TFSA 101: Where Should You Invest $2,000 Today?

Description

The 2020 market crash gives new TFSA investors a chance to buy some of Canada's top stocks at discounted prices.

In fact, this could be the best investing opportunity we will see in the next decade.

Risk vs. reward

Owning stocks comes with risks, and investors who thought the markets always go up recently received a blunt reminder.

A quick look at historical trends, however, points out the value of owning stocks for a long time. Each of the major market crashes in the past 40 years led to a new recovery that topped the previous highs. Investors who managed to catch the March 2020 low are already sitting on some nice gains.

Safe investments, such as GICs, only offer yields of 1-2% right now. In contrast, many top Canadian companies with strong revenue streams and steady profitability now provide dividend yields of 5-8%. Additional downside in the stock market could be on the way in the coming months, but the long-term upside potential likely offsets that risk right now.

Power of compounding

Young investors can harness the power of compounding to turn small initial investments into large sums for retirement. The strategy involves buying top dividend stocks and using the distributions to acquire new shares. In most self-directed trading accounts at the major banks, the dividend-reinvestment process can be set up to occur automatically.

The snowball effect can be significant, especially when dividends increase steadily and the share price moves higher.

Best stocks to buy

Companies that have leadership positions in their industries tend to perform well over the long term. In addition, these stocks normally exhibit long track records of dividend growth supported by rising revenues and profits.

Let's take look at one top Canadian stock that might be an interesting pick to get your TFSA retirement fund started.

Royal Bank

Royal Bank of Canada (TSX:RY)(NYSE:RY) is Canada's largest bank by market capitalization. It is also one of the top 15 in the world based on that metric.

The company is very profitable and entered the current recession with a strong capital position. This means Royal Bank has the means to ride out the downturn.

Loan defaults will jump in 2020, and all of the large Canadian banks are setting funds aside to cover potential loan losses. The unemployment rate is above 13%, and roughly 15% of mortgage holders have asked for payment deferrals. When the six-month payment holiday expires, the hope is that most people will be back to work.

In the event the economy does not rebound as quickly as expected, the banks will take a significant hit. This does not mean Royal Bank and its peers expect to report losses. In fact, the banks are still making good money due to a diversified revenue stream coming from a variety of banking activities.

Royal Bank's dividend should be very safe. The company didn't cut the payout in previous market crashes, and there is little reason to expect a reduction this time. Investors who buy the stock today can pick up a solid 5% yield.

Long-term shareholders have done well with the stock. A $2,000 investment in Royal Bank just 25 years ago would be worth more than $50,000 today with the dividends reinvested. A $20,000 holding would be more than half a million!

The bottom line

Challenging economic times come and go, but the downturns almost always turn out to be great opportunities for investors to buy great companies at cheap prices.

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