Let's Toke Business

The Commerce of Cannabis **www.letstoke.biz** **Ted Ohashi MBA, CFA**

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Week Ended October 6, 2023

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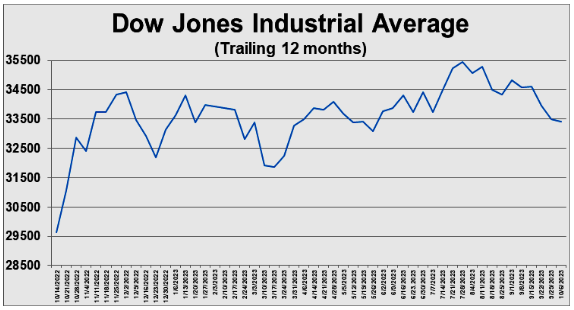
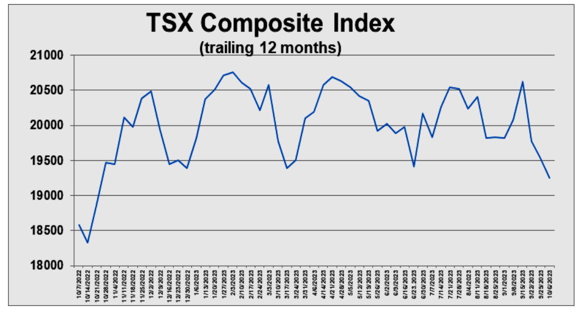
Stock Market Review & Outlook

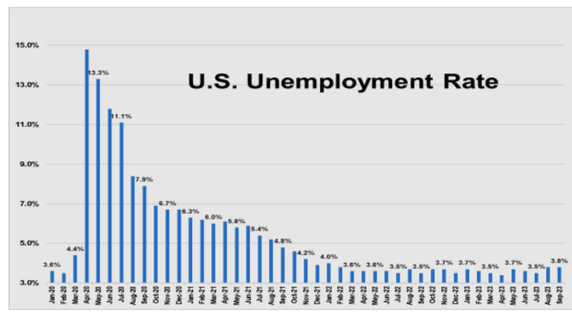
LTB MARIJUANA INDEX: **1wk -4.1% 1 mo -10.6% 3 mo -15.0% 6 mo -28.8% 1 yr -49.5%**

The fourth quarter got off to a modestly positive start with the Dow Jones Industrials down -0.3%, the S&P 500 up +0.5%, the NASDAQ Composite +1.6% higher and the Toronto Stock Exchange Composite Index down -1.5%. The trading pattern was something which we have become accustomed to. Investors bided their time waiting for the economic news of the week. Last week it was the September jobs report reported on Friday and next week it will be the Consumer Price Index due to be reported on Thursday.

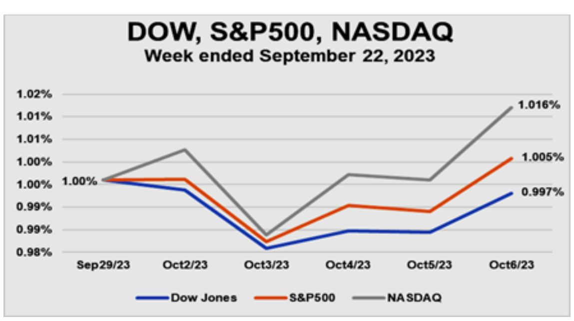




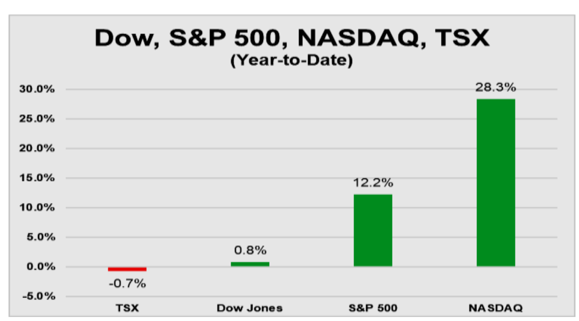
The market has established a pattern where it moves sideways until some new economic data is issued, it assesses the information and rallies or reacts based on their interpretation. Last week's jobs report was a mostly positive and the market liked the news. The economy added 336,000 jobs in September that was well above expectations of 170000 more jobs. Wages, on the other hand, increased +0.2% that was below the concensus forecast of +0.3%. Year-over-year, wages were up +4.2% compared with inflation that is running between 3% and 4%. The unemployment rate came in at 3.8% which was slightly above expectations but equal to the Auigust report. Behind the scenes, the participation rate was unchanged indicating the proportion of the labour force looking for jobs did not increase or decrease.



Next week, the September Consumer Price Index will be reported on Thursday so the markets will likely tread water until then although there might some positive momentum that carries over from Friday of last week. The next Federal Open Market Committee meeting takes place on October 31st and Nobember 1st and that will feature Chairman Powell's final major talk until the new year. Chances are that markets will remain flatish until then short of any major surprises. The normal pattern is for the markets to finish the year strong as November and December are the two strongest months of the year for the stock markets.

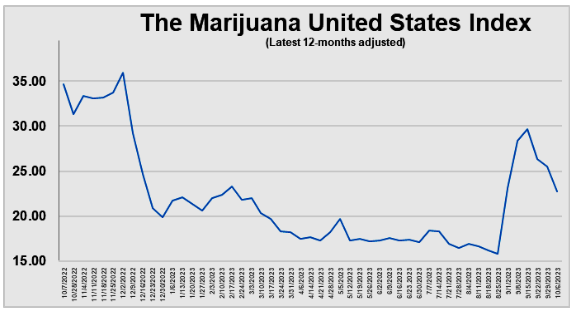


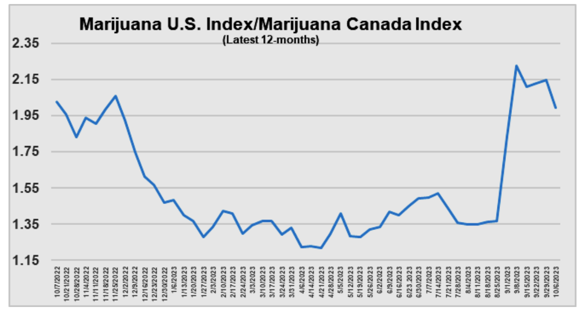
The chart to the left shows the major index performance last week. As you can see, the markets



were flat to lower early in the week and were saved by a strong rally on Friday on the jobs report. However, the Dow Jones Industrials and the Toronto Stock Exchange Composite did lose ground last week and the TSX turned negative on the year while the Dow is perilously close. The technology content is keeping the S&P 500 and NASDAQ higher and the Artificial Intelligence sector in particular. I believe the AI group will continue to shine in the balance of 2023 and all of 2024.

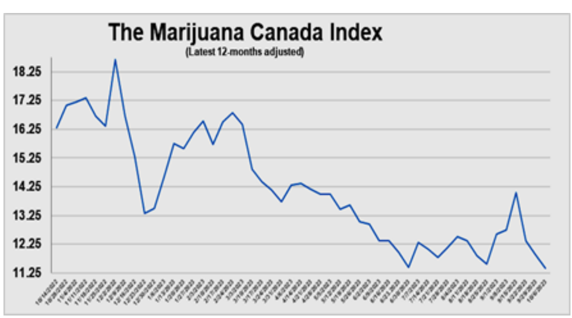
The U.S. cannabis stocks continued to correct last week following an almost unsustainable rally that started at the end of August and carried on through mid September. I think the U.S. cannabis sector will continue to lead the way as the Senate and House of Representatives work to pass the Secure and Fair Enforcement Regulation (SAFER) which I think they will do. SAFER has cleared committee in the Senate and will move to the floor for a debate and vote. To pass SAFER it will require 60 of the 100 votes in the senate but I am sure everyone has been polled and although the vote will likely be close, I think it will pass. Senate Majority Leader Charles Schumer has indicated he will schedule a vote relatively quickly.

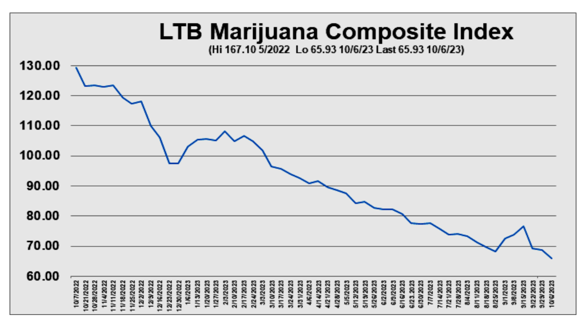




Assuming SAFER passes the Senate, it will move to the House. The House has passed the predecessor SAFE Banking Act seven times with the required majority vote but last year, the Democrats lost control of the house. I still think SAFER will pass the house but it is no longer a sure thing. As a result, there will be some uncertainty especially as the house does not have a leader at the moment since Kevin McCarthy was removed as speaker. This is the first time this has ever happened. But first things first. Let's ensure SAFER passes the senate vote before we start worrying about the house.

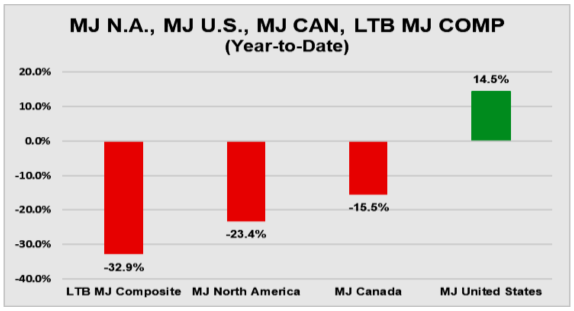
The correction in the Canadian cannabis operators continued last week. The difference between the Canadian and U.S. cannabis stocks is clear from the charts. The American operators are seeing a correction in their stock prices but from a much higher level than prevailed in late August when the current rally began. The stock prices of the Canadian operators are basically back to where they were when the Secretary of the Department Health and Human Resources sent a letter to the Drug Enforcement Administration recommending that marijuana be rescheduled from a Schedule I to a Schedule III drug. When the U.S. operators ran up on the stock market, the Canadian stocks were carried along. But when the Canadian stocks advanced, operators such as Canopy Growth and Aurora Cannabis were quick to finance. When a company finances it is the equivalent of deciding to sell its stock and by acting so quickly

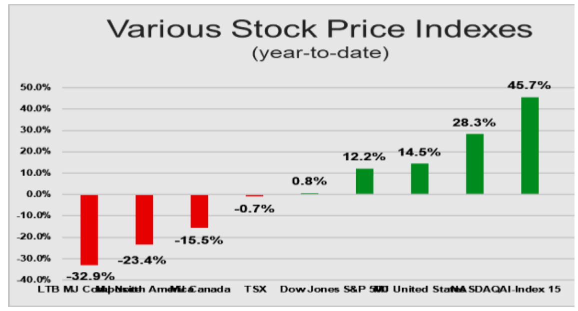




Canopy and Aurora tipped off the market that they didn't think the rally in Canadian cannabis stocks was going to last.

These charts show the year-to-date (y-t-d)performance of the cannabis sector below left and the cannabis sector compared to other major sectors below right. When the cannabis group rallied starting in late August, three out of the four indexes I follow actually made it into positive territory y-t-d. I look for the U.S. cannabis sector to rally again starting soon when it is announced the SAFER bill is scheduled to for a vote in the senate. This time, I expect investors to be a little smarter. I expect the U.S. cannabis stocks to rally sharply from an elevated level. I think the Canadian cannabis sector will benefit but less than it did between late August and mid September.





Conclusion: The stock markets have been trading in a range or channel as it is sometimes called. If you are a trader, that is someone who buys and sells short term price swings as opposed to a buy and hold investor, then your strategy is clear: buy the reaction and sell the rally. If you try to trade really short term moves in price, you might be a day trader.

For those of you who are shorter term traders, I think there is an opportunity in my list of stocks. For example, last week **1933 Industries (CSX: TGIF) (USOTC: TGIFF)** was down -20.0% and **Jushi Holdings (CSX: JUSH)(OTCQX: JUSHF)** was -12.1% lower. I think TGIF and JUSH are both attractive because they are U.S. operators and as explained above, I am more bullish on this sector. JUSH is the more liquid so if you want to trade a larger sum of money, it is the better choice. On the upside, **Predictmedix AI (CSE: PMED) (USOTC: PMEDF) (FRA: 3QP)** gained +5.6% and **Lexaria Bioscience (NASDAQ: LEXX)** was up +0.4%. I have talked about PMED's trading range in the past and the upper range tends to be toward the $0.12 level so at $0.095, it may be too early to initiate a trade. The LEXX gain was fractional and not enough to prompt a trade, in my opinion. **Organigram Holdings (NASDAQ: OGI) (TSX: OGI)** gives us Canadian cannabis exposure. For example, in The Cannabis Report model portfolio, OGI is just a 5% holding and the smallest in the portfolio. I spoke briefly with Alvaro Torres, CEO of **Khiron Life Sciences (TSXV: KHRN) (OTCQX: KHRNF) (Frankfurt: A2JMZC)** but we haven't been able to connect for full update. I expect to speak to him this week.

Question of the Week

Thank you for sending in your questions and I hope you will keep them coming. It's your questions that keep this feature interesting and useful. Send your questions to: ltbletter@gmail.com Include your initials or a pen name we can use along with your city and country of residence. Questions will be edited for clarity and brevity.

The objective of the 'Question of the Week' feature is to allow readers to ask questions about investing about investing that is on their minds rather than have me guess what you are wondering about.

"Has our Prime Minister Justin Trudeau sealed the fate of Predictmedix AI (CSX: PMED) (USOTC: PMEDF) (Frankfurt: A2JMZC) in India by angering Prime Minister Narendra Modi? Some 41 Canadian diplomats are being kicked out of India. This will hurt all Canadian companies trying to do business in India. I also wonder if the PMED equipment is overpriced for the Indian market."

We may never know all the relevant facts in this situation but it had some of the appearances of Trudeau marching to Washington's orders that created a very real and serious international incident for Canada with India. In any case, I think it could have been handled better by the Canadian government for Canadians and Canadian business.

Members of the ***Predictmedix AI (CSX: PMED) (USOTC: PMEDF) (Frankfurt: A2JMZC)*** management team are in India at the present time and due back later this month. We should get a full report at that time.

In terms of pricing, the business plan calls for a lease payment of $5,000 per month or $60,000 per station per year. A hospital can use 1 - 3 entry stations that are similar to the metal screening devices you walk under at airports. There are 69,000 hospitals in India.

You have a point with respect to pricing. The fact is prices will likely be lower, especially for a lead order of any size. I think $3,500 - $4,000 per month is more likely. I have been using $4,000 per month in my internal forecasts. Capital cost of a station is under $10,000 per machine so it's a rapid payback. Basically, a station is a metal frame, a multispectral camera and an Internet connection.

Using a $4,000 sales price, I estimate PMED only needs around 30 units installed to cover the corporate cash burn rate and the lease is planned to have first and last month paid in advance so the stations virtually pay for themselves.

Like most Artificial Intelligence businesses, the asset is the data base which PMED is adding to each day as we speak. With AI, more data should also produce more accurate results.

Finally, 65% of India's population is rural and 47% is dependent on agriculture for their income. The fact that PMED's technology works remotely is another major factor in health care delivery.

Conclusion: Although the charges are very serious, this is a political issue that will eventually be resolved. But in the short term it could be problematic mainly because it could drive India to a closer relationship with China and away from the United States and the west. I think it is important for Canada to recognize that India is growing in importance on the international stage both from a political and economic point of view. India is now #1 in population and Canada is #6. India ranks #5 in terms of economic size while Canada stands at #9. This is not to say anyone should be allowed to get away with murder. Obviously not. But it does mean Canada should ensure it accords India full diplomatic respect. In this millennium, Canada and the west will need India more than India will need Canada and the west.

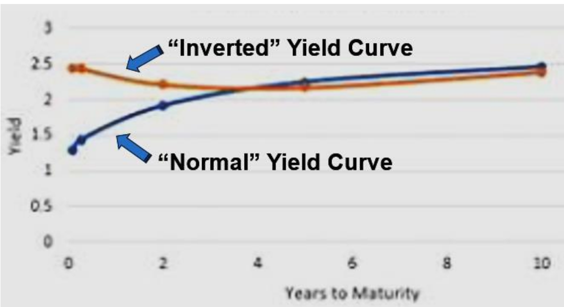
The Cannabis Report Model Portfolio

The two largest holdings are **1933 Industries (CSX: TGIF)(USOTCQB: TGIFF)** and **Predictmedix AI (CSX: PMED)(USOTC: PMEDF)(FRA: 3QP)** while **Lexaria Bioscience (NASDAQ: LEXX)** and **Khiron Life Sciences (TSXV: KHRN) (USOTCQX KHRNF) (Frankfurt: A2JMZC)** remain prominent holdings. The two smallest positions are **Organigram Holdings (NASDAQ: OGI) (TSX: OGI)** and **Jushi Holdings Inc. (CSX: JUSH) (USOTCQX: JUSHF).** Cash is around 17%.

Special Report

If you think stock markets are bad, take a look at the treasury bond market

Because the stock markets appear to be driven by interest rates, I thought it would be worthwhile devoting an entire article to the subject. By the way, I got my first job as an investment analyst having written my graduating thesis on inverted yield curves.

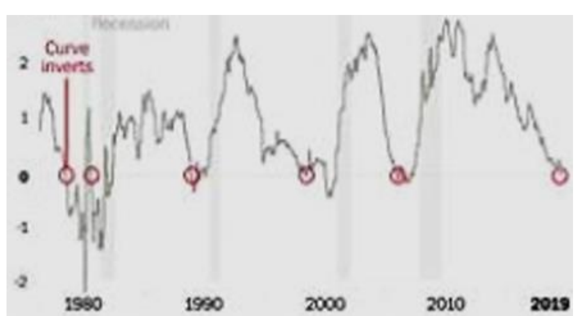


Let’s begin by looking at the chart to the left. The lines plot the yield on U.S. treasuries relative to the term to maturity. A bond with a longer term to maturity will fluctuate more in price for a given change in interest rates which means the longer the term, the greater the risk measured by volatility. This means a 20-yeaer bond is riskier than a 2-year bond hence an investor should receive a higher yield for holding a riskier longer-term bond than a shorter-term bond. In plain English, you deserve a higher rate of return from agreeing to tie up your money for a longer period of time. As a result, when this relationship prevails in the bond market, yields rise as terms to maturity increase so the curve, marked in blue, rises to the right. We call this a “normal” yield curve.

However, there are those rarer times when the curve is “inverted,” that is, the shorter-term maturity bonds provide higher yields than the higher risk, longer-term bonds. This produces the inverted, negative or twisted yield curve as it is sometimes called, shown in brown on the chart above, when yields decline to the right.

When we look at past and the current inverted yield curves, it will be evident they are closely related to recessions. In fact, the inverted curve has become one of the most reliable indicators or recessions.

We have witnessed firsthand one way that inverted yield curves come into existence. Sometimes, the economy gets over heated and inflation rises rapidly or the labour market gets too hot and wage demands rise. This provokes economists to think something needs to be done. Over the past several quarters, we have watched the Federal Reserve Board try to lower the rate of inflation. The business press reports that as “The Fed raising interest rates.” In a narrow sense that is true. But the Fed doesn’t raise interest rates as much as it raises the Federal Funds rate to signal to the economy that a tight money policy will be in effect so we can expect higher interest rates. The free market responds accordingly and interest rates rise. Sometimes, short term interest rates rise more than long term interest rates producing an inverted yield curve.



The next chart shows what happens more often than not following an inverted yield curve. The small circles identify periods of inverted yield curves and the shaded vertical lines represent recessions. To the extent that the circles were triggered by a period of tight monetary policy and each was followed by a recession, it shows how unsuccessful the Fed has been in producing a soft landing which is a period of tight money that is not followed by an economic slump. We haven't had a recession following this latest round of tight money unless you count the one-month shortest recession in history in March 2020 caused in response to the COVID pandemic.

Here's another way to look at it that produces a similar but not precisely the same picture. If you take the 10-year treasury bond yield and subtract the three-month treasury bill yield, you typically get a positive remainder. That is because 10-year yields are normally higher than 3-month yields. But if the difference is negative, then 3-month yields are higher than 10-year yields and the yield curve has inverted. Here is how that appears. It also shows clearly an inverted curve is a rare event. It has only happened five (or six?) times in the past half century.

In the current cycle, the yield curve went inverted in October 2022 and has remained inverted ever since and we are yet to see a recession. Here are some factors that make this inversion a little different from the previous four:

(a) The length of inversion this time is much longer than in the past. Recently, we have had an inverted yield curve for 237 days that exceed the 217 days in 2006 – 2007. There is no particular sign that this streak will end soon.

(b) The degree of inversion, the amount by which short term interest rates exceeded long term interest rates reached 2% which is significantly higher than in the previous cycles. With the rise in longer-term interest rates, the spread has been reduced to approximately -0.56% recently.

(c) Generally speaking, an inverted yield curve is also a harbinger of a decline in interest rates. This often begins with an increase in interest rates before a decline sets in. An increase in rates such as we are having now. My expectation is the inverted yield curve will unwind with longer term-rates rising above shorter-term rates followed by a decline over the entire yield curve with short-term interest rates falling more and more rapidly.

(d) though most people may not appreciate it, bonds can be almost as volatile as stocks. Since the COVID pandemic stock market low in March 2020 and the coincident high in treasury bonds, 10-year U.S. treasuries have dropped around 45% and 30-year treasury bonds are down over 50% in price. This is comparable to the nearly 50% drop in stock prices in the bear market following the dot-com cycle highs and more than twice as bad as the decline during the first half of 1981 when Federal Reserve Board Chairman raised the Fed Funds rate to 20%.

(e) This is a reminder that investments such as bonds and stock compete with each other. If interest rates rise, bond prices fall and the higher yield makes bonds more attractive than stocks. This results in investment capital flowing out of stocks and into bonds, in other words, stocks will be sold and bonds will be purchased. Eventually, equilibrium will be reached and the flow will reverse with capital moving out of bonds and into stocks.

(f) There is another factor impacting U.S. bonds in this cycle. The Biden administration has run massive deficits over the past three years. I am not assessing total blame on government policies. All recent governments have produced budget deficits and COVID created unusual pressures to spend. But the current administration has added to the deficit pressures which have to be covered by borrowing which is a process of issuing bonds, that is, increasing the supply of bonds. This will contribute to keeping interest rates higher.

(g) Finally, the Federal Reserve Board has been selling bonds into the market as they said they would. When the seriousness of COVID became clear, the Federal Reserve Board pursued a policy of buying U.S. government bonds. This had the effect of taking bonds out of the system and infusing cash into the system. But as COVID declined and inflation increased, the Federal Reserve reversed this policy and began to sell bonds into the market which removed cash. This policy continues and has the effect of increasing the supply of treasuries for sale and keeping interest rates higher.

Conclusion: In my opinion, the inverted yield curve is directly related to the Federal Reserve anti-inflation policy. The Fed's current stance is that short term interest rates will likely stay higher for longer than generally expected. Most recently, the Fed has used moral suasion, that is, trying to persuade the markets that interest rates need to stay higher rather than accelerating the steps needed to keep interest rates up.

The American equivalent of moral suasion is jawboning and all talk aside, the markets are very much focussed on economic results such as employment and inflation. This week we have the Consumer Price Index report on Thursday. The markets rebounded sharply on Friday so we may have some positive momentum carrying over into the week ahead, but I think investors will tread carefully until they see the CPI results.

Longer term, I think it is still too early to rule out a recession in 2024, especially if long term interest rates continue to rise. There are some forecasts out there for 5% yields on 10-year treasuries and these are looking less outlandish as rates continue to rise. Between now and the end of the first quarter of 2024 we may see the yield curve right itself through a combination of further increases in longer term interest rates and some minor easing at the short end. If this coincides with recessionary indications, there will be pressure on the Fed to lower rates ahead of the election next year.

Cannabis Quickies

I had a quick contact with Chris Bunka, CEO of **Lexaria Bioscience (NASDAQ: LEXX).** Here is a brief summary of what I learned:

(a) I was happy to note that the delay in the Investigational New Drug (IND) application is being taken very seriously. LEXX has been in regular touch with the contractor and I would look for some explanation shortly.

(b) The stock closed at U.S. $1.00 per share which I understand restarts the NASDAQ 30-day clock and relieves some of the pressure of a possible need for a rollback.

Conclusion: Clearly if **Lexaria Bioscience (NASDAQ: LEXX)** is able to get the IND application back on track, the stock performance should improve significantly. As the accompanying chart illustrates, LEXX has traded in a remarkably narrow range since the early spring of this year. The

delay in the IND application is an unexpected bump in the road but LEXX is a company with many irons in the fire. Recently, they added a plan to investigate a diabetes application to the list of projects. I anticipate a sharp move higher and for that to be timed with a full explanation of the IND delay. Hopefully we will have that information within a period of weeks.

Applications Watch

Health Canada issued one new license last week for an adjusted total number of licenses of 970. Last week a license was issued to 9482-3044 Quebec Inc. of Quebec for micro-cultivation. Over 40 public companies are LPs or own an interest in one or more LPs. For a complete list of LPs and related information, Ctrl-Click (here)

(For a free copy of this newsletter or to have your name removed or to contact us with feedback, industry and corporate news, email ted@letstoke.biz)