Do You Have $6,000 to Invest in Your TFSA? Here’s How to Turn it Into $180,000

Description

The TFSA (Tax-Free Savings Account) is one of the most useful tools that can help young Canadians and millennials build a significant savings fund.

How do you invest in a TFSA?

The TFSA was introduced in 2009 to provide Canadian residents with another savings option. You can contribute a certain amount of your after-tax savings into the TFSA. The contribution limit for 2020 is $6,000, while the cumulative contribution limit for TFSA investors is $69,500.

There are several ways to save and invest your hard-earned money, but registered accounts such as the RRSP and TFSA remain a popular choice. While RRSP contributions are tax deductible, any withdrawals from the TFSA are exempted from Canada Revenue Agency (CRA) taxes.

This means RRSPs can be leveraged by a person who is in a higher marginal tax bracket and expect to be in a lower bracket in retirement. You, however, need to pay tax on RRSP withdrawals.

Young investors who are just starting out and have their highest-income years ahead of them should look to leverage TFSA contributions and then look to invest in RRSP at a later date. Investing in TFSAs will also benefit retirees, and these withdrawals are not counted as part of your income and will help to reduce a clawback of pensions such as the OAS.

Top stocks for your TFSA

The TFSA can be used to buy quality dividend-paying stocks that also provide investors with capital gains over the long term. You need to identify market leaders that have the ability to generate profits and stable cash flows across business cycles.

Companies that have increased or maintained dividends even during an economic recession are the best bet for long-term TFSA investors. You can reinvest these dividends and benefit from compounded returns. Let's take a look at one such domestic heavyweight to show you how this works.

Royal Bank of Canada

Royal Bank of Canada (TSX:RY)(NYSE:RY) is the largest Canadian bank and the second-largest company on the TSX in terms of market cap. The ongoing pandemic has resulted in a sell-off in bank stocks, including RY.

Canada's high unemployment rates may increase the delinquency rates for financial institutions. Further, a low-interest-rate environment will also negatively impact profit margins for RY and peers. Alternatively, the demand for mortgage and corporate loans will surge higher due to cheap access to capital.

RY stock is in fact trading at $96.3, which is well below its 52-week high of $110. However, this pullback meant RY has a forward dividend yield of 4.5%. So, a $6,000 investment in Royal Bank of Canada stock will generate $270 in annual dividends.

Despite the underperformance in 2020, Royal Bank of Canada is well diversified and generates revenue from several divisions, such as personal banking, commercial banking, and capital markets, among others.

It is also investing in developing a robust digital platform to target the next generation of account holders and is a stock you need to buy at a lower valuation. RY stock has created massive wealth for buy-and-hold investors. For example, a $6,000 investment in RY stock 25 years back would have been worth $180,000 today after accounting for dividend reinvestments.

The bottom line for TFSA investors

While past returns do not guarantee future gains, you can use your TFSA to turn small investments into significant retirement savings. Investors need to be focused and disciplined to benefit from an enormous payout over time.

CATEGORY

1. Bank Stocks
2. Dividend Stocks
3. Investing

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1. NYSE:RY (Royal Bank of Canada)
2. TSX:RY (Royal Bank of Canada)

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