How to Get $500/Year From Your $6,000 in 2021 TFSA Contributions

Description

If you've yet to put your 2021 Tax-Free Savings Account (TFSA) contribution of $6,000 to work, you may wish to if you want $500 per year worth of passive investment income. To achieve $500 on $6,000 worth of invested principal, you're going to need just north of an 8% yield. For followers of the "4% rule," reaching for such a ridiculously high yield can seem reckless. Warren Buffett once said that the act of "reaching for yield" is "stupid," but very human and that he understood why one would chase yield, potentially risking their shirts by doing so.

Chasing yield is a dangerous game, especially if you haven't put in the proper due diligence. You'll not only at high risk of a significant dividend cut (or distribution reduction), but you could also stand to be on the receiving end of considerable downside, as others collectively look to throw in the towel in an effort to get their passive income from more reliable sources.

Should you raise the yield bar with your 2021 TFSA contribution?

For retirees looking to give themselves a raise, averaging an 8% yield is typically not a good idea, even though the yield bar has been raised following the 2020 stock market crash. If you need to find a reason to put your next TFSA contribution to work, though, there are securities out there that can allow you to have greater yield minus excessive amounts of risk that typically accompany stocks that sport "artificially" high yields, as a result of any excessive share price depreciation.

In this piece, we'll have a closer look at one ETF that I believe is the safest way to give yourself a raise. That said, the ETF shouldn't be invested with the entirety of your TFSA, as its constituents may not necessarily be immune from dividend reductions in the event of a drastic worsening of this crisis.

A solid ETF with a huge yield

Without further ado, consider shares of the **BMO Canadian High Dividend Equity Covered Call ETF** (TSX:ZWC

), a 7.9%-yielding security (you can lock-in a +8% yield on a pullback) that marries high-quality TSX-traded dividend stocks and a “covered call” options-writing strategy that adds another layer of premium income on top of the dividends distributed by the constituents of the ZWC. You’re getting dividends from long positions and premium income from the “covered call” strategy implemented by the ETF managers.

What’s the catch?

The extra income is for shareholders to keep. But it comes at the cost of upside potential in the ETF’s long positions, effectively capping upside in shares. For people like retirees who want more passive income and couldn’t care less about capital gains potential, the trade-off from a covered call strategy is worthwhile. For everybody else, I’d say the trade-off is not worthwhile, given the steep 0.72% MER and the fact that markets tend to go up over the long term.

While the near-8% yield may be safe, you’re unlikely to get much in the way of capital gains from shares. So, should you buy? If you’re bearish, seek a hedge against a prolonged period of low prospective returns, or are someone who needs income to make it through these unprecedented times, the ZWC’s above-average price tag is worth paying up for with your latest TFSA contribution.

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1. TSX:ZWC (Bmo Canadian High Dividend Covered Call ETF)

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Author
joefrenette