TFSA Investors in Canada Keep Falling for This Common Mistake

Description

If you have a TFSA, then you're already ahead of millions of Canadians. TFSAs are as close as it gets to free money. Not investing with one is a major mistake.

But after opening a TFSA, many investors get lulled into investing in the wrong sorts of companies. You see, many analysts and pundits recommend dividend stocks given the income that they produce will be tax free.

Bank of Nova Scotia (TSX:BNS)(NYSE:BNS), for example, pays a 4.7% dividend. That's like earning 4.7% interest on your money simply for owning shares. Plus, you earn capital gains!

Receiving this dividend income tax free is an incredible gift, but it comes with real downsides.

Because dividend stocks pay out regular cash to investors, they have less cash to fund internal growth projects. This is why most dividend-paying companies are mature, slow-growth businesses.

Bank of Nova Scotia, for example, has grown EPS by just 2.6% per year since 2014. That's hardly a figure worth bragging about.

By owning dividend stocks like Bank of Nova Scotia, you'll receive tax-free dividends, but you'll also forgo high-growth opportunities.

That's a mistake given that dividends aren't the only thing shielded from taxes in a TFSA. Capital gains are also protected, meaning that you could experience giant gains and still pay $0 to the government.

If you want to squeeze the most value out of your TFSA, go for growth stocks, not dividend stocks. The following examples present a compelling case for ditching income for growth.

Growth can be magical

Growth stocks can do things that dividend stocks simply cannot do. Consider **Constellation Software Inc**

(TSX:CSU). The company reinvests nearly all of its cash flow, and while it does pay a measly 0.39% dividend, it's clear that it's still very much a growth stock. Since 2006, shares have risen by 6,000%.

For comparison, the **S&P/TSX Composite Index** has returned just 37%, while ScotiaBank has returned only 78%.

Who cares about a 4.7% dividend when you could have increased the value of your portfolio by 6*0 times*?

Boyd Group Income Fund (TSX:BYD.UN) is another prime example. Since 2006, shares have popped by an astounding 15,000%. These results are unheard of in the dividend-paying world.

Boyd has reinvested the vast majority of its cash to fund future growth, which in this case means acquiring collision centres sand consolidating the industry. The good news is that the company likely has a decade or more of growth ahead of it using the same strategy.

To be sure, not all growth stocks explode in value, but the long-term upside can be lucrative. If you're going to save on taxes, you may as well accrue a 6,000% capital gain versus a 4.7% dividend.

While dividend stocks still have their place, don't ignore them if you're using the power of a TFSA.

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TICKERS GLOBAL

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2. TSX:BNS (Bank Of Nova Scotia)
3. TSX:CSU (Constellation Software Inc.)

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