New Investors: How to Use Dividend Stocks to Help You Save for Retirement

Description

Young Canadians are searching for ways to set aside some cash for the golden years.

In the past, this wasn't such a big issue, as most people found decent full-time jobs right out of school and companies offered generous pension plans.

Today, contract work is more common, and when a young person secures a full-time position, the pension benefit is more likely to be a defined-contribution plan rather than a defined-benefit plan.

This puts the risk on the shoulders of the worker, rather than on the company when it comes to ensuring a targeted payout upon retirement.

In addition, young Canadians can't count on a home being a retirement safety net. House prices have increased so much that new buyers are unlikely to see the same gains their parents or grandparents have enjoyed.

What can young savers do?

The Tax-Free Savings Account (TFSA) offers investors a way to build a retirement nest egg without having to worry about sharing any of the gains with the taxman.

One popular strategy involves buying dividend stocks and reinvesting the distributions in new shares. This sets off a powerful compounding process that can turn a modest initial investment into a substantial retirement fund over the course of many years.

When the time comes to spend the money, all of the gains go straight into your pocket.

Which stocks should you buy?

The best companies tend to be market leaders with strong track records of dividend growth.

Let's take a look at **Canadian National Railway Company** (TSX:CNR)(NYSE:CNI) to see why it has proven to be a good pick.

Competitive advantage

CN is the only rail operator in North America that owns tracks connecting three coasts. The advantage is unlikely to change, as merger attempts in the industry tend to hit regulatory roadblocks, and the odds of new tracks being built along the same routes are very slim.

CN still has to compete with trucking companies and other railways in some areas, so it works hard to ensure the business runs as efficiently as possible. In fact, CN is widely viewed as the top pick in the sector and regularly reports an industry-leading operating ratio.

Dividend growth

CN generates significant free cash flow and is generous when it comes to sharing the profits with shareholders. The company has a compound annual dividend growth rate of about 16% over the past 20 years, and it has historically repurchased shares in aggressive buyback programs.

Strong returns

A $10,000 investment in CN two decades ago would be worth more than $230,000 today with the dividends reinvested.

The bottom line

There is no guarantee that CN will deliver the same results over the next 20 years, but the strategy of buying dividend-growth stocks and investing the distributions in new shares is a proven one, and using the TFSA ensures all the gains are yours to keep.

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2. Stocks for Beginners

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