Passive Income: Stash This ETF in Your TFSA to Make $600 Per Month

Description

Many disciplined Canadian investors are likely to see their TFSAs (Tax-Free Savings Accounts) swell above the six-figure mark over the next year, making them capable of financing a bountiful passive-income stream.

Believe it or not, a TFSA worth $100,000 can generate a passive-income stream that could pay $600 per month or more. Of course, the higher the yield, the more risks you'll bear. While there are rules of thumb such as the 4% rule, which discourages excessive risk-taking with some of the higher-yielding names out there, I think that such a "one-size-fits-all" rule is not to be taken as gospel by a majority of investors, especially younger investors who can afford to take on more risk.

Now, when you think of passive income, you normally think of the retired or the soon-to-be retired. With the incomes of many young people, likes millennials, disrupted by COVID-19's impact, though, many younger Canadians may need to shift gears to passive-income-producing securities to help them make it through this financial rough patch.

Using your TFSA to get a passive-income raise

While it may be tempting to spend one's TFSA principal, I think that those who can afford to live off interest, dividends, or distributions should look to do so. Nobody wants to crack open their nest egg early. And for those who've amassed a six-figure nest egg, one can get a bit of relief with higher-yielding options that are out there.

Now, $600 per month, or around $20 per day, is not a life-changing amount of passive income, especially for those living in the inner city. That said, it can really go a long way for those who've seen their incomes take a bit of a hit during this crisis.

So, without further ado, enter **BMO Canadian High Dividend Covered Call ETF** (TSX:ZWC), a 7.2%-yielding basket of wonderful high-yield companies screened for the quality and long-term growth potential of their dividends or distributions. ZWC is pretty much a one-stop shop for those seeking passive income. And for best effect, one can stash the name in their TFSAs to take Canada Revenue

Agency (CRA) taxes out of the equation.

A worthy trade-off in tough times

ZWC is just like any run-of-the-hill dividend-focused ETF, but with one major difference. The ETF leverages the "covered call" strategy, which incorporates the writing of "covered call" options. Such options limit capital appreciation for some extra premium income upfront.

In flat or down markets, ZWC comes out on top. But in rising markets (markets tend to rise over the long term), ZWC pales compared to non-covered call ETFs with similar constituents. In a soaring market, not only would ZWC miss out on capital gains in exchange for the certainty of premium income right off the bat, but investors would also have to pay the fund managers a hefty 0.72% MER (management expense ratio).

Compared to mutual funds, a 0.72% MER is pretty low. But as far as ETFs are concerned, 0.72% is a tad on the rich side, especially considering the downward pressure on ETF fees sparked by the growing popularity of low-cost index funds among today's young investors.

Moreover, when investing a six-figure sum, the difference between a 0.72% MER and a 0.05% (typical for today's run-of-the-mill index funds) can mean the difference of hundreds of dollars annually.

Foolish takeaway for passive-income investors

So, in short, ZWC's juicy yield is no trap. In fact, the distribution is well supported by the dividends of some pretty wonderful businesses (think the Canadian banks and utilities) and the "covered call" options-writing strategy. There is a trade-off, however. You'll receive less in capital gains and will have to pay BMO's managers a slightly higher but not ridiculous MER.

If you could use an extra $600 in passive income per month, though, I'd say the trade-offs with ZWC are well worth making, especially if you believe that the markets will stagnate or plunge.

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Date
2025/07/22
Date Created
2021/06/02
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