How to Build a $1 Million Portfolio

Description

It's difficult for some people to not use up their paycheque by the end of the month, let alone save $1 million over time. However, if you want to amass a big sum of money for retirement or for a down payment, you must start saving somewhere.

Start saving early

If you don't have a habit of saving, start budgeting so that you may save some of your paycheque each time you receive it. Start saving 1% of your paycheque and slowly work your way up to 10% or higher. Some people I know save up to 50% of their paycheque!

Once you start saving, keep the momentum going. The next step is to get your savings working for you.

What should you invest in?

If you're saving small amounts each month, you might consider investing in low-cost exchange-traded funds (ETFs) that traditionally mimic the performance of an index. By dollar-cost averaging into ETFs over time, you'll end up averaging the cost you pay.

This way, you can get your savings to start working for you. For example, **Bank of Nova Scotia** offers 50 commission-free ETFs that are good starting points for research.

Alternatively, you may choose to invest in individual stocks. When you save at least $1,000 for a $10 trade, the cost per trade is 1%. If that's too much, wait until you save at least $2,000, so the cost per trade lowers to 0.5%.

Historically, by buying quality businesses when the stock market dips 15% or more, investors can generate above-average returns.

Time is the key for compounding

The earlier you save and invest, the longer compounding can work its magic. Anyone starting from square one, saving $500 per month, and earning a rate of return of 7% per year can reach the $1 million portfolio goal in 36 years.

The critical idea is that over 36 years, the investor would only contribute a total of $216,000. That is, of the $1,048,272 from the end result, $832,272 (79% of the end result) was generated by compounding!

At the midpoint of 18 years, the portfolio would only be $237,125, of which you contributed $108,000 and got $129,125 from compounding. Compounding becomes more powerful as time elapses.

Compounding only works if the businesses that you buy create more value and become more profitable over time. The good news is that even if you do end up choosing a few losers, your winners should more than cover the losses.

Which businesses can help you achieve 7% returns?

Other than choosing quality businesses to invest in, the other ingredient for successful investing is the price investors pay for the shares. So, buying on dips of 10-15% is always helpful, although the market could fall 50% like it did during the financial crisis of 2008-2009.

For example, **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM) fell 62% from over $100 in 2007 to about $38 in 2009. At the low point, it yielded more than 9%. Today, shares bought at the low point would yield more than 12% because of dividend hikes. So, from dividends alone, investors would get a 12% return, 5% higher than the required 7%.

It’s generally impossible to catch the bottom. Even if you bought Canadian Imperial Bank shares at $88 per share (a 12% dip from a recent high early this year), you’d still be sitting on a yield on cost of a little over 5.3%. So, you would only need 1.7% of growth from the bank each year to achieve a 7% return, assuming the bank maintains its dividend.

Conclusion

The Big Five Canadian banks have paid dividends for more than 140 years, and they tend to hike their dividends. Other companies that pay higher dividends over time include utilities, such as **Fortis Inc.** and **Brookfield Infrastructure Partners L.P.**, and energy infrastructure companies, such as **TransCanada Corporation**.

Unfortunately, these companies have recovered from their dips and aren’t particularly attractive today.

To preserve their capital, investors should wait for dips of 10-30%, unless they really need the income today (because the companies’ dividend yields are solid).

CATEGORY

1. Bank Stocks
2. Dividend Stocks
3. Investing

TICKERS GLOBAL

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