How to Invest: RRSP vs. TFSA

Description

Over time, we've had the opportunity to stand in the background and observe the mistakes of others. Sometimes the mistakes are made by professionals, and there is a learning opportunity. On other occasions, our friends and family are the ones making the mistakes, which results in a lot of sympathy for them. When we make the mistakes, however, sympathy flies out the window, and we are usually pretty hard on ourselves.

Traditionally, most Canadians have contributed to RRSP accounts with the expectation of taking money out only in retirement. In 2009, the TFSA came about, and things became a little more complicated. The average person had to figure out what would work best for them. There are tax implications for money going in and out of an RRSP, whereas the TFSA has no tax implications on money going in out of the account.

The conundrum faced by many investors is figuring out how to manage the money in each account.

The TFSA

The TFSA is more accessible if ever money is needed. Should investors run into an emergency of some sort, there are no tax consequences for withdrawing money from the account. It is in this account where investors can invest their money in the most boring of companies, otherwise known as defensive stocks.

Examples of defensive stocks are companies such as **North West Company Inc.** (TSX:NWC), which has increased its dividend in four of the last five years and delivers consistent revenues and profits every quarter. Another example of this would be any one of Canada's banks with a focus on the more diversified institutions. Given the large footprint of **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) in the United States, this company is at the top of my list.

One of the most important factors to look for is the consistency of the business and the growth of dividends through all phases of the business cycle, not just the boom times.

The RRSP

Given the long-term nature and tax consequences of putting money in or taking money out of the RRSP account, the average timeline for an investment in this account is usually much longer than in the TFSA account.

In the RRSP account, investors can invest in defensive or cyclical stocks. Cyclical stocks are securities characterized by higher profits during good times and significantly lower profits (or losses) during economic recessions. These are stocks can translate to significantly higher gains than defensive stocks if purchased at low prices.

Cyclical stocks to consider for one's RRSP account include **Baytex Energy Corp.** (TSX:BTE)(NYSE:BTE), **Cameco Corp.** (TSX:CCO)(NYSE:CCJ), and **Teck Resources Ltd.** (TSX:TECK.B)(NYSE:TECK). These companies are dependent on the demand for resources, which is significantly stronger during good economic times. The dividends, in turn, are often cut during tough times and increased significantly during good times.

Due to the boom-and-bust nature of cyclical companies, it is advisable for any investor looking to invest into any of these stocks to have a very long holding period. Although the long-term expected returns are higher for cyclical stocks than defensive stocks, the volatility will be there to match.

No tax advice is being offered in this article.

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1. Editor's Choice

TICKERS GLOBAL

1. NYSE:CCJ (Cameco Corporation)
2. NYSE:TD (The Toronto-Dominion Bank)
3. NYSE:TECK (Teck Resources Limited)
4. TSX:BTE (Baytex Energy Corp.)
5. TSX:CCO (Cameco Corporation)
6. TSX:NWC (The North West Company Inc.)
7. TSX:TD (The Toronto-Dominion Bank)
8. TSX:TECK.B (Teck Resources Limited)

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