TFSA Pension Wealth: How $20,000 Can Grow to $580,000 in 20 Years

Description

Canadians of all ages are looking for ways to boost the size of their retirement fund.

Younger investors are particularly concerned, as many do not have generous company pensions. Businesses that used to readily hire new grads to full-time jobs now prefer to offer contract work before adding permanent staff.

When a secure job is offered, it normally comes with a defined contribution pension plan, where the firm matches an employee's pension contributions to a certain limit. That's okay and can be adequate to meet savings needs, but the payouts at retirement depend on the value of the fund, rather than being guaranteed by the company.

The emergence of the gig economy in recent years has provided additional flexibility and challenges. People have more options to work when they want, but the result is a significant rise in the number of the self-employed, who have no benefits at all, let alone a pension plan.

In this situation, the responsibility for setting cash aside for the golden years sits squarely on the shoulders of the individual.

Even people with company jobs and a pension are wondering if they will be able to maintain a comfortable lifestyle in retirement. A growing number of Canadians retirees are making mortgages payments, and that trend is expected to continue with the increased cost of housing.

Overall, there is a widespread desire to boost personal pension portfolios.

One strategy is to buy dividend stocks inside a Tax-Free Savings Account (TFSA) and use the distributions to acquire more shares in the company. This harnesses a powerful compounding process that can turn a relatively modest initial investment into a significant fund over the course of 20 or 30 years.

Let’s take a look at one top Canadian dividend stock that has delivered impressive returns and should continue to be a solid pick for a TFSA retirement fund.

Canadian National Railway (TSX:CNR)(NYSE:CNI) was hit with a week-long strike in the fourth quarter of 2019 that hurt results for the period and had an impact on full-year 2019 results.

The one key thing that emerged from the shutdown is the fact that CN is an essential part of the efficient operation of the Canadian and U.S. economies. This is important for investors, as it highlights CN’s competitive advantages and long-term potential to grow.

CN is the only North American rail carrier with lines that connect ports on three coasts. New lines are not going to be built by a competitor to serve the same routes, so the company enjoys a wide moat.

That said, CN still has to compete with trucking companies and other railways along some routes. This forces management to make the necessary investments to ensure CN remains at the top of its class.

Despite the challenging fourth quarter, CN still generated adjusted net income of $4.19 billion in 2019 compared to $4.06 billion in 2018. Free cash flow in 2019 was just under $2 billion, and CN is targeting free cash flow of $3-$3.3 billion in 2020.

CN is generous with its profits. The board has increased the dividend by a compound annual rate of about 16% over the past 20 years. It raised the distribution by 18% in 2019 and just raised it by 7% for 2020. The 2021 hike should be back in line with the long-term average, assuming CN hits the free cash flow guidance.

A $20,000 investment in CN two decades ago would be worth $580,000 today with the dividends reinvested.

The bottom line

There is no guarantee CN will generate the same returns over the next 20 years, but the stock deserves to be part of a balanced TFSA dividend fund.

The **TSX Index** is home to many top dividend stocks and the strategy of investing the distributions in new shares is a proven one to create wealth.

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