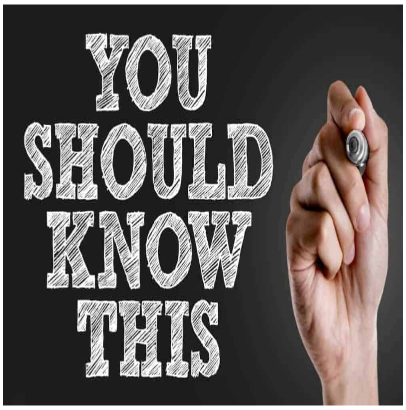

TFSA: Avoid This Critical Pitfall

Description

The Tax-Free Savings Account (TFSA) is perhaps the best thing since sliced bread. This Canadian wealth-accumulation tool ought to be utilized by every Canadian. Having access to tax-free returns over a long period of time adds up.

The growth one might achieve through compounding could be eroded significantly with taxes. Factoring capital gains and taxes into the calculation, many brokerage accounts don't return nearly what they should. Indeed, reviewing taxed returns is a bit depressing, considering the amount of time investors wait to realize these returns.

Use the TFSA for growth, not stacking piles of cash

That's where many investors go wrong. A significant percentage of Canadians are piling cash into their TFSAs and leaving it there. With interest rates near zero, investors are earning near-zero returns on this cash.

According to a recent **BMO** study on TFSA usage, the aggregate cash weighting in this vehicle is 38%, an incredibly high number. This means that more than one-third of the average TFSAs, on average, are cash only. Some Canadian investors think this is simply a savings account, rather than an investment account. This is an absolute travesty.

TFSA investments ought to be growth-oriented, and should be ones that are likely to grow steadily over a long period of time. Investors should not own hyper-speculative stocks in their TFSAs. However, owning a decent percentage of technology stocks and other high-growth investments is a good idea.

Cash is king, just not in a TFSA

Instead of taking advantage of the taxable benefit one receives on growth, too many Canadians are laying fallow on this opportunity. In my opinion, this is perhaps the most dangerous and insidious mistake investors can make.

I do understand that some investors want to keep cash on the sidelines in case of a market correction. Doing so is smart investing. However, doing so in a TFSA just doesn't make sense. Investors should instead consider investing their cash in a short-term bond ETF to get some return on their capital. An ETF like the **iShares Short-Term Strategic Fixed Income ETF** is a great place to stack cash for a short amount of time. This ETF offers a very safe yield of 3.1% at the time of writing.

Investors looking to pile up cash should do so in a traditional savings account. The TFSA, however, should be used as a long-term investment vehicle. If the TFSA is oriented toward growth investments, even better.

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