Power of Compounding: How to Turn $20,000 Into $425,000 for Retirement

Description

Tax-Free Savings Account (TFSA) and Registered Retirement Savings Plan (RRSP) investors are using top Canadian dividend stocks and the power of compounding to build significant portfolios for retirement.

Dividend reinvestment

One popular strategy for creating substantial portfolios for retirement involves buying top TSX dividend stocks and using the distributions to acquire new shares. This sets off a powerful compounding process that can turn small initial investments into large sums over time, especially in cases where the board raises the dividend regularly and the share price drifts higher. Investors can use a company's dividend-reinvestment plan (DRIP) to automate the process. Some firms even offer discounts of up to 5% on the share price.

The **TSX Index** is home to many top dividend-growth stocks that have delivered great total returns for decades and continue to be attractive picks today for a self-directed TFSA or RRSP pension.

BCE

BCE (TSX:BCE)(NYSE:BCE) is Canada's largest communications firm with a current market capitalization of nearly $59 billion. The company's size gives it the power to make the billions of dollars of investments needed to protect its wide competitive moat and ensure it can deliver world-class wireline and wireless service to its customers.

BCE is spending about $5 billion in 2022 across the business. The fibre-to-the-premises program will directly connect another 900,000 client buildings with fibre optic lines this year. BCE is also expanding its 5G network after spending $2 billion on new 3,500 MHz spectrum at the government auction in 2021.

BCE generated solid second-quarter (Q2) 2022 results and is on track to hit its guidance for the year.

Adjusted net earnings increased 5.3% to $791 million in the quarter compared to the same period last year. Free cash flow rose by 7.1% to $1.33 billion. BCE is targeting free cash flow growth of 2-10% for 2022. This should support a dividend increase in the 5% range for 2023. BCE raised the payout by at least 5% in each of the past 14 years. The current dividend provides an annualized yield of 5.7%.

The stock has long been a favourite among retirees and other investors seeking passive income, but BCE is also a good stock to own in a portfolio focused on total returns. A $10,000 investment in BCE stock 25 years ago would be worth about $190,000 today with the dividends reinvested.

BCE looks undervalued near $64.50 per share at the time of writing compared to the 2022 high of $74.

Enbridge

Enbridge (TSX:ENB)(NYSE:ENB) is a leader in the North American energy infrastructure industry with extensive oil and natural gas transmission networks that move 30% of the oil produced in Canada and the United States and 20% of the natural gas used by Americans. The company also owns natural gas distribution utilities and renewable energy assets that include solar, wind, and geothermal facilities.

Enbridge's recent investments focus on export opportunities. Enbridge spent US$3 billion last year to purchase an oil export terminal in the United States. Management recently announced the company is taking a 30% position in the Woodfibre liquified natural gas (LNG) facility being built on the coast of British Columbia. In addition, Enbridge is building new natural gas pipelines to bring natural gas to LNG sites on the American Gulf Coast.

International demand for North American energy is rising, and Enbridge is positioned well to benefit in the coming years.

Enbridge raised the dividend in each of the past 27 years. The current $13 billion capital program should support distributable cash flow growth and ongoing dividend increases. Investors who buy the stock today can pick up a 6.1% dividend yield.

A $10,000 investment in Enbridge stock 25 years ago would be worth about $235,000 today with the dividends reinvested.

The bottom line on using the power of compounding to build wealth

The strategy of buying top dividend stocks and using the distributions to acquire new shares is a proven one for building a self-directed retirement fund. BCE and Enbridge are two stocks in the TSX Index that have delivered strong total returns over the years and still deserve to be anchor picks for a diversified portfolio focused on dividends and capital gains.

The market pullback is giving TFSA and RRSP investors a chance to buy many top Canadian dividend stocks at cheap prices for a retirement fund.

CATEGORY

1. Dividend Stocks
2. Investing

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2. NYSE:ENB (Enbridge Inc.)
3. TSX:BCE (BCE Inc.)
4. TSX:ENB (Enbridge Inc.)

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aswalker