How to Make Good Use of Your TFSA

Description

Since Tax-Free Savings Accounts (TFSAs) are newer than Registered Retirement Savings Plans (RRSPs), some investors may wonder how to make good use of a TFSA.

What's earned in a TFSA is tax-free, which allows substantial tax savings for returns compounded over many years. Even though TFSAs are called "savings accounts," they are actually good for investing in stocks.

Why should you consider stocks? Interest rates are low. Additionally, long-term stock returns have tended to outperform other investments, including bonds.

Here's how you can make good use of your TFSA.

Investing for big purchases

Because you can withdraw from TFSAs without penalties anytime, they are great for saving or investing for big purchases, such as vacations, cars, and mortgages.

The TFSA contribution limit for 2017 is $5,500. If you've never contributed to a TFSA before, you could have as much as $52,000 of contribution room.

An amount of $52,000 invested in a TFSA for a 4% dividend yield would generate $2,080 of tax-free income per year. That's enough for a nice vacation every year!

You can achieve a 4% portfolio yield by building a portfolio with proven dividend-growth stocks, including **Telus Corporation** (TSX:T)(NYSE:TU), which offers a nice 4.3% yield. Management also aims to grow Telus's dividend at a compound annual growth rate of at least 7% for the next two years.

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think, plan, and act to work towards your financial goals

If you're planning to make bigger purchases, such as a car or mortgage (assuming you want to save at least 20% of down payment to avoid having to pay the CMHC mortgage loan insurance), you can target higher rates of returns, likely with a mix of dividends and growth from capital appreciation.

Expect to take multiple years to save enough for these big purchases because the amount you save and the careful investment for reasonable returns are both essential.

Also, be aware that if a market crash occurs, you'll have to delay your purchases. Assuming you build a diversified portfolio of quality stocks, market crashes will only bring your portfolio down temporarily. History shows that market crashes typically recover within two years.

Investing for retirement

If you're investing for retirement, you may have decades for your investments to grow. Investing in stocks in your TFSA can be a part of your overall strategy to help you secure a comfortable retirement.

Generally, you can't go wrong by focusing on quality companies across different sectors and industries, especially if they are companies that have track records of increasing their dividends.

You can also sprinkle in some growth stocks, such as **Shopify Inc.** (TSX:SHOP)(NYSE:SHOP), to boost the growth of your portfolio.

Assuming you invest $5,500 every year in your TFSA over 10 years for a reasonable rate of return of 8%, you'll amass nearly $83,850. In 20 years, you'll amass $269,966. And in 30 years, you'll have $683,076!

Investor takeaway

A TFSA can be a part of your overall strategy to reach your financial goals, whether it's to fund your vacation every year, your new car, a mortgage, or even your retirement. The earlier you start, the less risk you can take while investing for a reasonable rate of return.

Here's one more tip: since TFSA withdrawals are tax-free, you can also use your TFSA funds in an emergency if needed.

CATEGORY

1. Dividend Stocks
2. Investing

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