How a TFSA Could Help You Retire Rich

Description

When it comes to retirement planning, the Registered Retirement Savings Plan (RRSP) is the designated account for Canadians. However, it certainly isn't the only type of account that can be used for retirement savings. Based on your situation, the RRSP may not even be the account that you should be prioritizing contributions to today.

Introduced to Canadians in 2009, there's a lot to be excited about with the Tax-Free Savings Account (TFSA). Annual contribution limits have changed over the years, but the benefits from contributing have not. The TFSA, in my opinion, is a savings account that most Canadians should seriously consider contributing to. Here's why.

Why invest in a TFSA?

As the name suggests, there are tax benefits to contributing to a TFSA. Contrary to the RRSP, when you make a withdrawal from your TFSA, you don't need to pay any tax at all. There are also no limitations as to when you withdraw the funds. As a result, the TFSA can be used for both short- and long-term goals.

But, even more importantly, especially if you have a long-term time horizon, your contributions can grow tax-free. Year after year, the investments you hold in your TFSA can compound and grow exponentially, completely tax-free.

The catch is that there are contribution limits. In 2022, the limit is set at $6,000, which is what it's been at since 2019.

What should you own in your TFSA?

To benefit from the magic of compound interest, you'll need to own funds with a certain level of growth potential.

If you're investing for a short-term objective, investing in stocks may not be the wisest choice. Those with short-term savings goals should focus on limiting risk to avoid selling at an inopportune time. But if you've got a time horizon of five years or longer, owning stocks is one of your best ways to grow your wealth.

For anyone new to TFSAs and investing, owning a well-diversified index fund is an excellent choice. Investing in an exchange-traded-fund (ETF), such as **Vanguard FTSE Canada All-Cap ETF**, provides Canadians with broad exposure to the Canadian stock market.

More seasoned investors with the desire to have a hands-on approach to their portfolios may be interested in owning shares of individual stocks. Owning individual companies could be seen as a risker approach and very likely a more volatile one. The upside, however, is the potential to earn growth that far exceeds what an index ETF could provide.

The reason you should be investing in growth

Let's look at two situations to understand how your TFSA holdings can have a significant impact on your savings.

Assuming that you've been maxing out your TFSA with cash each year since 2009, you'd have a total of $75,500 today. For simplicity purposes, let's round-up and assume the total is $78,000 and the contribution limit each year has been $6,000.

If you had instead been investing that $6,000 each year into a total stock market index fund, earning 8% a year, that $78,000 would be worth over $130,000. What could that potentially look like if you had owned shares of an individual stock generating a higher average return?

Brookfield Asset Management (TSX:BAM.A)(NYSE:BAM) is a perfect stock for both new and seasoned investors. The asset management company may not be an ETF, but it sure can provide its shareholders with diversification. Brookfield Asset Management has operations spread across the globe in all kinds of different industries.

Even at its massive size, Brookfield Asset Management has been a top-performing **TSX** stock over the years. The Canadian stock has delivered an average annual total return of more than 20% since 2009, when the TFSA was introduced.

TFSA Investors that had been buying $6,000 worth of Brookfield Asset Management stock each year since 2009 would be sitting on about $300,000.

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