Canadians Beware: Using a TFSA to Save Is a Bad Idea! Here's What to Do Instead

Description

The TFSA is a powerful tool that's sadly underutilized by many young investors. While the power of long-term tax-free compounding is difficult to fathom over the near to medium term, it's capable of making a world of difference over the course of many decades. The simple decision of choosing to save rather than invest your TFSA funds could mean the difference between a comfortable or early retirement or having to keep working until your 70s, given it's become so tough to retire on OAS or CPP pension payments alone, with the ever-rising costs of living.

We're in a horrific pandemic that's showing no signs of slowing down. So, for many TFSA-levering Canadians, it's become tough to justify investing, given the profound potential for volatility and the possibility of another market crash that could give the one we suffered February and March a run for its money.

The high opportunity cost of hoarding TFSA cash

By sticking with cash, you're not only surrendering the TFSA's ability to compound wealth without the effects of taxation over the long run, but you may unknowingly be putting yourself at risk of losing purchasing power through the insidious effects of inflation. Interest rates are at the floor right now, and the Bank of Canada has signaled that it'll likely be this way for many years to come. That means you'll get near-zero interest for your savings and could be at risk of feeling the full impact if we're due for an uptick in inflation coming out of this crisis.

A dovish commitment to keep rates at floor means that inflation will likely go unchecked, and it could exceed that of the 2% target that many central banks have. Rising inflation coming out of a near-zero interest rate environment suddenly made cash, a risk-free asset, an asset whose opportunity cost is close to the highest it's been in recent memory.

This pandemic-plagued environment doesn't bode well for

TFSA savers

Savers and bondholders could stand to be punished severely with overly dovish monetary policies. As such, TFSA users should be ready to start defending themselves, not from near-term stock market volatility, but from the more insidious long-term wealth-eroding effects of inflation.

Yes, investing in equities can be scary at a time like this. Fortunately, you don't need to reach for the stocks that depend on the timely advent of a COVID-19 vaccine to grow your wealth at an above-average rate in this kind of pandemic-plagued environment. Instead, you can go with the low-beta value stocks that are likely to do well over time, regardless of the pandemic timeline.

Consider dipping your toe into the investment waters with a name like **Fortis** (TSX:FTS)(NYSE:FTS), a low-beta defensive utility that offers a 3.8%-yielding dividend that's poised to continue growing a mid-single-digit rate, regardless of when we're due for a COVID-19 vaccine.

Fortis stock is the epitome of a bond proxy. While there are no guarantees in the world of equities, the firm offers a dividend payout that's the closest thing to one that you'll find on the TSX. Unlike fixed coupons, Fortis's payout will increase every year that you hold it. After bonds took a plunge back in February and March's cash crunch, I'd say bonds are no longer as "risk-free" as they used to be. They're just unrewarding.

Foolish takeaway

Warren Buffett was right in that "safe" bonds should come with a warning label. Defensive utilities with solid payouts, I believe, are a far safer bet for TFSA investors with a long-term horizon who desire to grow their wealth and not have to see their purchasing power being eroded by the rising threat of inflation.

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