2020 TFSA Contribution Room: This 3-Item Checklist Will Make You Rich

Description

The 2020 TFSA contribution limit is $6,000. Although there's new contribution room every year and it adds up over time, you can project years ahead and realize that there's a limit to the amount that you can contribute in your lifetime.

Because income and gains earned in TFSAs are tax-free, you don't want any of your investment dollars to go to waste. It's your hard-earned money!

Therefore, consider investing defensively in your TFSA — that is, invest for satisfactory returns while aiming to reduce downside risk.

Investing in proven dividend stocks is one way to invest defensively. Here are three things you should have on your checklist for choosing defensive dividend stocks, such as **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD).

Does the company have reliable profits?

Profits of the company in question must be reliable, because dividends are paid from earnings. It's even better if the company tends to increase its earnings over time.

TD Bank's earnings are pretty reliable, allowing it to compound its earnings per share by more than 7% per year for more than a decade. The growing profits also supported generous dividend growth of almost 9% per year.

Does the stock offer safe dividends?

Other than growing earnings, a reasonable payout ratio also helps protect the dividend.

In the years around the financial crisis of 2007-2008, TD's diluted earnings dropped quite dramatically. However, the leading North American bank's payout ratio had a big enough margin of safety to protect its dividend; it only froze its dividend in fiscal 2010 before resuming dividend growth in the following year.

TD Bank's payout ratio is estimated to be roughly 43% of this year's earnings. Even if the bank increased its dividend by about 10% in late February, its payout ratio would still be below 50% for the year.

Regardless of how much TD will increase its dividend next month, investors should welcome TD's current safe yield of 4%.

Are the estimated returns satisfactory for you?

If you pay too much for a stock, you'll end up with mediocre returns. Buying stocks at reasonable to discounted valuations is essential for satisfactory to incredible returns.

At $73 and change per share, TD stock trades at about 10.9 times earnings — a discount of roughly 10% from its long-term normal multiple. Additionally, management estimates long-term earnings-per-share growth of 7-10% per year.

Let's be more conservative and use a 6% growth rate. Making this assumption, TD stock can deliver five-year total returns of about 11-14% per year.

I typically aim for total returns of at least 10%. TD satisfies this criterion.

Investor takeaway

By going through this checklist every time before you buy a stock, you'll be well on your way to building vast wealth. Other than TD, I'd consider buying these dividend stocks for my TFSA.

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