RRSP Wealth: How to Turn $20,000 into a $190,000 Retirement Fund

Description

Canadians have a number of options to consider when putting together a retirement plan.

The fortunate ones have generous defined-benefit pensions at their place of work, but those situations are harder to find these days. Most company pensions are now defined-contribution plans where the employees put part of their salary into the fund and the company matches the contribution at a specified percentage.

This can be a rewarding option, especially if the company kicks in a 100% match, but it also shifts risk to the employee as the payout in retirement depends on the value of the fund, rather than being guaranteed.

Self-employed Canadians, or those who are part of the new gig economy, normally don't have any pension plan at all, and relying on CPP and OAS payments to cover their living expenses in the golden years could be a challenge. As a result, their need to create a self-directed pension is more important.

What should savers do?

An RRSP is a good option to get the process started. The contribution limit is generous, at 18% of earnings, and the funds placed into an RRSP can be used to reduce taxable income for the designated year.

It's always better to defer the amount of tax you have to pay the government as long as possible. Money buys more today than it will in 30 years. In addition, the tax rate when you remove the funds from the RRSP down the road will likely be lower than when you make the contribution.

A popular strategy for building retirement wealth involves buying reliable dividend stocks and using the distributions to acquire additional shares. The compounding effect can turn a small portfolio into a substantial retirement fund over time.

Let’s take a look at one of Canada’s top bank stocks to see why it might be an interesting pick.

Bank of Nova Scotia (TSX:BNS) (NYSE:BNS) is Canada’s third-largest bank with a market capitalization of $92 billion.

The company has strong Canadian operations in personal and commercial banking and wealth management. Scotiabank understands that demand is rising in the wealth management sector and made two large, aggressive acquisitions in the past year.

The bank is also betting on growth opportunities in Latin America. This might appear to be a risky endeavour, given the history of economic and geopolitical volatility in the region. However, the countries of interest hold significant growth potential.

Scotiabank is focusing on Mexico, Peru, Colombia, and Chile. The four countries make up the core of the Pacific Alliance trade bloc and are home to more than 230 million people. Despite recent unrest in Chile and concerns over the policies of Mexico’s new government, the long-term prospects are attractive.

In fact, the international operations are already performing very well for Scotiabank and contribute nearly a third of the company’s earnings. As the middle class expands in the Pacific Alliance countries, revenue and profits should continue to rise.

The bank has a strong track record of dividend growth and the board recently raised the payout. Investors who buy today can pick up a solid 4.8% yield.

A $20,000 investment in Scotiabank just 20 years ago would be worth about $190,000 today with the dividends reinvested.

The bottom line

A diversified RRSP portfolio is always recommended and owning a basket of stocks that includes top dividend payers similar to Scotiabank should perform well over the long-haul and help Canadians meet their retirement goals.

CATEGORY

1. Bank Stocks
2. Dividend Stocks

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2. TSX:BNS (Bank Of Nova Scotia)

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