Invent for Your Retirement

Description

Tom is 20 years old. Sue is 40. They both consider themselves young investors. The differences between the two are the amount they can invest and the time available for their money to work for them.

They both plan to retire when they're 60. In this case, Tom will have 40 years for his investments to compound, and Sue will have 20. Since Tom is younger, he has less savings available to invest than Sue.

Here are several different investments Tom and Sue can consider for their retirement funds.

Exchange-traded funds

Tom has heard about exchange-traded funds (ETFs) from his dad, so he knows they traditionally mimic the performance of an index and are low-cost alternatives to mutual funds.

Since Tom is young, his part-time job brings in limited money for him to save. In fact, he can only save $50 per month. On top of that, he has little time to learn how to manage his investments.

That's why his dad suggests that Tom should invest in an ETF with a broad market exposure, such as the **SPDR S&P 500 ETF Trust** (NYSEARCA:SPY), which mimics the performance of the S&P 500.

Tom thinks he doesn't need this money for at least 10 years. So, he can dollar-cost average into the ETF as the market goes up and down. If he gets a 6% rate of return, at the end of the decade he will end up with $8,235, which is 37% higher than his $6,000 total savings if he only socked away his $50 per month in a tin can.

Of course, as Tom grows older and his pay increases, he plans to save and invest more for higher returns.

Quality dividend-growth stocks

Sue started saving and investing in ETFs when she was 25, but she converted her ETFs to individual stocks over time as she developed a strong interest in them.

By 40, she has accumulated $114,373 by saving and investing $300 a month over 15 years at an average rate of return of 9% per year. Her stock portfolio consists of 20 quality dividend-growth stocks that include the likes of **Royal Bank of Canada** (TSX:RY)(NYSE:RY) and **Canadian Utilities Limited** (TSX:CU).

In fact, the Royal Bank shares she bought in 2004 for $30 per share give her a yield on cost of 10.8%! Likewise, the Canadian Utilities shares she bought in 2003 for $14 per share give her a yield on cost of 9.3%.

In the past five years, Royal Bank increased its quarterly dividend at an average rate of 10.1% per year. Likewise, in the same period Canadian Utilities also coincidentally increased its quarterly dividend at an average rate of 10.1% per year.

Sue saw the advantage of building a quality dividend-growth portfolio with the intention of holding it for the long term.

Firstly, she can reduce her cost by buying only when the shares are at reasonable valuations.

Secondly, as long as the companies are doing fine, she can choose to hold on to them to collect a growing income in the form of dividends.

Thirdly, the dividend income she receives from her portfolio is higher than the amount she would have gotten from investing in ETFs.

Conclusion

Whether you choose to invest in ETFs like Tom or individual stocks like Sue, as long as you stay invested and earn a rate of return, you'll allow your money to work for you over time. This is called compounding.

Over 15 years, we saw Sue's original investment of $54,000 turn into $114,373. This is more than double the amount she saved!

You can also use a portion of your portfolio for "double down" opportunities for outsized gains.

CATEGORY

1. Bank Stocks
2. Dividend Stocks
3. Investing

POST TAG

1. Editor's Choice

TICKERS GLOBAL

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2. TSX:CU (Canadian Utilities Limited)
3. TSX:RY (Royal Bank of Canada)

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