How to Turn a $6,000 TFSA or RRSP Into $600,000

Description

Your personal savings is a critical part of your retirement. Pension plans, including the Canada Pension Plan and Old Age Security, would help contribute to more of your retirement income.

The more the savings you accumulate, the more comfortable your retirement can be. Actually, you can even shoot for an early retirement. You can grow your portfolio 100-fold by starting with $6,000 and following through to arrive at $600,000 and beyond! All it takes is some serious retirement planning and discipline to follow through a sound plan.

Step #1: Saving regularly

The first step is to save regularly in your tax-advantaged accounts such as your Tax-Free Savings Account (TFSA) or Registered Retirement Savings Plan (RRSP). If you can save regularly in both accounts, that's best. It would serve most Canadians best to contribute to their TFSAs first, because all earnings in there are tax free. Beware that there are penalties to overcontributing to your TFSA, though.

For high-income earners in high tax brackets, it would be smart to contribute to their RRSPs first to reduce their taxable income for the year and earn tax-deferred returns in their RRSPs. The refund from RRSP contributions can then be used to contribute to the TFSA.

It would be a good start if you can contribute $500 a month to the accounts. That would equate to savings or contributions of $6,000 a year.

Step #2: Invest for high returns

It would do your retirement no good if you're putting all your savings in GICs, which would erode your purchasing power, because inflation is high right now. For your limited and precious TFSA or RRSP contribution room, you want to invest for high returns.

Historically, the stock market has delivered the highest returns in the long run. For reference, the

Canadian stock market, using **iShares S&P/TSX 60 Index ETF** as a proxy, has delivered annualized returns of 8% in the last decade.

Higher returns come with higher risk. Stocks are volatile. Their performance is impacted by the macro economic environment and the underlying businesses that drive the stocks. In the worst-case scenario, a business can go bankrupt, and the corresponding stock becomes worthless.

The stock market is down this year. The prominent macro headlines nowadays are about high inflation and rising interest rates, which are bringing down stock valuations and creating buying opportunities for long-term investors.

It wouldn't be farfetched to aim for a minimum compound annual rate of return of 12% for new cash deployed in quality stocks today.

Where can you invest for 12% return today?

Toronto-Dominion Bank (TSX:TD) is a low-risk, quality stock that can deliver returns of more than 12% per year over the next three to five years. The bank stock has declined about 9% year to date, which brings the stock to a discount of about 10% from its long-term normal valuation.

Importantly, it has outperformed the industry by increasing its earnings per share (EPS) by approximately 8.8% annually over the last decade. The bank's focus in Canadian and U.S. retail banking should allow it to continue to grow at a good rate long term.

Assuming a more conservative earnings-per-share growth rate of 8% combined with its current dividend yield of 4.1%, it could deliver long-term returns of just north of 12%. Any valuation expansion will simply add to that return.

TD stock's dividend is safe. Its trailing 12-month payout ratio is 41%, which is at the low end of its target range of 40-50% for its payout ratio.

Building a $600,000 portfolio

If you're starting from scratch and able to invest for $6,000 per year at a CAGR of 12%, you'll arrive at $600,000 in fewer than 23 years. While buying TD stock on weakness is a good start, remember to invest in other top stocks to ensure sufficient portfolio diversification.

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1. Investing
2. Stocks for Beginners

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kayng