Over 50% of Canadians Are Making This 1 Massive TFSA Mistake

Description

When it comes to long-term investments and retirement savings, the first account that comes to most Canadians' minds is the RRSP. It was created for that specific purpose, and it has stipulations to ensure that it's used specifically for that one purpose. Its tax-deferred nature, a generous contribution limit, and tax-deductible contributions make it a powerful investment tool.

Yet, the relatively new TFSA has surpassed it in terms of popularity and usage. More people have a TFSA now than RRSP, and since its contribution limit is relatively modest, more people try to max out their TFSA before maxing out the RRSP. But the most attractive feature of the TFSA is that it's accessible anytime, and you don't have to wait till retirement to touch your TFSA funds.

Even with a lower contribution limit, TFSA (in many ways) is a more powerful investment tool than the RRSP, yet over 50% of Canadians are making a huge mistake in terms of their TFSAs.

Taking the name too literally

In the early days of the TFSA, the name "Tax-Free Savings Account" was a bit misleading. Many assumed that it was just another savings account and that they might not be able to put anything other than cash in that account. But that was about a decade ago. According to a study conducted by the **Bank of Montreal**, 38% of TFSAs have cash as the primary investment.

But even that's not as bad as the TFSA perception problem that more than 50% of Canadians have. According to the study, about 51% of the respondents weren't even aware that the TFSA can hold anything other than cash. It points to the painful underutilization of this great investment tool. Thanks to its tax-free nature and the fact that you can withdraw your TFSA funds whenever you want, it's ideal for short-term financial goals.

And one amazing way to meet your short-term financial goals is by growing your savings because if you only rely on savings and interests, it might take you a very long time to save an adequate amount.

Leveraging growth stocks

Growth stocks like **Goodfood Market** (TSX:FOOD) can be an amazing way to grow your TFSA nest eggs at an expedited rate. It has a three-year compound annual growth rate (CAGR) of 67.2%; much of that is owed to the after-crash growth momentum that catapulted the valuation of several stocks significantly higher than their typical growth pace could.

Still, if we assume that the stock will keep growing at half this rate (33.6) for the next five years, it can convert just one year's TFSA contributions to about $25,000. The same $6,000 would take a depressing 71 years to grow to $25,000 at a 2% growth rate (a bit higher than the best TFSA interest rates you might get). That's the difference between the potential of investing in stocks and keeping your TFSA limited to cash.

Foolish takeaway

It's important to point out that relatively few stocks show this high growth pace, and they come with their fair share of risk. But you can mitigate this risk by diversification and choosing fundamentally strong companies. You'd lose a bit of growth, but you will have a relatively safer portfolio, and your overall growth will likely be miles ahead of what you can get with just cash in your TFSA.

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