What Should You Buy in an RRSP Before the End-of-February Deadline?

Description

You have until February 29 to contribute to your RRSP for the 2015 tax year, but the amount you contribute until then can be used to reduce your taxes for the 2016 tax year instead. Contributing to an RRSP is especially effective if you're in a high tax bracket because the higher your bracket, the more taxes you will save. What should you invest in with your contributions?

U.S. dividend stocks

It's beneficial for Canadians to invest in high-yield U.S. dividend stocks (excluding master limited partnerships) in an RRSP because there's no withholding tax on those dividends in an RRSP. There's a 15% withholding tax if they are held in a TFSA or non-registered (taxable) account. However, in a taxable account you can claim the 15% back via a foreign tax credit when you file your tax return.

Unfortunately, because of the oil price plummet it costs 39% more to convert Canadian dollars to U.S. dollars. That is, CAD$1.39 converts to US$1. After factoring in the foreign exchange the number of U.S. dividend stocks that still look attractive are limited. Here are a few value dividend stocks that may still make sense despite the pricey forex.

General Motors Company (TSX:GMM.U)(NYSE:GM) seems to be turning around from its bankruptcy in 2009. General Motors is priced at only 5.6 times its earnings, while its earnings per share (EPS) are estimated to grow 10% this year. It's also generating healthy cash flows.

General Motors just raised its dividend by almost 5.6%, and its annualized payout is now $1.52 per share and equates to a 5.3% yield. The payout is only 30% of its fiscal year 2015 EPS, so there's a margin of safety for its dividend.

Like General Motors, **Ford Motor Company** (NYSE:F) is also priced at a low valuation. Ford trades at 5.9 times its earnings. It yields 5.2% and its payout ratio is 31% based on its fiscal year 2015 EPS.

Ventas, Inc. (NYSE:VTR) is a real estate investment trust (REIT) that owns interests in healthcare properties, such as senior housing communities, medical office buildings, hospitals, and skilled nursing facilities. At US$56.30 per share, it yields 5.2% and has a payout ratio of 66%.

HCP, Inc. (NYSE:HCP) is also a healthcare REIT that owns similar types of properties as Ventas. At US$35.60, HCP yields 6.5% and has a payout ratio of 73%. Since it has a higher payout ratio than Ventas and similar funds-from-operations growth potential, investors can expect faster distribution growth from Ventas.

Interest-producing investments

You might also want to put interest-producing investments such as GICs, high-interest savings accounts, and bonds in an RRSP because interest is fully taxable in a taxable account. In an RRSP, interest can be compounded in a tax-deferred environment.

Conclusion

Inside an RRSP, your investments can grow and compound tax deferred. Particularly, high-yield U.S. dividend stocks should be held in an RRSP to avoid withholding tax on the foreign dividends. However, don't buy U.S. master limited partnerships because you will get a 35% withholding tax on their distributions, even if they are held in an RRSP, and you cannot recover that tax.

Of course, if you have room in a TFSA, it's better to maximize it first with interest-producing Canadian stocks or U.S. stocks that have no dividends because what's inside grows tax free.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:F (Ford Motor Company)
2. NYSE:GM (General Motors Company)

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