Buy the Pullback: 2 Top Canadian Dividend Stocks to Own for TFSA Passive Income

Description

Retirees and other TFSA investors who are seeking passive income can now buy top TSX dividend stocks at undervalued prices for a self-directed portfolio focused on generating tax-free earnings.

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Royal Bank

Royal Bank (TSX:RY)(NYSE:RY) has a long track record of delivering attractive dividend growth and total returns for investors. The bank is Canada's largest financial institution with a current market capitalization near $174 billion. According to Royal Bank's investor report it ranks among the top 10 banks in the world based on that metric.

Royal Bank generated $16.1 billion in earnings in fiscal 2021. The first two quarters of fiscal 2022 delivered earnings growth of about 6% compared to the same period last year. Despite the strong performance, the stock price is down from $149 in January to $124 at the time of writing.

Investors are concerned the Canadian banks will see a decline in revenue and a jump in loan losses in the next 12-24 months. High inflation is forcing households to tap into savings to cover rising food, gas, and other monthly expenses. This leaves less money for the bank to use for loans. Customers might also sell investments to cover the increase in living costs.

At the same time, the Bank of Canada is aggressively raising interest rates to try to cool off the economy and drive down inflation. The resulting jump in higher loan and mortgage expenses will be put added pressure on businesses and property owners. This could lead to a spike in defaults.

The banks certainly face some headwinds, but the selloff in Royal Bank's share price appears overdone. Royal Bank finished fiscal Q2 2022 with a common equity tier one (CET1) ratio of 13.2%. This means the bank has significant excess capital on hand to ride out a downturn.

Another point to consider is that soaring interest rates tend to boost net interest margins. This can help offset some of the other negative effects.

Royal Bank increased the dividend by 11% near the end of last year and raised the distribution by another 7% when the bank reported the fiscal Q2 2022 results. Canadian banks tend to be quite conservative, so the generous payout increases would suggest the management team is not overly concerned about the revenue and profit outlook over the medium term.

Investors who buy RY stock at the time of writing can get a 4.1% dividend yield.

BCE

BCE (TSX:BCE)(NYSE:BCE) is a leader in the Canadian communications industry. The company's core operations provide businesses and households with essential mobile, internet, and security services that are required regardless of the state of the economy. BCE is also able to increase its prices for these services when costs go up. As a result, the stock should be a good defensive pick for investors who are concerned about high inflation and the risk of a recession.

Retirees have relied on BCE for steady passive income for decades. The generous payout typically increases by about 5% per year and is supported by rising free cash flow. BCE is investing billions of dollars to upgrade the wireline connections to fibre optic lines while also building out its 5G network. These capital projects will help drive revenue growth in the coming years and go a long way in protecting BCE's competitive position in the market.

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Even with the big spending, BCE still expects to deliver free cash flow growth of 2-10% in 2022.

The stock appears attractive at the current price near $64.50. BCE traded as high as $74 a few months ago. Investors who buy now can lock in a solid 5.7% dividend yield.

The bottom line on top stocks to buy for passive income

Royal Bank and BCE are industry leaders paying generous dividends with attractive yields. If you have some cash to put to work in a TFSA focused on passive income, these stocks look cheap today and deserve to be on your radar.

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