At age 30 or 60 – how best to invest your TFSA

If you can aggressively save $52,000, or fortuitously have inherited some money, what's the best way to invest it in your TFSA? Would the plan be different for age 30 or age 60?

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More than a half century after introducing the popular registered retirement savings plan (RRSP) in 1957, the federal government provided Canadians with a new financial instrument to save for their future: the tax-free savings account in 2009.

Now in its ninth season, the TFSA has – through annual contribution limits of $5,000, $5,500 and one year at $10,000 – allowed taxpayers to sock away as much as $52,000. The current annual contribution limit is $5,500.

Like the RRSP, the principal contributed each year to a TFSA can be invested in a wide array of financial instruments. Unlike the RRSP, which involves tax-deferred money, funds contributed to a TFSA are after-tax, and the investment income produced within the TFSA accumulates on a tax-free basis.

This article examines how a hypothetical 30-year-old investor and a hypothetical 60-year-old investor who have invested the maximum principal of $52,000 within their TFSA (ignoring whether the TFSA had gained or lost value as a result of previous years' investments) might want to invest that money.

Investment advisors emphasize that these recommendations are very general. They stress that a portfolio must be individually tailored to family mortality, financial aspirations and risk tolerance, among others.

Situation No. 1: Portfolio considerations for a 30-year-old investor

Most 30-somethings have a decades-long time horizon until their expected retirement. Their investment strategy will be focused on the long term, secure in the knowledge there will be plenty of time to recover from inevitable periodic market slumps.

"I always want to emphasize with them, 'Start planning. Learn how to invest. Don't worry about making a mistake,'" says Adrian Mastracci, a senior portfolio manager with Lycos Asset Management Inc. in Vancouver.

Experts note that an investor around the age of 30 is typically just starting to build their financial portfolio. They might choose to place all of their savings in a TFSA as they pay off obligations like student loans, while also contending with credit card, mortgage and other debt. A TFSA can also be used to provide all or a portion of a down payment on a house.

A 30-year-old investor may also be accumulating savings room in – but have not yet begun contributing to – an RRSP.

"My view is with a TFSA, if you're 30, you probably should be close to 100 per cent, if not 100 per cent in equities," says Mr. Mastracci, who explains that most 30-year-olds will have an aggressive investor profile.

Mr. Mastracci notes that young people tend to be very familiar with tech companies such as Amazon.com Inc., Apple Inc. or Facebook Inc., and investing in any of those stocks can be a solid investment.

"But I caution any 30-year old, or anybody of any age, not to put a lot of money into one particular area," he adds.

A diversified North American portfolio of equities could also include, for example, consideration of at least one major Canadian bank stock; perhaps a stock in the consumer discretionary area, like Wal-Mart Stores Inc. or Target Corp.; or a stock of a big pharmaceutical company such as Merck & Co. or Pfizer Inc., he says.

The equity side of a TFSA can also consist of a mixture of other types of investments, such as exchange-traded funds (ETFs).

Mr. Mastracci suggests three ETFs that might be effective for a 30-year-old: BMO S&P 500 Index ETF; Vanguard U.S. Total Market ETF (Canadian dollar hedged); and the iShares S&P/TSX 60 ETF.

"The reason why I picked those is because they have growth prospects. At age 30, the spotlight is on growth," he explains.

Mr. Mastracci is not bullish on mutual funds for a TFSA, which he says are more expensive than ETFs. "I think in a world of low returns and emphasis on fees, you don't want to spend a whole lot on mutual fund fees," he says.

Situation No. 2: Portfolio considerations for a 60-year-old investor

Sixty-year-olds may still be in their peak earning years, but many of their prime investing years are behind them. Yet, with the average life expectancy in Canada pushing into the mid-80s, they still need to plan for enough growth to sustain them for the rest of their life.

Instead of being their sole investment account, the TFSA is more likely to be an integral part of a larger overall portfolio which also consists of an RRSP or registered retirement income fund (RRIF), and perhaps also a non-registered investment account.

Many 60-year-old investors will likely be leaning more toward an income flow, as opposed to earlier in their lives when their portfolios were in more of a growth phase, says Mr. Mastracci.

They might want their total portfolio balanced at around 50 per cent in equities, including stocks, ETFs and private equity mutual funds, and 50 per cent in fixed-income instruments such as bonds. Others might want to invest more aggressively, perhaps as high as 80 per cent in equities and 20 per cent in fixed-income instruments, he notes.

As long as the total desirable ratio in the overall portfolio is maintained, a 60-year-old investor has a lot of flexibility regarding the composition of their TFSA.

For example, an investor who wants to maintain an overall 50/50 balance between equities and fixed-income investments could still elect to have up to 100 per cent equities in a TFSA, so long as they are able to maintain the desired overall investment balance with a heavier weighting of fixed-income investments in other accounts, says Mr. Mastracci.

He recommends the BMO S&P 500 Index ETF, the Vanguard FTSE Canada All Cap Index ETF, and the BMO Equal Weight REITs Index ETF as possible instruments that will generate the desired income inside of a 60-year-old investor's TFSA.