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'Best gift government has given us': Long-term power of the TFSA yet to be fully tapped

By Danielle Kubes, Special to Financial Post

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The TFSA is new enough that Canadians haven't had time to experience its long-term investing implications, generally preferring to focus more on the S-for-savings.

But that could be a mistake.

"The TFSA is the ideal place for long-term equity investment and the power of it comes from that long-term compound growth and not as a savings account with cash in it," says Steve Bridge, a money coach from Money Coaches Canada.

He gives the example of someone in a 40 per cent marginal tax bracket stashing $5,000 in cash at one per cent interest. They earn $50, so only save $20 from sheltering it within a TFSA. If you compare that to an equity investment that grows at 5 per cent, earning you $250, they're now saving $100 in taxes.

"That's five times the amount of just having cash in there," he says. "If you add in the long-term power of compounding, now you've gotten yourself a powerful retirement tool."

The best fit for a TFSA, most advisors will tell you, are equities that have steady and stable growth.

"It's not a place for speculative securities," says Ian Black, a fee-only financial advisor at Macdonald, Shymko & Company Ltd. "If it works out, you're fine, but speculative more often than not doesn't work out."

Instead, Black suggests ETFs.

"Not just picking one or two stocks, but using more exchange-trade funds to get exposure; reducing the risk," says Black.

Some Canadians with a long-term time horizon, more investing experience and a slightly higher risk-profile may, however, may opt for a more aggressive approach.

Take Ben Feferman, for example, a 33 year-old app developer, who opened his TFSA the first year it was available and views it as a investment vehicle to fund his downpayment or retirement.

He prefers to puts the majority of his portfolio in large-cap growth stocks, with 10 per cent as his "cowboy money" where he invests in high-risk speculative stocks.

> I'm extremely loyal to my holdings and I never abandon ship, I go right until the bitter end.

Indeed, the first part of such an approach can result in a windfall.

Let's say that TFSAs existed 13 years ago. Let's also say that you were 22, in your first job with no university debt.

And let's say you decided to invest $5,000 CAD to buy 45 shares of Google on the day it went public in 2004, when it was trading at $85 USD.

Ten years later, after an average annual rate of return of 26 per cent, that seed money has grown into $45,809, earning you a tidy profit of $40,809.

Had you held the stock outside the TFSA, you would have been on the hook for capital gains tax. At a 40 per cent marginal tax rate you would have been forced to hand over to the CRA $8,162

But because you invested within your TFSA, you owe the government precisely nothing.

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Of course, had Google gone the other way, selling within a TFSA could have been a disadvantage - a loss is just a loss; it can't be offset.

Still, this is unlikely to deter someone like Feferman.

"I don't see any tax advantage of me investing a non-registered accounted," he says. "Because of the long-term time horizon, there is a much greater chance that I'll have more gains than losses."

Besides, selling low goes against one of the main, good-sense long-term investing rules.

"Investors are their number one enemy." Bridge says. "Don't touch it. It doesn't matter if Donald Trump gets elected. It doesn't matter."

Thats one piece of advice Feferman abides by religiously.

"I don't sell stocks," he says. "I'm extremely loyal to my holdings and I never abandon ship, I go right until the bitter end."

Even if you choose to follow the market passively with ETFs, you'll still end up ahead of the game with a sum large enough to fund your golf membership and travels.

Continuing our Google example, let's say you're now 32 with a wife, a baby on the way, and your risk tolerance has gone way down so you decide to invest that $45,809 into four different ETFs to create a balanced and diversified portfolio. Over the next 30 years, you average a rate of return of 4 per cent. Nothing spectacular, but it's consistent. By the time you're 62 and itching retire, your nest egg has grown to $148,576.80. That's $26,000 more than the $122,104.19 you would have ended up with had you reinvested the after-tax gain in the same fashion.

And that's entirely yours to keep, which is where the TFSA veers off from an RRSP or a non-registered account, where you would end up giving the CRA a significant portion of your fortune.

With the accumulated contribution room at $52,000 for those who were at least 18 when the TFSA was introduced, the vehicle has become "an important part of long-term wealth accumulation," Bridge says.

"The TFSA is the best gift the government has given us in a long time."

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