TFSA Investing 101: How to Turn $1,888 Into $18,880

Description

Canadian investors are embracing the tax-free attributes of the Tax-Free Savings Account (TFSA) to build stock portfolios.

Some new investors set the goal of building a substantial retirement fund. Others simply use the TFSA to create savings for a down payment on a new condo, house, or cottage.

Regardless of the endgame, the objective of most savers is to use the TFSA to turn modest initial investments into significant funds for long-term spending projects.

TFSA advantage

The TFSA contribution limit increased by $6,000 in 2020. Cumulative maximum contribution space currently sits at $69,500 for Canadian residents who were at least 18 years old in 2009, the year the government launched the TFSA program.

Under existing rules, the CRA indexes TFSA contribution limit increase to inflation. Hikes to the limit occur in $500 increments. As such, the 2021 limit boost will either be $6,000 or $6,500.

Any interest, dividends, or capital gains earned on TFSA investments are yours to keep. The CRA does not tax earnings generated inside or paid out of the TFSA.

TFSA investment options

Risk tolerance varies from one investor to the next.

Funds needed in the next 12 months should probably go into GICs or government bonds. However, investors with longer time horizons might want to consider quality dividend stocks that offer reliable payouts and a shot at decent capital gains.

People with a higher risk tolerance could consider adding a few growth stocks in the tech space to potentially boost total returns. That said, tech stocks soared in recent months and many of the top picks now sport valuations that appear stretched, even for this hot sector.

As such, it might be a good idea right now to focus on high-quality dividend payers that continue to trade at attractive valuations.

Best stock picks

While past performance is no guarantee of future gains, long-standing industry leaders with decades of revenue and profit growth tend to continue along that path.

Let’s take a look at **Royal Bank of Canada** (TSX:RY)(NYSE:RY) to see why it might be an interesting pick to get the TFSA investment fund started.

Earnings strength

Royal Bank generated return on equity (ROE) of better than 17% in fiscal 2019. The pandemic has hit all the banks hard and 2020 results won’t be as spectacular. Nonetheless, Royal Bank remains very profitable, even after booking hefty provisions for credit losses in the fiscal Q2 report.

In fact, the bank’s ROE for the three months that ended April 30, 2020 came in at 7.3%. Most European banks would consider this to be a great result in good times, let alone during a global economic and health crisis.

Royal Bank made it through every major financial crisis in the past 100 years and maintains a strong capital position to help it to ride out the current difficult times. Investors might even see the bank make another strategic acquisition south of the border. Royal Bank invested US$5 billion in 2015 on a major push to bolster its U.S. operations.

Great returns

Buying the stock on any pullback tends to be a rewarding move over the long term. A single investment of $1,888 in Royal Bank 20 years ago would be worth more than $18,880 today with the dividends reinvested.

A $100,000 position in the stock would be worth more than $1 million!

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