved by the FDA. However, some pharmaceutical companies have drugs (both marketed and in development) that are derived from marijuana, or a synthetic form of marijuana, and have gone through the appropriate FDA steps. These companies are primarily developmental-stage companies, concentrated in just a few products, or companies so large that it is not a meaningful driver of sales.

Overall, we believe that FDA-approved products derived from marijuana will be just a small part of the prescription drug market. We prefer investors get exposure to innovation through pharmaceutical companies that are diversified by product and geography, and that have an extensive operating history and experience bringing drugs to market.

**Recreational Market Has Many Uncertainties** - Even if recreational use were federally legalized in the U.S., we believe there would be a large number of uncertainties. We would expect the market to be heavily regulated and taxed, with many players and very high competition. We also don't know how consumers would choose to consume marijuana. In the food, beverage and tobacco subsector, we prefer companies with strong brands, larger markets, and a proven track record.

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Please see important disclosures and analyst certification on page 3 of the report.

## **The Marijuana Market**

**U.S. Market Overview** - Most states have legalized marijuana in some form. However, marijuana remains classified as a Schedule 1 drug, making it a controlled substance and illegal under federal law. Businesses that operate in those states that have some form of legalization are generally private companies or public companies that aren't easily available for trading. The fear of federal enforcement has kept banks from doing business with marijuana companies, and it has kept many large consumer companies headquartered in the U.S. from entering the market.

**Medical Market** - Many states have legalized access to marijuana for medical purposes. However, the FDA has not approved marijuana as a safe and effective drug for any indication. While marijuana itself, and CBD oil, lack FDA approval, there are biopharmaceutical companies that have FDA-approved products derived from marijuana. These products are approved for uses such as nausea, vomiting, appetite stimulants and seizures. The opioid epidemic has also led to a search for alternative pain medications, and we expect an increase in the number of clinical studies on marijuana-derived products.

While the medical marijuana market is experiencing impressive growth as access and acceptance increase, many risks exist, such as evolving regulations, increasing competition, product concentration, and general risks associated with biopharmaceutical companies, such as political and regulatory risks and product safety. Overall, we believe that FDA-approved products derived from marijuana will be just a small part of the prescription-drug market.

**Recreational Market** - If legalized, we'd expect the recreational marijuana market to be significantly larger than the medical market. However, there are many uncertainties in how the market dynamics would play out. The market is likely to be heavily regulated and taxed, with limitations on advertising. The market is also likely to be very fragmented with significant competition, which could cause pricing pressure. These risks make it difficult to predict how much of the industry would move to the legal market versus stay in the illegal market. There is also uncertainty in how consumers would choose to consume marijuana products – smoke, vapor, consumables, beverages, etc.

Other general risks include agriculture-related risks associated with growing the crop and health and safety risks, given there is no FDA system in place to regulate products. For example, the vaping industry has come under significant pressure recently for illnesses and deaths, some of which appear to be tied to vaping marijuana-related products. Despite the increased public acceptance of marijuana, we would expect that if legalized, the total marijuana market would be significantly smaller than the U.S. alcohol and tobacco markets.

### **Addressing Common Questions From Investors:** **What are the risks involved with getting exposure to the marijuana market through biopharmaceutical companies?**

There are many publicly traded biopharmaceutical companies that have drugs (both marketed and in development) derived from marijuana or a synthetic form of marijuana. However, these are primarily development-stage businesses that carry significant risk, in our view. While these products are going through the appropriate steps to gain FDA approval, the companies generally have a small number of drugs, and many are not yet profitable. We believe investors should avoid drug companies that are heavily reliant on the success of one particular product.

We think investors interested in gaining exposure to new, innovative drugs should look to companies with strong fundamentals that are profitable, diversified, and have a successful track record. While some of the larger biopharmaceutical companies may be involved in the synthetic marijuana industry, we do not expect it to become a meaningful part of their business, given the smaller relative size of the market for marijuana-based products.

### **Will U.S. companies become involved in the marijuana market?**

Several large, established companies have invested to some extent in the marijuana industry, including Altria (MO), and Molson Coors (TAP). We view these investments as small relative to the size of these companies, and we would not expect these partnerships to be meaningful to the companies' sales or profits in the foreseeable future. Given that marijuana is federally illegal in the U.S., we expect companies to be limited in their involvement and favor partnerships to potentially gain exposure to the market.

As a result, we do not recommend making investment decisions based on involvement or potential

involvement in the marijuana industry, particularly given the significant regulatory risks and unknowns in the marketplace. Instead, we recommend focusing on companies that have strong brands, operate in larger, established markets, and have a proven track record.

**With recreational legalization in Canada, does Edward Jones have any Canadian recommendations?**--While there are a number of publicly traded marijuana companies headquartered in Canada, investors should be aware that they have poor profitability and limited operating history. We would consider any investment in the Canadian marijuana market to be speculative. As with any startup company in a new, growing market, inherent risks exist. An increasing number of competitors and changing regulations make it difficult to predict who the ultimate winners and losers will be. Aside from the rapidly changing dynamics in the marijuana industry, new companies need to secure funding and fight for market share among the numerous competitors.

Larger companies could also get involved and disrupt the Canadian marijuana industry. Given the evolving nature of the industry, we expect the stock prices of these companies to experience large fluctuations. Lastly, the valuations for many of these companies reflect the potential opportunity for marijuana use to become legalized in the U.S. or other international markets, and international trade laws add a level of complexity. We cannot predict with any degree of certainty the outcome of future government regulations. Downside risk to marijuana stock prices likely exists if legalization doesn't meaningfully expand beyond Canada.

**What is the bottom line?** -- Any investment in the marijuana industry should be viewed as speculative. To benefit from medical innovation, we prefer established drug companies that are diversified by product and geography, and that have extensive operating history and experience bringing drugs to market, such as Johnson & Johnson (JNJ), Merck (MRK) and Pfizer (PFE). In food, beverage & tobacco, we prefer companies with strong brands, larger markets, and a proven track record, such as Mondelez (MDLZ) and General Mills (GIS).

**Valuation** -- When valuing consumer staples and health care companies, we use various methods, including, but not limited to, comparing price-to-earnings ratios (P/E) and PEGY ratios (price-to-earnings ratio divided by growth plus dividend yield)

with historical and peer averages. We also use discounted-cash-flow models to incorporate long-term growth expectations.

**Investment Risks** -- Some potential risks involved with investing in the consumer staples sector include deteriorating economic conditions, a slowdown in consumer spending, rising interest rates, higher commodity prices, and currency fluctuations. Some risks related to health-care-sector companies include political and regulatory risks, pricing pressure, and product failures and/or liabilities.

**Please see the individual research reports for additional information, including disclosures, analyst certifications, valuation and risks specific to each company.**

### Analyst Certification

I certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers; and no part of my compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in the research report.

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