Why You Should Start Saving for Retirement Now

Description

Here's a scenario about twins Joanne and Joe to illustrate why it's critical to start saving and investing for retirement as early as you can.

From 25 to 35, Joanne was able to save and invest $6,000 at the beginning of each year for an 8% rate of return. After that, other obligations came in, and she couldn't put more money into her long-term investment portfolio. When she was 35, her investments had grown to $93,872.92. Her investments continued to grow at 8% per year after that. She was able to retire with an impressive amount of $944,610.99 at age 65 — the typical retirement age.

Joe didn't think about retirement until he was 40. He then saved and invested $6,000 per year for an 8% rate of return. At age 65, his retirement portfolio was only $473,726.49.

At retirement, Joanne's wealth almost doubled Joe's! Additionally, Joanne only put in a total of $60,000 of her savings during the 10-year period. In contrast, Joe saved a total of $150,000 over 25 years.

The above scenario assumes no commission-fee trading, and the investments were in a Tax-Free Savings Account (TFSA) so that no income taxes were paid.

Save as early as you can

I hope I've encouraged you to save as early as you can, even if it's just putting away $100 a month in your TFSA. Your savings will add up, especially when you invest for a reasonable rate of return. The Canadian stock market, using **iShares S&P/TSX 60 Index ETF** as a proxy, returned 8.9% per year over the past 10 years. So, an 8% rate of return is very reasonable.

The earlier you put your money to work for a positive return, the longer your money can compound and build your wealth. According to the Rule of 72, investing for an 8% rate of return could double your money in nine years.

Where to invest for a +8% rate of return

An 8% rate of return is not an aggressive target when investing in stocks. In fact, many stable dividend stocks can deliver that kind of return, if not closer to 10%, in the long run. This means long-term investors can take low risks to generate satisfactory returns that result in a sizeable retirement fund.

For example, **Royal Bank of Canada** (TSX:RY)(NYSE:RY) stock delivered annualized returns of about 11.5% in the past decade. The Big Six Canadian banks operate in a oligopoly structure supported by a federally regulated environment. They take up about 90% of the country's banking deposits.

Royal Bank is a leading Canadian bank that will grow its profits in the long run. Its yearly net income exceeds $16 billion. It shares 40-50% of its profits with shareholders each year in the form of quarterly dividends.

RBC stock appears to be fairly valued right now. So, it's a good time to buy shares for a dividend yield of 4.1%. The bank stock targets an earnings-per-share growth rate of 7%. Therefore, an approximated long-term rate of return would be about 11%.

Savings, time, and return

Ultimately, how much you'll have to enjoy for retirement depend on three factors:

- How much you save regularly for long-term investment
- The time you allow your investments to grow
- The rate of return you achieve

The earlier you save, the better. The longer you allow your investments to grow, the more your money can compound. The higher the rate of return you achieve, the larger your retirement fund will be.

If you save and invest early on, you can park your money in low-risk, stable dividend stocks like RBC stock.

CATEGORY

1. Dividend Stocks
2. Investing

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2. TSX:RY (Royal Bank of Canada)

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