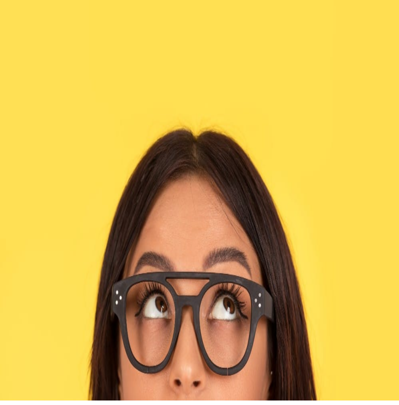

TFSA Investors: Where to Invest $5,000 Right Now — GICs or TSX Stocks?

Description

Tax-Free Savings Account (TFSA) investors who've been sitting in GICs (Guaranteed Investment Certificates) and "high-interest" savings accounts may wish to take advantage of the recent pullback in markets. Undoubtedly, rates on GICs have become much better in recent months, with various 14-month and 18-month non-cashable GICs now sporting yields well north of the 4% mark.

Longer-duration GICs boast even higher interest rates! That seems like a great deal. However, when you consider inflation is well above 7%, investors will still be lose 3-4% in purchasing power, assuming inflation doesn't roll over quickly in response to Bank of Canada rate hikes.

Rates rise, crushing bonds and stocks

On Wednesday, the Bank of Canada delivered yet another jumbo rate hike of 75 basis points (bps). Though it's smaller than the 100-bps hike it clocked in prior to this one, it's still a big move that could begin to drag inflation lower — perhaps much lower over the coming quarters. For now, it's unknown as to how quickly inflation will fall. If inflation rolls over and rates on the 10-year Treasury note move lower, the GIC rates you see today are compelling.

That said, if more rates are needed to put the smallest dent in the rate of inflation, I'd be unsurprised if we see 18-month GICs sporting north of 4.5% or even 5% over the next year. In any case, TFSA investors should find the right allocation of risk-free and risky securities. That means finding the right mix of blue-chip stocks, GICs, and fixed-income debt securities (or bonds).

Even if you're a young and venturesome investor, it's tough to pass up today's bountiful GICs. As the market continues to feel the full force of the bear, I'd look to allocate a portion of the liquidity that you don't plan to use to buy on further dips to non-cashable GICs, which boast higher rates than cashable GICs.

Of course, it's always wise to have cash, so you'll be able to take advantage of bargains in the TSX or further rate increases on various GICs.

GICs or TSX stocks: Why not both?

So, if you’ve got an extra $5,000 in TFSA funds, it may prove wise to spread across cash, GICs, and low-risk TSX stocks. Now, I’ve never been a fan of GICs for young investors. However, we live in strange times, with GIC rates that are close to the highest they’ve been in decades. While a 4% rate on a GIC seems to outperform nearly everything on the TSX these days, I’d urge investors to consider that the biggest gains in markets tend to follow closely behind some of the worst market losing streaks. Further, GICs don’t have the capital loss risks that bonds do in this rising-rate environment.

This bear market is nearly nine months old. It will end, and the next bull could enrich many contrarians who stayed the course. Of course, nobody knows if this bear will be more aggressive than those in the past. That’s why it’s vital to only invest what you’re willing to lock in for five years. Treat it like a five-year GIC with higher returns potential.

If you subscribe to the 60/40 (60% stocks, 40% bonds or GICs) strategy with your TFSA, perhaps $3,000 could go towards a top-tier blue-chip like **Fortis**, with $2,000 going towards a 14- or 18-month GIC with rates in the 4-4.5% range.

Fortis boasts a modest 3.64% dividend yield at writing. That’s well below that of GICs. Over the next 14- or 18-month period, though, I’d be willing to bet that Fortis can make up for the difference with strong capital gains. It’s a well-run company that can really crush the TSX during times of recession.

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Date
2025/08/27
Date Created
2022/09/11
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