Young Investors: How to Turn a $20,000 TFSA Into $780,000 for Retirement

Description

Canadians investors in the early years of their careers can benefit by using the TFSA as their primary savings vehicle.

Is the TFSA or RRSP better for young investors?

Ideally, we would max out contributions to both the TFSA and RRSP every year. Most people, however, don't have that much extra savings.

The big benefit of the RRSP is the reduction in taxable income that you get from the contributions. Unused RRSP space can be carried forward, so many people who expect to have higher income in coming years prefer to save the RRSP room for when they are in a higher marginal tax bracket. This is a good strategy. RRSP withdrawals are taxable, so the goal is to contribute when you are in a high tax bracket and plan to remove the funds when you retire at a potentially lower tax rate.

The TFSA gives young investors more flexibility. Funds are easily removed to cover an emergency, and you get the contribution room back in the next calendar year. In addition, all interest, dividends, and capital gains earned inside the TFSA can be removed tax-free.

The best stocks to build TFSA wealth

Buy-and-hold investors typically do well with top dividend stocks, especially when the distributions are used to acquire new shares. Reinvesting the dividends harnesses a powerful compounding process that can turn relatively small initial investments into large savings for the golden years. Each dividend adds more stock, leading to even more dividends, and so on. It's like a snowball rolling down a hill.

Let's take a look at **Canadian National Railway** (TSX:CNR)(NYSE:CNI) and **Royal Bank of Canada** (TSX:RY)(NYSE:RY) to see how the strategy works.

CN

CN went public in the mid-1990s. Investors who'd bought shares at that time have enjoyed stellar returns. In fact, a $10,000 investment in CN stock 25 years ago would be worth about $480,000 today with the dividends reinvested.

CN generates great cash flow and enjoys a wide competitive moat. The company is the only rail carrier in North America with lines that connect three coasts. Management still focuses on efficiency and invests billions of dollars every year on new locomotives, additional rail cars, technology, and network upgrades.

CN raised the dividend by 7% for 2021. The long-term compound annual dividend-growth rate is about 15%.

Royal Bank

Royal Bank is Canada's largest financial institution. It is also among the top 15 on the planet. The bank is navigating the pandemic in good shape. Royal Bank earned net income of $11.4 billion in fiscal 2020. The bank expects defaults to rise in the coming year, but the number will be much lower than forecast at the beginning of the pandemic.

The housing market continues to hold up well, despite last year's warnings from the CMHC of a 9-18% crash. At this point, the plunge is unlikely to materialize. In fact, record-low mortgage rates continue to fuel strong demand and rising prices. A strong housing market is good for Royal Bank investors.

As the global economy recovers, Royal Bank stands to benefit. The wealth management, commercial banking, personal banking, and capital markets divisions provide a balanced revenue stream. At some point, rates will increase, and that should improve net interest margins.

Long-term investors have done well with the stock. A $10,000 investment in Royal Bank 25 years ago would be worth more than $300,000 today with the dividends reinvested.

The bottom line on TFSA investing

Buying top dividend stocks and using the distributions to acquire new shares is a proven strategy for building long-term wealth. It takes patience and discipline, but young investors have the benefit of time to set themselves up for a comfortable retirement.

CATEGORY

1. Bank Stocks
2. Dividend Stocks
3. Investing

POST TAG

1. Editor's Choice

TICKERS GLOBAL

1. NYSE:CNI (Canadian National Railway Company)
2. NYSE:RY (Royal Bank of Canada)
3. TSX:CNR (Canadian National Railway Company)
4. TSX:RY (Royal Bank of Canada)

PARTNER-FEEDS

1. Business Insider
2. Koyfin
3. Msn
4. Newscred
5. Quote Media
6. Sharewise
7. Yahoo CA

Category

1. Bank Stocks
2. Dividend Stocks
3. Investing

Tags

1. Editor's Choice

Date
2025/08/23
Date Created
2021/02/18
Author
aswalker