Got $6,000 to Invest in Your TFSA? Here's How to Turn It Into $175,000

Description

Tax-Free Savings Account (TFSA) investors can take advantage of the latest market correction to add top-quality dividend stocks to their TFSA portfolios.

TFSA investing

The Canadian government created the TFSA in 2009 as a new vehicle to help Canadians save money. The current cumulative contribution limit is as high as $69,500, giving TFSA investors adequate room to build a significant portfolio.

Young investors can use the TFSA to create a self-directed pension. The investments can grow inside the TFSA without being taxed. In addition, any gains removed from the TFSA go straight into your pocket. This can be very useful for a tax strategy when you decide to retire.

Income from company pensions, CPP, and OAS are all considered taxable income. Withdrawals from RRSPs are also taxed. In the event you choose to retire early, it makes sense to live off RRSP investments until you decide to start taking CPP and OAS pensions. At that time, the TFSA funds can also be tapped without pushing you into a higher tax bracket.

Retirees who receive OAS also have to keep the CRA clawback in mind. Any net world income above a minimum threshold triggers the OAS pension recovery tax. Funds received from the TFSA, however, do not count towards the net world income calculation.

The Bank of Canada says interest rates are set to remain near record lows for some time, which means dividend stocks probably offer investors the best opportunity for decent TFSA returns.

Let's take a look at one top dividend stock that might be an attractive TFSA pick right now to get the fund started.

Should Royal Bank of Canada be on your TFSA buy list?

Royal Bank of Canada (TSX:RY)(NYSE:RY) is Canada's largest financial institution by market capitalization. It is also one of the top 15 in the world.

The bank gets its revenue from several divisions. These include personal banking, commercial banking, wealth management, capital markets, investor and treasury services, and insurance.

The pandemic forced Royal Bank to set aside significant provisions for credit losses this year. Given the resurgence of COVID-19 in the past month, the economic recovery could take longer than anticipated. High levels of unemployment and a potential plunge in the housing market definitely carry risk for Royal Bank and its Canadian peers.

TFSA investors should anticipate ongoing market volatility, but Royal Bank has the financial strength to ride out the tough times. The company finished fiscal Q3 with a CET1 ratio of 12%. This means its capital position is solid.

Royal Bank remains very profitable, despite the challenging environment. The bank reported net income of $3.2 billion for the three months ended July 31. Return on equity (ROE) was 15.7%. Most large global banks would love to have that kind of ROE in good times, let alone during a financial crisis.

Royal Bank trades near $91 per share at the time of writing and provides a 4.75% dividend yield. The share price topped $109 before the pandemic, so there is decent upside potential when the economy recovers.

Long-term investors have done well buying the stock on dips. A $6,000 investment in Royal Bank stock just 25 years ago would be worth close to $175,000 today with the dividends reinvested.

The bottom line

Royal Bank is just one stock in the **TSX Index** that appears oversold and should be a solid buy-and-hold pick for a dividend-focused TFSA.

The strategy of owning top-quality stocks and using the distributions to buy new shares is a proven one for building wealth.

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Date
2025/08/26
Date Created
2020/10/29
Author
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