TFSA Investing: How to Retire a Millionaire

Description

Canadian savers have an opportunity to build strong Tax-Free Savings Account (TFSA) portfolios that could make them millionaires by the time they retire.

TFSA 101

The government created the TFSA in 2009 with an initial contribution limit of $5,000 — an allowance that increased by $5,000 per year through 2012, and then increased by $5,500 for 2013, 2014. The government bumped it up by $10,000 in 2015 and by $5,500 for 2016-2018. Another increase of $6,000 occurred in 2019 and 2020.

All told, Canadian residents now have as much as $69,500 in TFSA contribution space. That's enough to start building a self-directed pension fund that could set you up for a very comfortable retirement.

Interest and capital gains generated inside the TFSA remain beyond the reach of the CRA. Dividends on Canadian stocks are also tax free, which means investors can hold Canadian dividend stocks and use the full value of the distributions to buy more shares. The strategy sets off a powerful compounding process that can turn small initial investments into large savings over time.

Down the road, investors can decide to use the dividend stream as a tax-free source of income. In addition, any stocks that have increased in price can be sold and the profits on the investments go right into your pocket.

One thing to keep in mind is that stocks based in the United States can be held in RRSP accounts without dividends being impacted, but those held in a TFSA are subject to a withholding tax.

Best stocks to buy?

Investors want to put together a buy-and-hold portfolio of top-quality Canadian stocks with solid track records of paying reliable and growing dividends. Ideally, the businesses serve essential needs in the economy, making them more resilient during economic downturns.

Let's take a look at one company that might be an interesting pick to get a TFSA pension fund started to help meet the goal of a wealthy retirement.

Fortis

Fortis (TSX:FTS)(NYSE:FTS) is a Canadian utility company with more than $50 billion in assets located in Canada, the United States, and the Caribbean.

Large acquisitions made in the United States in recent years diversified the geographic revenue base of the businesses. As a result, Fortis is a great way for investors to get good U.S. exposure in a TFSA through a Canadian company.

The businesses include power generation, natural gas distribution, and electric transmission operations. Revenue tends to be predictable and reliable in these segments. This is part of the reason why Fortis has increased its dividend in each of the past 46 years.

The company's capital program should support ongoing growth in cash flow. Fortis is spending more than $18 billion on projects that will significantly boost the rate base in the next few years and drive higher revenues.

At the same time, low interest rates are expected to remain in place for the foreseeable future. Fortis uses debt to finance development initiatives, so lower rates can mean reduced borrowing costs.

The board expects to raise the dividend by an average of 6% per year through 2024. The stock is holding up well during the current crisis and offers a 3.6% yield.

A $69,500 investment in Fortis 25 years ago would be worth about $1.52 million today with the dividends reinvested.

The bottom line

There's no guarantee that Fortis will generate the same results in the next two decades, and diversification is always recommended. However, the strategy of buying top dividend stocks and using the distributions to acquire additional shares is a proven one.

Several top Canadian dividend stocks have delivered great returns for long-term investors. The recent downturn in the market has made many of these companies attractively priced. In fact, some are very cheap right now by historical measures.

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