2020 Market Rally: How to Turn $5,000 Into $124,000!

Description

The stock market rally off the March low caught many investors by surprise.

Pandemic lockdowns sent official unemployment to 13% in April. Stores closed, businesses shut their operations, and more than 8.3 million Canadians have already applied for the Canada Emergency Relief Benefit (CERB).

Despite the tough times and an uncertain near-term outlook for the economy, investors are buying stocks.

Why are stocks rising?

The market action indicates investors expect a strong economic recovery next year. This is in line with IMF predictions of GDP growth around 6% in 2021 in Canada. Government aid programs continue to roll out to support the unemployed and help businesses get back on track.

The move by most countries to begin reopening their economies is giving investors hope that the worst is over.

The Bank of Canada recently said the economic impact is tracking along the projected best-case scenario and that the peak of the economic damage appears to be in the rearview mirror.

Looking ahead, the flood of government stimulus measures in major economies could result in a significant economic rebound and kick off another multi-year growth phase. Interest rates are at record lows in many countries and government debt is at negative rates in some, including Japan, Germany, and the U.K.

When you have to pay the government to borrow your money, stocks become more attractive. This is particularly true with ones that have strong track records of raising their dividends.

Power of compounding

Young investors have an advantage over their parents. It's called time.

Buying quality dividend stocks and using the distributions to acquire new shares sets off a snowball effect that starts out slow but can turn small initial investments into a large retirement fund over the course of 20 or 30 years. The secret lies in being patient and sticking with the strategy through the ups and downs of the markets.

Let's take a look at one top Canadian stock that has delivered strong returns for investors and should continue to be a solid pick for a self-directed retirement fund.

CN

Canadian National Railway (TSX:CNR)(NYSE:CNI) operates tracks that connect the Pacific and Atlantic coasts in Canada and the Gulf Coast in the United States.

CN transports roughly $250 billion in goods every year. The company generates revenue in both Canadian and U.S. dollars and serves as a major player in the smooth running of the Canadian and American economies.

Rail companies built their networks long ago when communities were small and open land was plentiful. In fact, the railways are responsible for the expansion of development across Canada and the United States. Today, the networks run right through the heart of most cities. As a result, the odds of new competing lines being built along the same routes are pretty much zero.

Rail companies do compete on certain existing routes and have to battle with trucking companies for some business. CN knows this and works hard to make sure the business runs efficiently. The company spent nearly $4 billion in 2019 on capital projects.

CN is very profitable in normal economic times and generates significant free cash flow.

A $5,000 investment in CN just 20 years ago would be worth about $124,000 today with the dividends reinvested.

The bottom line

There is no guarantee CN will deliver the same results over the next 20 years, but the stock should be a solid pick for a self-directed TFSA or RRSP.

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Date
2025/07/17
Date Created
2020/06/05
Author
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