

Defence funds deliver 19% returns in 2026, HDFC Defence Fund leads.

Should investors chase the rally or stay cautious?

By Surbhi Khanna, ET Online Last Updated: Sep 18, 2026, 11:28:00 AM IST



Defence sector funds have delivered strong returns so far in 2026, with the category generating an average return of 19% year-to-date (YTD), an analysis by ETMutualFunds showed. The analysis further showed that HDFC Defence Fund, the only actively managed fund based on the defence sector, delivered the highest return at 24.51% during the period.

The sharp gains may make investors wonder whether they should increase their exposure to the category or wait for a better entry point.

Market experts believe the recent rally has been supported by factors such as higher defence spending, government policies promoting domestic manufacturing, strong order books and growing export opportunities. However, with valuations also rising after the sharp gains, investors need to assess whether the recent performance can continue and how much defence exposure fits into their overall portfolio.

Hrishikesh Palve, Director, Anand Rathi Wealth Limited told ETMutualFunds that investors should not enter defence funds simply because of their strong recent performance, as this could lead to recency bias. He said heightened geopolitical uncertainty and sustained growth in defence spending have supported the recent outperformance.

India's defence capital budget has risen from Rs 1.13 lakh crore in FY20 to Rs 2.19 lakh crore in FY27, providing a positive long-term structural outlook for the sector. However, Palve cautioned that this does not mean the recent pace of returns can continue.

Historically, sharp rallies in the sector have been followed by periods of consolidation or correction. The sector's decline of around 15-20% between mid-2024 and early 2025 is a reminder that defence stocks and funds can be highly volatile.

Vishal Dhawan, Founder & CEO, Plan Ahead Wealth Advisors told ETMutualFunds that government policies promoting self-reliance through initiatives such as Make in India, along with increased defence capital allocations globally, are supporting order pipelines. "Major defence companies have strong contract and order books, which could provide earnings visibility over several years."

He added that rising global demand for defence equipment and new trade agreements are creating international export opportunities for domestic suppliers. As companies increase production and improve their technical capabilities, international sales could become an additional growth driver alongside government procurement.

However, Dhawan said current stock prices already factor in expected earnings growth following the sharp rally. While business fundamentals remain healthy, elevated valuations leave limited margin of safety, which could mean future gains are more moderate than the recent performance.

There were nearly six defence sector based funds in the said time period. After HDFC Defence Fund, Groww Nifty India Defence ETF FOF gave 18.30% return in 2026 so far. Aditya Birla SL Nifty India Defence Index Fund gave the lowest return of around 17.42% in 2026 so far.

Continue allocation or review allocation?

Post seeing the performance of defence sector based funds in the current calendar year so far, the important question is should one continue with current allocation or review their allocation after this sharp rally?

Dhawan said investors should check whether recent outperformance has pushed their defence fund allocation above 5% of their total portfolio. If the exposure has crossed that level, investors could consider selling a small portion and reallocating it towards broader market funds.

He cautioned against making sudden investment decisions based purely on recent high returns. Similarly, completely exiting the category out of fear of a correction may not necessarily be appropriate. According to Dhawan, systematic rebalancing can help manage concentration risk without making emotional decisions.

Palve also said existing investors should first review their overall portfolio and assess how much exposure has built up to the defence sector. If defence has become an oversized allocation, investors should consider rebalancing.

For example, if defence allocation has grown to around 30% of the portfolio, bringing the exposure closer to 5% could help reduce sector concentration risk, Palve said. The balance could be moved towards diversified categories such as flexi cap, multi cap or large and mid cap funds, which provide exposure across different market capitalisations and sectors.

According to a report by ETMarkets, India's defence industry is entering a new phase of growth, with the combat deployment of indigenous weapons giving locally developed systems a stronger stamp of credibility in global markets.

The shift is backed by a sharp increase in defence spending. India's defence budget has surged from Rs 2.53 trillion in FY14 to Rs 6.81 trillion in FY26, reflecting the Narendra Modi-led government's strong focus on military modernisation and national security.

At the same time, the government's preference for domestic manufacturers under the Atmanirbhar Bharat initiative is creating a powerful multi-year opportunity across aircraft, helicopters, missiles, naval platforms, artillery systems, air-defence systems, defence electronics, radar systems and unmanned platforms.

The report also highlighted that global brokerage firm, Jefferies expects defence exports to grow 11% annually through fiscal 2030, reaching Rs 584 billion.

Jefferies believes Indian defence companies could see growing demand for missiles, artillery and electronic systems following successful deliveries to Armenia. Europe's rearmament cycle may not immediately translate into large platform exports because of established supplier relationships, but it could open the door for Indian companies to participate as component and subsystem suppliers.

Lumpsum or SIP: Which is the preferred route?

For investors who do not currently have exposure to defence funds, the next question is how to deploy fresh money after the strong rally. Making a large lump-sum investment after a sharp rise can expose investors to the risk of entering at elevated valuations.

Palve said new investors should avoid entering defence funds simply because the sector has rallied sharply. Since sector funds are cyclical and can create concentration risk, investors can also get exposure to defence through diversified equity funds that already have meaningful allocations to the sector.

For investors looking to deploy fresh money, Palve prefers SIPs over a lump-sum investment after a strong rally. If a meaningful market correction occurs and a lump sum needs to be deployed, he suggested staggering the investment across five to six instalments rather than investing the entire amount at once.

Dhawan also said putting a large lump sum into a sector after a significant run-up carries considerable risk, as buying at elevated price levels can leave capital vulnerable to short-term losses if the market corrects.

A staggered approach through SIPs can help smooth out purchase costs over time. Investors buy fewer units when prices are high and more units if prices decline, thereby reducing the risk associated with a single entry point.

Dhawan suggested that investors maintain a defined allocation to the sector rather than allowing defence exposure to become a large part of the portfolio. A 5% allocation cap could work for many investors, he said, while the remaining portfolio can be built around core, diversified equity holdings.

Short and long term performance of defence sector funds

Only HDFC Defence Fund has been around in the market for the last three years. The fund gave 34.49% return. In the last six months, the defence sector based funds gave upto 23.88% return with HDFC Defence Fund leading the return chart and Aditya Birla SL Nifty India Defence Index Fund gave the lowest return of 15.60% return in the last six months.

What should investors check beyond recent returns and outlook?

Recent returns alone may not be sufficient when selecting a defence fund. Investors also need to examine the underlying companies, portfolio concentration, consistency of performance and the fund's exposure to individual defence businesses.

Dhawan said investors should assess a fund's portfolio, company execution track record and concentration before investing. A large order book alone does not guarantee earnings growth. While the defence sector has a positive long-term outlook, investors should expect more moderate and steady returns rather than a repeat of the recent sharp rally.

Palve said investors should assess portfolio exposure, rolling returns, holdings overlap and long-term performance before choosing a defence fund. While higher defence spending supports the sector's long-term outlook, valuations may already reflect much of the optimism, leaving room for consolidation.

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