This $5,000 Investment Now Generates $5,000 Per Year in Dividends

Description

The goal of retirement investing is to build a portfolio that will eventually provide a significant stream of passive income. One way to meet that objective is to buy top Canadian dividend stocks inside your RRSP or TFSA.

Power of compounding

The secret lies in harnessing the power of compounding. Investors can use dividends to buy new shares during their savings years. Each new share that is acquired increases the dividends received in the next payout, and this process continues to slowly build the size of the initial stock holdings. The compounding effect takes time, but the portfolio can eventually become very large when compared to the original investment. This is particularly true when the company raises the dividend payment on a steady basis and the stock's price appreciates over time.

It takes patience and discipline, but the strategy can turn a modest initial investment into a meaningful portfolio that generates significant passive income once the time comes to retire and spend the money.

Let's take a look at one top Canadian company to see how the process works and why it might be an attractive stock to buy for a retirement fund.

Royal Bank

Royal Bank of Canada (TSX:RY)(NYSE:RY) is Canada's largest financial institution and ranks among the biggest banks in the world based on its market capitalization, which is currently close to $185 billion.

The bank is making important investments in digital solutions to improve efficiency and ensure it remains competitive in a world where people are increasingly comfortable doing their borrowing and investing activities through a mobile phone, tablet, or computer.

Royal Bank is very profitable, even during challenging times. The bank earned $4 billion in profits in fiscal Q2 2021 and posted a return on equity (ROE) of better than 19%. Management is targeting long-term ROE of at least 16%, which would be a dream for most large American or European banks.

Royal Bank is sitting on substantial excess cash right now. Investors should see a string of generous dividend increases once the government gives the Canadian banks the green light to start boosting payouts again. Royal Bank might also use the cash hoard to make a strategic acquisition to drive growth.

The stock currently trades near $130 per share and provides a 3.3% dividend yield.

Long-term investors have done well owning Royal Bank. In fact, some have become quite rich. A $5,000 investment in Royal Bank stock just 25 years ago would be worth about $180,000 today with the dividends reinvested. That holding would generate more than $5,900 per year in dividends today.

That’s right, the initial $5,000 investment now produces more than the original amount in passive income every year!

Investors who had more cash to put to work are now receiving a solid pension just from the dividends. A $50,000 investment in Royal Bank in 1996 would now be worth $1.8 million and generates $59,500 per year in passive income through the quarterly distributions.

The bottom line

There is no guarantee that Royal Bank will produce the same returns in the next two or three decades, but the strategy of buying top dividend stocks and using the payouts to acquire new shares is a proven one. The **TSX Index** is home to many great dividend stocks for a TFSA or RRSP retirement portfolio.

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Date
2025/07/27
Date Created
2021/08/19
Author
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