Growing to a $1,000,000 TFSA: The Magic Behind Saving and Investing

Description

Once you're 18 years old and have a valid social insurance number, your Tax-Free Savings Account (TFSA) contribution room starts accumulating. By next year, you could have as much room as $75,500 that you can invest for tax-free returns.

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Year	TFSA Contribution Limit for each year
2009-2012	$5,000
2013-2014	$5,500
2015	$10,000
2016-2018	$5,500
2019-2021	$6,000
Total	$75,500

When it comes to growing your TFSA to $1,000,000, is saving more or investing for higher returns more important?

Initial years: Savings are essential

Savings come from spending less than you earn. It also comes from earning more from doing well in your career and getting a raise or promotion. If you earn more but maintain a similar level of spending as before, you'll be able to save more.

Savings also come from cutting unnecessary expenses, including reducing interest expenses by regularly paying down debt and prioritizing paying back high-interest debt like credit cards.

In your TFSA's initial years, savings are more important than investment returns and will act as the essential fuel for your portfolio growth.

Later years: Your investments pull more weight

In later years, your investment returns (income and price gains) will pull the weight of your portfolio growth.

Let's say you achieve the long-term average market returns of 10% per year and you make TFSA contributions of $6,000 per year. You'll end up with a +$1,000,000 TFSA portfolio in 30 years.

Years	TFSA Portfolio Value	Savings	Investments
10	$105,187	$60,000	$45,187
20	$378,015	$120,000	$258,015
30	$1,085,661	$180,000	$905,661

In the first 10 years, your savings would make up the bulk of your TFSA portfolio with your investment returns making up only 43%.

In 20 years, your investment returns would have taken the lead and contributed 68% of your TFSA portfolio.

Over time, your investments will pull greater and greater weight. In 30 years, 83% of your TFSA portfolio would have come from your investments.

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What if you aim for greater returns?

Some of the greatest investors of our time were able to generate incredible market-beating returns. For example, Warren Buffett led **Berkshire Hathaway** to compound returns at 20.3% per year from 1964 to 2019.

If you can get 20% rates of returns, here's how your TFSA portfolio will look.

Years	TFSA Portfolio Value	Savings	Investments
10	$186,903	$60,000	$126,903
20	$1,344,154	$120,000	$1,224,154
30	$8,509547	$180,000	$8,329,547

Savings will still play an irreplaceable role in your early years of investing. Without a sufficient amount saved and invested, it'll be difficult to get the portfolio growing even with annualized returns of 20%.

Surely, this year's market action provided the opportunities to generate gains far greater than the average 10% returns. The March market crash led to multibagger opportunities, though investors would need to have the cash and courage to make the jump.

In normal years, to get greater returns, you might end up taking greater risks. Will you invest in small/mid-cap or high-growth stocks? Will you be paying a higher multiple? What's the extra time and effort that goes into managing a higher-risk portfolio?

The Foolish takeaway

It'll help your TFSA grow tremendously if you start saving early. Your investments will play a bigger role in your TFSA growth over time. The important thing is to generate satisfactory returns consistently and not necessarily take greater risk for super-high returns potential.

Those who aim for multibaggers could see large gyrations in their portfolio value, as some ideas might end up losing 90% while others turn out to be multibaggers. Not everyone can stomach this strategy well.

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