A TFSA Asset-Allocation Mistake With $0 Return

Description

The Tax-Free Savings Account (TFSA) is the best investment vehicle for Canadians to meet their short-term, long-term, and retirement financial goals. Unlike the Registered Retirement Savings Plan (RRSP), you can keep your TFSA past 71 years of age.

The government wants users to take advantage of the tax-free money growth in TFSAs for life. Eligible investments include bonds, mutual funds, GICs, ETFs, stocks, and cash. All interest, earnings, or capital gains inside the account are tax free. Therefore, the TFSA balance grows faster. Withdrawals are likewise tax free, so there are no penalties whatsoever.

Asset allocation

TFSA users should also see asset allocation as equally important as the tax exemptions. The TFSA isn't a regular savings account, as the name suggests. Many users underutilize their accounts or miss out on huge tax savings, because they hold more cash than income-producing assets.

It's true that cash is king, but the TFSA isn't a storage for idle money. While cash is instant liquidity, the return in a TFSA is negligible, if not zero. The financial instruments mentioned above will return so much more than cash.

Many TFSA accountholders prefer dividend stocks, because of higher returns and recurring income streams, usually every quarter. Your balance should compound faster if you keep reinvesting the dividends. As long as you don't overcontribute or conduct a business by buying and selling stocks, the Canada Revenue Agency (CRA) won't intervene or impose taxes.

Cheap cash cow

If budget is a concern or you don't have enough to maximize the 2022 annual limit, cheap dividend stocks are available. **Diversified Royalty** (TSX:DIV) trades at only $3.28 per share but pays a generous 6.71%. Instead of spending $1,000 on needless things, invest the money in this royalty stock to generate $67.10 in tax-free passive income.

The $395.86 million multi-royalty corporation own the trademarks to six ongoing business concerns. It collects revenue or royalties from Mr. Lube, AIR MILES, Sutton, Mr. Mikes, Nurse Next Door, and Oxford Learning Centre. In pre-pandemic or under normal conditions, the royalty streams are predictable and growing.

The good news to investors is that the company has returned to profitability last year. For the year ended December 31, 2021, net income reached $23.5 million compared to the $8.9 million net loss in 2020. Its president and CEO, Sean Morrison, said, “DIV is well positioned for a strong 2022 with continued improvement from our Royalty Partners and increased royalty acquisition opportunities.”

Long-term hold

Canada’s sixth-largest bank is an ideal holding for TFSA investors building retirement wealth. **National Bank of Canada** (TSX:NA) continues to impress investors. In Q1 fiscal 2022 (quarter ended January 31, 2021), net income rose 22% to $932 million versus Q1 fiscal 2021.

Laurent Ferreira, NA’s president and CEO, said, “Solid revenue growth helped the bank achieve a high return on equity in the first quarter.” At $93.58 per share, would-be TFSA investors can partake of the 3.72% yield. The payout should be safe, recurring, and sustainable, given the low 31.71% payout ratio.

Hold less cash

Cash is okay in a TFSA, but users must allocate less of it in the account. The focus should be more on the tax-free money growth and tax-savings features of the unique investment vehicle.

CATEGORY

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2. Investing

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