Got $5,000 for Your TFSA?: Here's How to Turn It Into $133,000 for Retirement

Description

Tax-Free Savings Account (TFSA) investors are searching for ways to get better returns on their hard-earned savings.

Dividend stocks vs GICs

A recent TFSA survey showed that Canadians have nearly 40% of their TFSA money sitting in cash. The name Tax Free Savings Account might be misleading. Just under half of the people who responded to the poll indicated they were aware that the TFSA can be used for investments other than holding cash.

If the TFSA money is earmarked for a near-term vacation, home purchase, or emergency fund, it makes sense to keep it in cash or short-term GICs. Fixed-income investments don't pay much these days, but they are secure and you know exactly how much money will be available when the term ends.

TFSA investors with a longer time horizon should consider top dividend stocks. This is particularly true for those who use the TSFA to build self-directed retirement funds. Seniors who want to generate income from the TFSA might also prefer top dividend stocks over GICs. The current best offer on a 12-month GIC is about 1%.

Young TFSA investors can use dividends to buy additional shares, kicking off a powerful compounding process that can turn small initial TFSA investments into large sums for retirement. The snowball effect takes time to get going, but after a few years the result can be impressive, especially when combined with rising share prices.

Investing dividends in new shares also takes advantages of market downturns. When stock prices dip, the dividend payment can buy even more new stock.

Best dividend stocks for a TFSA

The top stocks to own for a TFSA dividend portfolio tend to be industry leaders. These companies have long track records of dividend growth supported by rising earnings. The best firms pay dividends from profits, or free cash flow, left over after covering required investments.

Look for businesses with sustainable competitive advantages.

Is CN stock a good buy for a retirement fund?

Canadian National Railway (TSX:CNR) (NYSE:CNI) is a good example of a top dividend-growth stock for a TFSA. The company's compound annual dividend growth rate since the mid 1990s is about 15%. That's one of the best performances in the **TSX Index**.

CN operates extensive rail lines across Canada and through the centre of the United States. The company is the only rail carrier that owns tracks connecting ports on three coasts, giving it an important advantage when customers need flexibility in moving their cargo to various North American or international locations.

CN generates income in both Canada and the United States. As economic activity expands, CN's revenue rises. The railway plays a key role in the efficient operations of the two economies, carrying everything from crude oil and raw materials to forestry products, cars, and finished goods.

CN invests significant funds to ensure it remains competitive. The company spent nearly $4 billion last year on new locomotives, additional rail cars, track upgrades and hub expansions. Even with the heavy outlays, CN still had ample free cash flow to reward investors.

That's probably why Bill Gates owns 14% of CN's outstanding common stock.

Long-term holder of CN stock have enjoyed great returns. A $5,000 investment in CN just 20 years ago would be worth $133,000 today with the dividends reinvested.

The bottom line on TFSA investing

TFSA investors can use top dividend stocks to build large portfolios for retirement. It takes patience and discipline, but harnessing the power of compounding can help turn small initial investments into substantial cash for the golden years.

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1. Dividend Stocks
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