Canadian Investors: Are You Banking on Big TFSA Returns?

Description

Canadians are increasingly using their TFSA contribution limits to buy stocks inside self-directed accounts.

Since its launch in 2009, the TFSA contribution room has grown to $63,500. The limit jumped $6,000 in 2019 and is expected to increase by at least that amount every year going forward. At the current pace, investors will have up $100,000 in tax-free space available in the TFSA in the next six years.

The TFSA is an attractive tool for investors of all ages, and younger Canadians can use it as part of their retirement planning program. When dividend stocks are inside the TFSA, the distributions can be used to buy new shares to grow the portfolio.

For retirees, the TFSA is a good spot to earn additional income that isn't taxed and doesn't count toward annual income calculation that the government uses to determine Old Age Security (OAS) payments. Once your income breaks through a specific threshold (currently $75,910), some of the OAS pension gets clawed back.

Which stocks should you own?

Canadian bank stocks have historically been top buy-and-hold picks for investors. Some pundits say the fantastic run of outsized gains is coming to an end as a result of an anticipated slowdown in mortgage sales and ongoing challenges from non-bank digital competitors entering the sector.

Adjustments are certainly likely, but ruling out the big Canadian banks completely might be a mistake. The two largest players, **Royal Bank of Canada** (TSX:RY)(NYSE:RY) and **Toronto Dominion Bank** (TSX:TD)(NYSE:TD) have strong reputations built on more than a century of trustworthy operations. They have the financial clout to invest in digital platforms to stay competitive, and while they might lose some revenue to new entrants, the overall businesses still enjoy a wide moat.

Royal Bank earned $12.4 billion in profits in fiscal 2018. TD had adjusted earnings of $12 billion. Both companies are targeting earnings-per-share growth of 7-10% over the medium term and should raise their dividends each year in line with earning increases. Royal Bank and TD's dividends provide yields of about 3.9% right now.

A $10,000 investment in Royal Bank 20 years ago would be worth more than $130,000 today with the dividends reinvested. The same investment in TD would be worth close to $90,000.

Should you buy TD or Royal Bank?

There is no guarantee these stocks will deliver the same returns over the next two decades, but they both remain top stocks with growing revenue and dividends. As part of a balanced TFSA retirement fund, these banks deserve to be on your radar. Royal Bank has delivered better returns and currently trades at a slightly lower multiple, so I would probably make Canada's largest bank by market cap the first pick today.

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2. NYSE:TD (The Toronto-Dominion Bank)
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