How to Turn Your $6,000 TFSA Contribution Into $88,000

Description

Canadian savers are starting to take full advantage of the benefits offered by the Tax-Free Savings Account (TFSA).

Since the TFSA's launch in 2009, Canadian residents have contribution room of as much as $63,500. The limit increased by $6,000 for 2019, and similar or larger hikes are expected in the coming years.

The attraction of using the TFSA for retirement planning lies in the tax-free status. Any dividends that are distributed inside the TFSA are not subject to tax, so investors can invest the full value in new shares to take advantage of the magic of compounding. In addition, any gains in the share price are also 100% yours to keep when the time comes to cash out and spend the money. This is different from RRSP contributions, which are taxed when the funds are withdrawn.

Which stocks are the best picks?

Ideally, you want to own industry leaders with strong track records of revenue and earnings growth. Let's take a look at one top Canadian dividend stock that might be an interesting pick today for your TFSA.

Toronto-Dominion Bank

Toronto-Dominion Bank (TSX:TD)(NYSE:TD) is well known as a giant in the Canadian banking sector, but it also has a large American operation that is now a top-10 bank in the United States. TD spent billions of dollars over the past 14 years to acquire attractive regional banks located along the east coast of the country. Today, the bank actually has more branches in operation south of the border than it does in Canada.

The U.S. division is important, as it provides a stable revenue and income stream that balances outany potential troubles in the Canadian economy. Tax cuts in the United States and a stronger U.S.dollar have provided a boost to profits in the past couple of years, and TD continues to generate solidresults.

The company delivered fiscal Q2 2019 adjusted earnings of $3.3 billion, representing a 7% increase over the same period last year. Adjusted net income from the American operations came in at $1.26 billion, up 29% from Q2 2018.

TD raised its quarterly dividend by 10% earlier this year. The current payout of $0.74 per share provides an annualized yield of 3.9%. The bank has hiked the distribution by a compound annual rate of better than 10% for the past 20 years.

On the risk side, pundits point to rising debt levels in Canada as a potential threat to TD and its peers. A meltdown in the housing market triggered by higher interest rates or rising unemployment would certainly be negative for TD, as it carries a large mortgage portfolio. That said, the bank is more than capable of riding out a downturn. For the moment, mortgage rates are actually falling and Canada’s unemployment rate is the lowest it has been in decades.

Long-term investors have done well with TD. A $6,000 investment in the stock 22 years ago would be worth $88,000 today with the dividends reinvested.

The bottom line

There is no guarantee TD will deliver the same returns in the coming years, but the strategy of buying top dividend stocks and using the distributions to acquire new shares is a proven one. TD is just one of many top-quality companies on the TSX Index that have strong businesses that generate growing dividends supported by rising revenue and profits.

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