2 Top Stocks to Start a TFSA Retirement Fund

Description

Young Canadian savers have a chance to buy top Canadian stocks at discounted prices to launch a personal TFSA pension fund.

Why the TFSA?

The Tax-Free Savings Account (TFSA) came into existence in 2009. Since then, the government has increased the contribution limit each year. It now sits at $69,500. That's large enough to create a solid personal investment fund that could set you up for a very comfortable retirement.

Canadians traditionally put retirement savings into RRSPs. That's still a great idea, especially for people in the peak earning years of their careers. RRSP contributions can be used to reduce taxable income.

Younger investors who are at lower income levels than they expect to be in the next 10-15 years might prefer to put savings into their TFSA as the first option and then the RRSP once the TFSA limit is reached.

The TFSA is also more flexible than the RRSP when it comes to removing funds. A withholding tax is applied to RRSP withdrawals. This isn't the case with the TFSA. In the event you have a financial emergency or if the investments skyrocket in value, you can tap the TFSA funds without a penalty.

Power of compounding

Young investors have time on their side. Funds held inside the TFSA can be used to buy top dividend stocks, and the full value of the distributions can then be invested in new shares to harness the power of compounding. It's like a snowball rolling down a mountain.

When the time comes to cash out and spend the money, you keep all the gains. That’s correct; the CRA does not take any of the profits you generate inside the TFSA.

Let’s take a look at two stocks that might be interesting picks to start the TFSA pension fund.

Royal Bank of Canada

Royal Bank is Canada’s largest financial institution. It is also among the 15 biggest banks on the planet. The company is one of the most profitable of all the large banks with a return on equity in fiscal Q1 2020 of 17.6%. Royal Bank has a strong capital position and is capable of riding out the current economic downturn.

The stock looks cheap right now and offers an attractive 5% dividend yield.

A $10,000 investment in Royal Bank 20 years ago would be worth $100,000 today with the dividends reinvested.

Fortis

Fortis is a North American utility company with more than $50 billion in assets located in Canada, the United States, and the Caribbean.

The operations include power generation, natural gas distribution, and electric transmission businesses. Nearly all the revenue comes from regulated assets. This means cash flow should be reliable and predictable over the the long term. Fortis might not be an exciting company, but it is a great defensive pick during a recession. People and businesses still need electricity and natural gas to keep the lights on and heat their buildings.

Fortis is working through a five-year capital program that will significantly boost the rate base. As a result, the board intends to raise the dividend by an average of 6% per year through 2024. The current payout provides a yield of 3.6%.

A $10,000 investment in Fortis 20 years ago would be worth $145,000 today with the dividends reinvested.

The bottom line

Buying top dividend stocks and using the distributions to acquire new shares can help young investors slowly build a substantial retirement fund for the golden years.

If you are searching for reliable companies to start the TFSA pension fund, Royal Bank and Fortis deserve to be on your radar.

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