How to Turn a $40,000 RRSP Into $1.68 Million

Description

Canadian savers are using their RRSP contributions to invest in top stocks to build a self-directed pension fund for the future.

Power of compounding

One popular strategy for creating retirement wealth involves buying dividend-growth stocks and using the distributions to acquire new shares. Gains are small at the start but pick up speed over time, as the power of compounding kicks into gear.

In fact, the result can turn a modest initial investment into a substantial fund for retirement. This is particularly true when dividend growth is steady, and the share price gradually moves higher.

Let's take a look at two top TSX dividend stocks that are good examples of how the strategy works and should be attractive picks for RRSP investors.

Royal Bank of Canada

Royal Bank (TSX:RY)(NYSE:RY) is a giant in both the Canadian and global banking sector with a current market capitalization of more than $190 billion. The bank generated $16 billion in 2021 profits and posted a return on equity (ROE) of better than 18%. To put this into context, the U.S. banks typically report average ROE around 12%. European banks would be happy to hit ROEs in the double digits.

Royal Bank raised its dividend by 11% late last year and is buying back up to 45 million shares under the current share-repurchase program. In addition, Royal Bank recently announced a $2.6 billion acquisition in the U.K. to drive growth in its international wealth management operations.

The stock trades near $135 at the time of writing compared to the 2022 high above $149. The current share price looks attractive and offers a 3.5% dividend yield.

Long-term investors have done well when buying RY stock on dips. A $20,000 RRSP investment in Royal Bank 25 years ago would be worth about $480,000 today with the dividends reinvested.

Canadian National Railway

CN (TSX:CNR)(NYSE:CNI) is a leader in the North American rail industry with a unique network of tracks that connects the Pacific and Atlantic coasts in Canada to the Gulf Coast in the United States. This gives CN a competitive advantage when securing contracts to move goods for both domestic and international clients.

CN's strategy in 2022 and the coming years is squarely focused on delivering strong total returns to shareholders. The company put a cap on capital outlays for 2022 after heavy spending in recent years on new locomotives and rail cars. Investments are still ongoing to ensure CN drives more efficiency into its operations, but a larger chunk of free cash flow is likely headed to investors.

CN raised the dividend by 19% for 2022 and has allocated roughly $5 billion to buy back up to 6.8% of the outstanding common stock under the current share-repurchase plan.

The company is very profitable and revenue growth should continue with the expansion of the U.S. and Canadian economies.

A $20,000 RRSP investment in CN stock 25 years ago would be worth about $1.2 million right now with the dividends reinvested.

The bottom line on building RRSP wealth

Past performance is no guarantee of future returns, but Royal Bank and CN still look attractive as anchor picks for a diversified buy-and-hold RRSP focused on harnessing the power of compounding. If you have some cash to put to work in a self-directed retirement fund, these stocks deserve to be on your radar.

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2. NYSE:RY (Royal Bank of Canada)

3. TSX:CNR (Canadian National Railway Company)
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