How a TFSA Can Be Used to Create a Million Dollars and Passive Income for Life

Description

I have always been a backer of long-term investing. How long you remain invested is more important than how much you invested. A longer investment horizon allows for compounding at a higher rate, which ultimately results in a bigger reserve.

Investing in stocks through a TFSA

In a world where almost every income is taxable, the Tax-Free Savings Account (TFSA) is one useful option Canadians have to grow wealth tax-free. The money you save on tax dollars can be reinvested, which can grow even bigger over the longer term.

Stock markets have created massive wealth for investors over the long term. Many avoid equities, as they perceive them as risky and uncertain. However, there are numerous stocks with varied risk-return characteristics. If you are planning to retire in the next few years, your risk tolerance will likely be low, and dividend stocks could be apt for you.

At the same time, if you are in your 30s and are not planning to retire for the next couple of decades, you probably have a high risk tolerance, and growth stocks could be more suitable. These types of investors mainly have a longer investment horizon and a sustained cash inflow compared to investors in later years.

Top TSX stocks: Growth versus dividends

Let's say you managed to save and invest $100 a month for a total of $1,200 a year. If you'd invested this $1,200 annually in Canadian growth stock **Constellation Software** (TSX:CSU) for the last two decades, you would be sitting on a reserve of $2.5 million today.

That's the beauty of growth stocks. Growth stocks like tech generally grow at a far superior rate than broader markets and thus are relatively risky. Constellation Software stock has been a long-term outperformer, driven by consistent profitability and a growing portfolio of smaller software companies.

However, stocks like Constellation exhibit high stock price swings as well and could give you sleepless nights at times.

But consider a low-risk utility stock **Fortis** (TSX:FTS)(NYSE:FTS). The stock has returned more than 1,000% in the last two decades. If you'd invested $100 per month in Fortis stock since 2001, the reserve you would create today could be close to $98,000. Based on FTS's current dividend yield, this reserve would also make $3,952 in dividends annually. That's $329 per month.

Fortis is a comparatively safe stock, as it generates stable cash flows and pays stable dividends. It pays regular dividends and hardly sees volatility. Even if markets turn ugly overnight or a recession hits next week, the shareholder payouts will remain intact because of its earnings stability. That's why the utility has managed to increase dividends for the last 47 consecutive years.

TFSA for long-term investing

Aggressive stocks should give growth to the portfolio in bull markets, while defensive stocks like Fortis should offer downside protection in volatile times. Investors in their sunset years can park more funds in dividend stocks to support their retirement income with dividends.

It does not mean that younger investors should avoid defensive stocks like Fortis and focus only on growth stocks. The portfolio should be a suitable combination of both defensive and aggressive stocks based on your risk tolerance and return requirements.

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2. TSX:CSU (Constellation Software Inc.)
3. TSX:FTS (Fortis Inc.)

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Author
vinitkularni20