TFSA Investors: 42% of You Are Making This Major TFSA Mistake

Description

Tax-Free Savings Accounts (TFSAs) are now more than a decade old. And even though it's still far, far younger than the age-old RRSP, it has trumped RRSP when it comes to the number of users. More people have a TFSA now than ever — and it's easy to see why.

With its tax-free nature, it gives investors much more investment potential compared to taxed or tax-deferred accounts, and you can plan your future with relatively more certainty when you're saving or investing in TFSA.

Still, many people aren't using TFSA the right way. In fact, 42% of Canadians are using it the *wrong* way, which means that they are treating the TFSA as just another savings account.

The meager returns you might get by using your TFSA for hoarding cash don't even come close to what it can do for you when you put to the right use.

Just another savings account

Let's say you have a fully stocked TFSA, and you decided to play it safe and break it into three parts. $25,000 for interest-based earnings, $25,000 in GICs, and the rest left alone for a rainy day.

Even if you managed to grab the best interest rates on your TFSA savings (2.75%) and best GIC rates (2.9%), your accumulated return for a year would be somewhere around $1,400.

Even if you employ the awesome power of compounding and keep adding $5,000 to your TFSA in savings and in GICs, you'd be sitting at $346,000 in 30 years — more than half of which will be your capital.

The right way: investing in stocks

The most effective way to use a TFSA is to invest in stocks. Even if you pour the bulk of it in blue-chip

Dividend Aristocrats, your returns will be better than those of savings and GICs. Alternatively, you may want to opt for a combination of growth and dividends.

Laurentian Bank (TSX:LB) and **Genworth MI Canada** (TSX:MIC) are two companies you can direct your TFSA toward instead of using it simply as a cash stash.

Laurencin Bank is a Dividend Aristocrat with over 12 years of increasing payouts under its belt. Currently, the bank is offering a yield of 6%, a definite step up from the GIC rates of 2.9%. Let's say we put $25,000 in there.

Genworth MI is another Dividend Aristocrat with a history of increasing dividend payouts for 10 consecutive years. The current dividend yield is a modest 3.7%, which, while not as high as the other stock is still better than the returns you might get from using your $25,000 TFSA chunk as savings. And the best part of Genworth is not its dividend yield, but rather, its growth.

The company has grown its market value over 80% in the past five years, bringing its compound annual growth rate to 13%.

In dividends alone, the combined $50,000 of your TFSA in the two stocks will get you over $2,400 in annual returns. And if we factor in the 13% growth of your Genworth stock over 30 years, you'll be sitting on a sum of over $977,000.

This is over 2.5 times the growth compared to the interest and GIC-based growth over the same period — with half the investment.

Foolish takeaway

Investing in stocks isn't as dangerous as many people believe, however. And you can mitigate the risks by carefully choosing stocks and picking companies with good businesses.

The purpose of TFSA was to help Canadians grow their wealth for long-term and short-term financial goals. But if you stick with putting cash into your TFSA, the growth rate will barely help your savings keep pace with inflation.

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1. TSX:LB (Laurentian Bank of Canada)

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