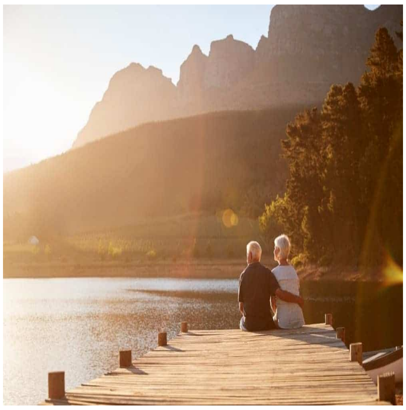

Wealthy Retirement: How a $50,000 TFSA Can Turn Into $690,000

Description

Canadians are using their Tax-Free Savings Accounts to create self-directed pension funds.

Since its launch in 2009, the TFSA cumulative contribution room has grown to as much as $63,500 per person.

The great thing about the TFSA is that any interest, dividends, or capital gains earned inside the account are not taxed. When the time comes to remove the money, the amount taken out of the TFSA is also not counted towards taxable income.

This is different from Registered Retirement Savings Plans (RRSP), which that provide a reduction in taxable income at the time the funds are put into the RRSP, but are taxed later, when removed.

Which investments are the best for a TFSA?

Owning top-quality dividend stocks has proven to be a solid strategy for buy-and-hold investors.

Let's take a look at one stock that has delivered strong returns and should continue to be an attractive pick for a self-directed pension portfolio.

RBC

Royal Bank of Canada (TSX:RY)(NYSE:RY) is a very profitable company. In fact, Canada's largest bank by market capitalization earns more than $1 billion per month!

The secret to the success lies in the company's balanced revenue stream that comes from a wide array of segments in the banking industry across a number of geographic locations.

Royal Bank is one of the 15 largest banks in the world and has operations in 36 countries with 86,000 employees providing financial services to more than 16 million clients.

Canada remains the most important market for Royal Bank, generating 62% of the bank's revenue. the

U.S. contributes 23% and the international business units add the remaining 15%.

On a segment basis, the personal and commercial banking group contributes 49% of earnings. Capital markets activities add 21%, while wealth management provides 18% of profits and the insurance group contributes 7%. Investor and treasury services round things out at 5%.

Royal Bank is well capitalized with a common equity Tier 1 ratio of 11.9%. This is important, as it means the bank has ample reserves to ride out a downturn.

Return on equity for the first three quarters of fiscal 2019 came in at a respectable 17%.

Royal Bank has a strong track record of raising the dividend. The board has increased the payout by a compound annual growth rate of 7% over the past decade.

The company anticipates earnings per share to increase by at least 7% per year over the medium term, so investors should see the dividend trend continue. The current distribution provides a yield of 3.9%.

The payout ratio remains within the 40% to 50% range, meaning Royal Bank has significant cash leftover to invest in its digital initiatives and make strategic acquisitions.

Risk?

One potential threat to consider is the bank's large Canadian residential mortgage portfolio. Royal Bank finished fiscal Q3 2019 with $295.5 billion in housing loans. The exposure is significant and a meltdown in Canadian home prices would be negative.

However, the loan-to-value ratio on the uninsured component is 52%, so things would have to get pretty bad before Royal Bank took a meaningful hit. As a percentage of the company's overall market capitalization, the mortgage book is actually smaller than that of some other Canadian banks.

Returns

A $10,000 investment in Royal Bank 20 years ago would be worth $138,000 today with the dividends reinvested. A couple who invested $50,000 in the stock at that time would now have $690,000!

The bottom line

Royal Bank should continue to be a solid anchor pick for a buy-and-hold retirement portfolio.

Diversification is always advised and the TSX Index is home to several top dividend stocks that have provided similar, or even better, results.

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