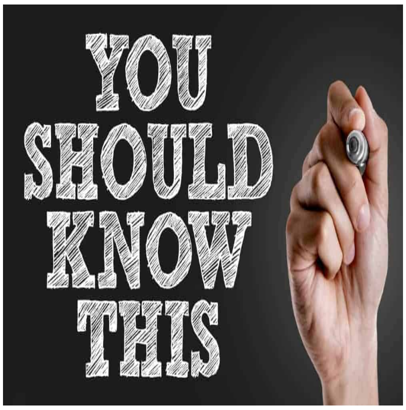

TFSA Investors: This Is The Worst Mistake You Can Make

Description

Having a TFSA is the single greatest thing you can do to avoid taxes and maximize the value of your portfolio. If you don't have a TFSA, sign up for one *today*. It's free, and the benefits are immediate.

Yet even those who already have a TFSA still leave money on the table. Long term, one classic mistake can easily add up to millions of dollars in lost value.

Fortunately, correcting this mistake is rather easy. The single biggest solution is simple awareness. If you know what the mistake is, you're significantly less likely to make it.

Know your advantages

The biggest mistake you can make with a TFSA should be obvious if you understand its primary advantages. As the name suggests, a Tax-Free Savings Account shields you from taxes. From dividends to capital gains, your money grows tax-free and is withdrawn tax-free, no exceptions.

This is no trivial benefit. In total, various taxes can reduce your portfolio's value by up to one-third. A $1 million nest egg could quickly be reduced to $700,000 or less.

Because the tax advantages are unlimited, it makes sense to maximize your growth. After all, you'd pay significantly more taxes on a 100% gain than a 10% gain. If you never need to pay taxes, might as well rack up as much tax-free gains as possible.

Avoid holding cash

This brings us to the biggest mistake Canadians keep making with their TFSAs: holding cash. Fool contributor Ambrose O'Callaghan highlights how this mistake is prevalent across all age groups.

"Bankrate, a New York-based consumer financial services company, released a report in 2018 that showed nearly one in three millennials prefer cash instruments for long-term investments," he wrote.

"Unfortunately, millennials are not alone in making this mistake. A study from Statistics Canada that revealed 42% of TFSA-holders primarily stick to cash."

There is simply no reason to hold cash in a TFSA. At the very minimum, buy an index fund that holds high-quality, short-duration bonds. The returns will be minimal, but should still outpace the interest rate you'd get with cash.

Most investors, especially young ones, should continue to own a diversified portfolio of stocks and bonds. Over a decade or more, the stock market has consistently outperformed nearly every other asset class. If you can afford to think long term, don't worry about short-term volatility.

If you're shielded from taxes, don't throw away the benefits by holding cash and earning an ultra-low interest rate.

Another reason to avoid holding cash is the flexibility of a TFSA. You can withdraw your savings at any time for any reason. Plus, withdrawals open up additional contribution room the following year. And because contribution room for previous years *rolls forward*, you don't need to worry about maxing out your TFSA space.

Holding cash all but eliminates your tax advantages. If you need to withdraw for whatever reason, a TFSA gives you the same flexibility as a bank account, and you don't need to worry about using up your lifetime contribution room. At minimum, stick with low-risk bonds, although owning a broad portfolio of wealth-generating stocks is still the best option for most investors.

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