



The Perfect TFSA Stock for Young Investors

Description

The Tax-Free Savings Account (TFSA) is one of the most powerful tools for any Canadian investor. Being able to shield capital gains and dividends from the taxman is a key ingredient in the recipe for financial freedom.

However, the TFSA can be used in different ways to help you meet your financial goals based on your age. If you're a veteran investor with a huge TFSA deposit, your focus is probably on wealth preservation and income generation. Younger investors, however, should focus on wealth creation instead.

Here's how young investors can leverage their TFSA for maximum gains.

Growth over income

Most companies fall into one of two categories: growth or income. To identify which basket a particular stock falls into, you need to pay attention to what the company does with the earnings it generates.

A company that gives most of its earnings back to investors, either through dividends or buybacks, is an income stock. These stocks usually offer high yields, but don't offer much price appreciation. **BCE** is a good example. Although the stock offers a lucrative 5.8% dividend yield, the stock price has been pretty much flat since 2015.

However, a company that doesn't offer dividends and reinvests all its earnings to expand is a growth stock. Growth stocks are better for younger investors because they tend to have less wealth accumulated and don't need cash flow to support themselves.

By focusing on growth (capital gains) instead of income (dividends) these young investors can use the power of compounding and get better returns than their income-seeking older counterparts.

Example of TFSA growth

Constellation Software ([TSX:CSU](#)) is my favourite example of a growth stock that's ideal for young TFSA investors. The stock doesn't offer much in dividends. In fact, the dividend yield is just 0.34% right now.

However, the company's management team has aggressively reinvested earnings to acquire smaller companies and expand the business. Since its inception, Constellation Software has gobbled up over 300 small- and medium-sized software companies to grow its earnings power.

Over the past five years, the stock price has nearly tripled. That's a compounded annual growth rate of 24.6%. Compare that to BCE's 5.8% annual dividend yield and lack of capital appreciation. That's why a growth stock like Constellation is a much better fit for your TFSA than a boring high-yield dividend stock. Bear in mind that the CRA cannot touch any of these capital gains. It's all yours!

Bottom line

As a young investor, what you lack in capital you can make up for with time. Investing in robust stocks for decades, instead of a few years, could help you outperform most of your older, wealthier peers.

Your TFSA is particularly well suited to this long-term growth strategy. The CRA cannot touch any capital gains you accumulate in your account. So, the best way to leverage this account is to focus on hyper-growth stocks with a solid track record. My top pick is Constellation Software.

CATEGORY

1. Investing
2. Tech Stocks

TICKERS GLOBAL

1. TSX:CSU (Constellation Software Inc.)

PARTNER-FEEDS

1. Business Insider
2. Koyfin
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6. Sharewise
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