How to Turn a $20,000 TFSA Into $235,000 for Retirement

Description

The Tax Free Savings Account (TFSA) is a great vehicle for Canadians to build a self-directed pension fund.

Since its inception in 2009, the TFSA cumulative contribution limit has increased each year. The maximum total space in 2020 is $69,500 per person. That's adequate room for older investors to create a steady stream of tax-free income to help cover living costs.

Younger investors can take advantage of the tax-free status to maximize the power of compounding inside the TFSA and build a personal pension fund over the course of the next 20-30 years. In fact, the initial amount you need to invest isn't that high and can become a substantial savings fund.

The best stocks to buy tend to be industry leaders with long track records of boosting dividends. Ideally, these companies have wide competitive moats and generate solid profits in all economic conditions.

Let's take a look at two top dividend stocks that have generated fantastic returns for investors over the years and should continue to be attractive holdings for a TFSA retirement fund.

Royal Bank

Royal Bank (TSX:RY)(NYSE:RY) generated $12.9 billion in adjusted net income in fiscal 2019. Return on equity (ROE) was above 17%, making Royal Bank one of the most profitable big banks on the planet.

The current economic downturn means the bank will see income drop this year. Royal Bank booked $2.8 billion in provisions for credit losses for the quarter ended April 30. A surge in unemployment due to pandemic lockdowns could trigger large loan losses if businesses can't reopen successfully and people don't get back to work quickly.

Royal Bank already provided payment deferrals on nearly $60 billion worth of mortgage, credit card, auto, and other personal loans for up to six months. Government aid should also help people get through the worst of the downturn.

Despite the nearly $3 billion in provisions, Royal Bank still earned $1.5 billion in net income for fiscal Q2 2020. ROE remained a respectable 7.3%.

The stock appears cheap at the current price and provides a dividend yield of 4.5%.

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

Fortis

Fortis (TSX:FTS)(NYSE:FTS) owns $57 billion of utility assets located in Canada, the United States, and the Caribbean.

The majority of the revenue comes from regulated businesses. This means cash flow should be predictable and reliable. Electricity transmission, power generation, and natural gas distribution businesses might not sound very exciting for investors, but they serve as solid holdings over the long term and tend to ride out tough economic times better than many other sectors.

Fortis is working on a capital program of more than $18 billion. The investments should boost the rate base enough over the coming years to support average annual dividend hikes of 6% through 2024. That's attractive guidance in the current economic environment.

Fortis raised the dividend in each of the past 46 years, so investors should feel comfortable with the outlook.

Low interest rates will be in place for some time. This reduces the company's borrowing costs and should increase the amount of cash available for distributions. At the time of writing, Fortis provides a 3.5% dividend yield.

A $10,000 investment in Fortis 20 years ago would be worth $135,000 today with the dividends reinvested.

The bottom line

Royal Bank and Fortis might not deliver the same returns in the next two decades, but they remain attractive picks for diversified TFSA pension portfolio.

The strategy of owning top dividend stocks and using the distributions to buy new shares is a proven one. The **TSX Index** is home to many top stocks that have delivered great long-term returns for investors and several still appear cheap today.

CATEGORY

1. Coronavirus
2. Dividend Stocks

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2. NYSE:RY (Royal Bank of Canada)
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