Young TFSA Investors: A Top Canadian Dividend Stock to Start Your Retirement Fund

Description

Millennials are searching for ways to set some serious cash aside for a comfortable retirement.

In the past, young professionals didn't have to worry as much about their retirement planning. Most people found good jobs right out of college or university and those positions used to come with generous pension benefits. Today, contract work is more common, and when a full-time job becomes available, the pension component of the total remuneration package can vary significantly. Defined-benefit plans are rare these days, unless you get a gig with the government. Instead, companies tend to offer defined-contribution plans.

In addition, the old strategy of buying a home to use as a retirement safety net is not a guaranteed home run. Property prices have skyrocketed in the past 20 years to the point where owning a home is out of reach for many young families, and the ones who manage to scrape together the down payment to buy might not see the value increase the way it has for their parents.

Fortunately, young investors have alternative options to set aside cash for their golden years. One popular strategy involves owning dividend growth stocks inside a Tax Free Savings Account and using the distributions to buy more shares. Over time, the power of compounding can create some substantial savings.

Let's take a look at one of Canada's top companies to see why it might be an interesting pick to start your TFSA retirement fund.

Royal Bank of Canada (TSX:RY)(NYSE:RY)

Royal Bank is a giant in the Canadian financial sector, with strong operations in commercial and personal banking, wealth management, capital markets, investor and treasury services, and insurance.

The balanced revenue stream provides multiple avenues for growth; when one segment has a rough quarter, the others often make up the slack.

Royal Bank reported fiscal Q2 2018 net income of $3.1 billion, representing a 9% increase over the same period last year. Diluted earnings per share increased 11% to $2.06, and the company generated a solid 18.1% return on equity.

Rising interest rates might trigger a slowdown in mortgage sales, and a plunge in home prices would certainly be negative for the banks. That said, Royal Bank is more than capable of riding out a downturn in the housing sector. The company is well capitalized with a CET1 ratio of 10.9%. A significant part of the mortgage portfolio is insured, and the loan-to-value ratio on the uninsured mortgages is low enough (51%) that the broader Canadian housing market would have to fall substantially before Royal Bank sees a material impact.

Net interest margins are improving with rising interest rates, which should offset any negative impact on mortgage growth.

Royal Bank has a strong track record of dividend growth, and the annual increases should continue in line with targeted earnings growth of 7-10%. The current distribution provides a yield of 3.7%.

Long-term investors have done well with the stock. A $10,000 investment in Royal Bank 20 years ago would be worth about $110,000 today with the dividends reinvested.

The bottom line

Young Canadians can take advantage of the tax-free status of the TFSA to set aside a nice nest egg for the future as part of their overall retirement plan. Owning quality dividend-growth stocks and investing the distributions in new shares is a proven strategy for building long-term savings.

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aswalker