TFSA Investors: Why Growth Stocks Might Be Better Buys Than Dividend Stocks

Description

If you're looking for an investment to put in your TFSA, a dividend stock can often seem like the default option. It pays a recurring amount every month or quarter, and it's a mature enough stock that it may seem like a safe buy.

However, as long as it's an eligible investment inside your TFSA, it doesn't matter whether a stock is paying you dividends or if you're benefiting from capital appreciation; either way, you'll be earning tax-free income.

While growth stocks may not offer anything in the way of dividends, they could more than make up for that with their overall returns. Dividend stocks sometimes fail to produce good returns, and in some instances, investors may see the dividend income only offsetting the stock's losses and, in some cases, even falling short of that. Dividend stocks can give investors a false sense of security.

A good example is **High Liner Foods** (TSX:HLF), which, earlier in the year, was paying as much as 7.4%. In 2018, however, the stock had lost nearly half of its value, and so the high yield may not have been terribly helpful for dividend investors.

The company would ultimately go on to slash its dividend payments from $0.145 every quarter to just $0.05. Now, High Liner's yield is around just 1.9% — a far cry from where it was a year ago. The stock had also been increasing its dividend payments over the years, so it is doubly bad, as not only has it become less likely that the company will hike its payouts in the future, but they have also been drastically reduced.

It's an important reminder for investors that dividends are never a guarantee. Even a company that has a long track record of dividends is not immune from a cut. And without a dividend, there may be little reason for investors to hang on to a stock. That's where investing in a growth stock may be a more attractive option.

Take, for example, a stock like **Amazon.com** (NASDAQ:AMZN), which has become the poster boy for growth stocks and high returns. While the tech giant doesn't pay a dividend and likely won't pay one anytime soon, it has still produced very good returns for investors. In 2018, the stock had risen more than 26%, and through the first seven months of 2019, it is up another 21%.

As big as Amazon is, it's still proving to be a good investment today. A dividend stock paying more than 5% per year combined with an above-average return of 10% would still fall short of what Amazon would have been able to produce. However, it's important to remember that just because Amazon has seen 20% returns doesn't mean that they're a guarantee either.

Bottom line

The key difference is that with Amazon, the company isn't going to be limited by a dividend or the expectations that it will have to continue paying one to keep investors happy. By not being weighed down by a dividend, the company has a lot more flexibility, and that's where it could be a better buy for TFSA investors.

When there's no advantage as to whether the income generated comes from dividends or capital appreciation, then growth stocks may be the better buys.

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TICKERS GLOBAL

1. NASDAQ:AMZN (Amazon.com Inc.)
2. TSX:HLF (High Liner Foods Incorporated)

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