Why Millennial Investors Should Contribute to Their RRSPs

Description

Investing for retirement has always been a good idea, but the process has become critical for many young Canadians who have entered a workforce that doesn't provide pension benefits.

The new reality of working in Canada is one of contract employment with no pension or full-time employment with a defined contribution pension plan.

This is a big change from the good old days when companies hired people for life and offered a defined benefit pension, where the retirement cheque was guaranteed and the company forked out all of the money to pay for it.

TFSA vs RRSP

The recent popularity of the tax-free savings account (TFSA) has distracted some young people from contributing to their registered retirement savings plans (RRSPs), but the TFSA is a savings product that can be used as a part of retirement planning whereas the RRSP is specifically designed to help people put money away for the golden years.

Ideally, young savers would have enough money to max out contributions to both, but that simply isn't the situation for most people.

RRSP contributions are useful because they reduce taxes today and ideally grow to become much larger amounts that can be used to pay the bills in retirement.

Yes, the money is taxed when it is withdrawn, but the tax rate in retirement might be lower than the current rate savers pay on their income. If it isn't, that means the funds have probably grown substantially during the years they were invested.

Another reason for using the RRSP is the fact that investors are more likely to leave the funds alone. Penalties for tapping money in the RRSP act as a good incentive to let the money grow. Money invested in a TFSA is much more accessible, as it should be, but that isn't good if the savings are earmarked for retirement.

Which stocks should young investors buy?

Millennials with self-directed RRSP accounts should consider dividend stocks with long track records of earnings growth. These companies tend to be leaders in their industries and operate in sectors with significant protection from new entrants.

When dividends are reinvested in new shares of the company, a small initial investment can grow significantly over time.

Canadian National Railway Company (TSX:CNR)(NYSE:CNI) and **Toronto-Dominion Bank** (
TSX:TD

)(NYSE:TD) are two good examples.

A single $10,000 investment in Canadian National Railway 15 years ago would be worth $120,000 today with the dividends reinvested.

A similar investment in Toronto-Dominion Bank would have grown to $42,000.

The secret to building a substantial retirement nest egg lies in the power of compounding, but the critical factor is time. Saving money these days can be a challenge, but young investors who can muster the discipline to put some cash aside every month have the potential to reap huge benefits down the road.

CATEGORY

1. Investing
2. Stocks for Beginners

POST TAG

1. Editor's Choice

TICKERS GLOBAL

1. NYSE:CNI (Canadian National Railway Company)
2. NYSE:TD (The Toronto-Dominion Bank)
3. TSX:CNR (Canadian National Railway Company)
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