TFSA Investors: Growth vs. Dividends

Description

The Tax-Free-Savings Account (TFSA) is probably the most powerful income-building investing vehicle to be established in Canadian history. No matter what your income level, the TFSA is a handy savings device for growing your assets tax-free over the long term.

There are a number of benefits to using the TFSA as an investment vehicle. First of all, the money you put into the TFSA consists of after-tax dollars. This means that while there is no tax credit on the TFSA, you do not have to pay any tax on anything you pull out of it as well.

If you are investing for the long-term with the intention of pulling out your earnings when you hit retirement, this is great news, as every dollar earned in this account can be pulled out without paying additional taxes. This is in stark contrast to an RRSP, where the money is taxable when removed.

So how can you get the best bang for your buck in this account? Should you invest in high-growth stocks that most likely lack dividends, or should you put your money into more stable stocks which provide steady income? Well, as Obi-Wan Kenobi once said, “many of the truths we cling to depend greatly on our own point of view.”

Let’s look at the benefits and drawbacks of both types of investing and you can decide what will work out best for you.

Growth stocks

Stocks that fit into this category, like the recent growth superstar **Lightspeed POS Inc.** (TSX:LPSD), can give you massive capital growth if you are around to ride the wave upward.

In Lightspeed’s case, if you had bought the stock in Canadian dollars less than a year ago, you would now be sitting on a staggering one year gain of around 100%!

You won't find that level of return from the much safer, stable dividend stocks in your portfolio, I'm afraid. But as an enormously expensive growth stock, Lightspeed also faces a huge risk of a correction.

It is entirely possible that Lightspeed, for example, could collapse in value, leaving you far underwater on your investment. This has been the case for many stocks that have attracted attention over the years.

If you find yourself in the position of having huge losses, you will not be able to write off those losses in your TFSA. Your contribution room will also be gone, as you can't replace money gone from capital losses.

Dividend stocks

While you most likely will not double your TFSA money in the space of one year as you could with growth stocks, stable dividend stocks will give you a more reliable, albeit slower growth over time.

Stocks like **Fortis Inc.** (TSX:FTS)(NYSE:FTS) are the archetype of this kind of investing in Canada. With decades of dividend growth behind it, Fortis currently sports a dividend of about 3.24%, much higher than most GICs where you have to struggle to find a 2% yield. Fortis is likely to increase that dividend again in the coming quarter.

Fortis also had some decent capital appreciation, with its shares appreciating approximately 30% over the coming years. Of course, 30% is not going to be the norm for a dividend stock. It even suggests that a pullback might occur in the near future, although the risk of capital loss is far less than is the case for Shopify.

Which should you buy?

The ideal situation would look like this: Buy a growth stock like Shopify, ride it up, sell the shares tax-free after a double and invest the proceeds in a dividend stock like Fortis. Then, re-buy half the Shopify shares in a taxable account and let them ride.

At that point, you are "playing with the house's money" as it were and can write off a loss on your taxes if it falls. But if you just wanting to choose one strategy, it all depends on your risk profile.

If you can handle severe volatility, go with the growth stocks. Personally, due to global and domestic economic risks, I've sold all of my growth stocks in my TFSA, have switched those to dividend stocks, and have re-bought those dividend growth stocks in my taxable accounts.

If you do that, you can still enjoy tax-advantaged gains by reserve the right to sell your growth stocks for a tax loss should they fall.

CATEGORY

1. Dividend Stocks
2. Investing
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TICKERS GLOBAL

1. NYSE:FTS (Fortis Inc.)
2. TSX:FTS (Fortis Inc.)
3. TSX:LSPD (Lightspeed Commerce)

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