TFSA Fortune: How Canadians Can Turn $50,000 Into $2 Million for Retirement

Description

Canadians are wondering if they will have enough money to live comfortably in their retirement years.

Why?

The days of walking out of school and into a life-long job at a company that pays a generous defined-benefit (DB) pension are essentially history.

The DB pension has largely been replaced with the defined contribution (DC) plan where employees allocate part of their pay to a retirement fund and the company kicks in an amount at an agreed percentage. This might be a 100% match or better, but it shifts risk to the worker in that the retirement payout depends on the returns generated by the fund. This is different from a DB pension where the company guarantees a payment for your entire retirement life.

In addition, people who are self-employed or work on perpetual contracts have no company pension at all. This has led to a rise in Canadians searching for ways to build their own self-directed retirement portfolios.

One strategy that is gaining in popularity is to use a TFSA to hold reliable dividend stocks. The TFSA protects all income from being taxed so the full value of dividends can be used to buy new shares. This triggers a powerful compounding process that can turn reasonably small initial investments into a large retirement fund over the course of two or three decades.

Let's take a look at one top Canadian dividend stock that has made investors quite rich and shows how the strategy works.

CN

Canadian National Railway Company (TSX:CNR)(NYSE:CNI) only offers a 1.9% dividend yield, but investors shouldn't be put off by the perceived small payout.

CN has a track record of dividend hikes that is among the best in the **TSX Index** with a compound annual dividend growth rate of better than 15% over the past 20 years. The rail operator just raised the distribution by 7% for 2020 after an 18% hike in 2019.

CN isn't without risk. The one-week strike in late 2019 hit results and current blockades of the rail network in Canada will have an impact on near-term results.

Any downturn in the share price, however, should be viewed as a buying opportunity.

The company is targeting free cash flow of $3 to $3.3 billion in 2020, according to the Q4 2019 earnings report. CN is a key player in the efficient operations of the Canadian and U.S. economies and that is going to continue for decades. The company has to compete with trucking companies and other rail lines on some routes, but its network is the only one that connects ports on three coasts.

The business is very profitable and CN invests billions of dollars each year on network upgrades, new locomotives, and additional rail cars to make sure it meets the needs of its customers.

The stock went public in late 1996 and early buyers of the shares have enjoyed impressive gains. A $50,000 investment in CN just 23 years ago would be worth more than $2,000,000 today with the dividends reinvested.

The bottom line

A diversified portfolio is always recommended and there is no guarantee CN will deliver the same results over the next 25 years, but the strategy of buying quality dividend stocks and using the distributions to acquire more shares is a proven one.

Fortunately, the TSX Index is home to many top dividend stocks that can help Canadians build a substantial TFSA wealth fund.

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