



# *The Value of a Long-Term Perspective*

October 1999

John W. Henry & Company, Inc. (JWH<sup>®</sup>) has provided investment management services for individual and institutional investors for 17 years. During that time, our firm has grown to be one of the largest managed futures advisors in the world, with \$2.0 billion under management as of October 31, 1999.

**We believe  
this analysis  
demonstrates that  
JWH's disciplined  
approach to  
investing has  
resulted  
historically in  
strong recovery  
from declines.**

The long-term trend identification strategy utilized by JWH has provided many investors with excellent risk-adjusted returns over the years. However, these returns have not been achieved without periods of unfavorable performance from time to time. During periods of drawdowns\*, investors may question whether a fundamental change in markets has occurred, negatively impacting JWH's ability to rebound.

In this report -- which analyzes the historical performance of JWH's largest program, Financial and Metals Portfolio -- JWH addresses drawdown-related issues from a long-term performance perspective, with a particular emphasis on the periods of recovery from drawdowns. In JWH investment programs generally, and in the Financial and Metals Portfolio in particular, JWH's disciplined approach to investing historically has resulted in strong recovery from such declines.

The data concerning recoveries from drawdowns has been extremely favorable. To obtain a balanced perspective on this performance, the reader should bear in mind that favorable recoveries in the past cannot be used to predict future performance or recoveries, which will depend on conditions in the markets traded by JWH. Our analysis is based on composite performance data, covering all accounts trading the Financial and Metals Portfolio. The experience of any one investor would vary from that shown on a composite basis, depending on the beginning and ending dates of an investment.

\*For the purposes of this analysis, a drawdown is defined as a loss of 10% or more from the previous performance peak.

*ALTHOUGH OFFERING POTENTIAL BENEFITS, AN INVESTMENT WITH JWH IS SPECULATIVE, INVOLVES A HIGH DEGREE OF RISK, AND IS DESIGNED ONLY FOR SOPHISTICATED INVESTORS WHO ARE ABLE TO BEAR THE LOSS OF MORE THAN THEIR ENTIRE INVESTMENT. READ AND EXAMINE THE DISCLOSURE DOCUMENT BEFORE SEEKING JWH'S SERVICES.*

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### **Two Types of Drawdown Analysis**

Different statistical analyses can be performed with regard to drawdowns; this report presents two types of analysis. When a program is currently experiencing losses and the end of the drawdown is not known, the first methodology, called **drawdown threshold analysis**, can be useful -- especially to prospective investors or to those wishing to add to or withdraw from their holdings. Based on the fact that an investor does not know where or when a bottom will be hit, drawdown threshold analysis enables the investor to evaluate performance from various threshold levels during a drawdown -- from 10% below a previous peak, from 15%, from 20%, etc.

The second methodology, **peak-to-peak analysis**, has the benefit of hindsight, i.e., the bottom of the downturn is known before the analysis is started. This widely used method measures from one peak in historical performance to the next, examining the intervening period -- peak to trough to peak -- as one continuous event. Peak-to-peak analysis is very useful in viewing the track record of the program as a whole.

## The Value of a Long-Term Perspective

When evaluating the return on an investment, investors look at annual returns. By doing this, shorter periods of very strong performance are not given too much importance. Taking a long-term perspective on periods of negative performance also may make sense, as **Table 1** indicates.

**Table 1** provides a summary of five categories of drawdown thresholds -- ranging from negative 10% below a previous peak to negative 30% -- for our largest program, Financial and Metals Portfolio. Any month which ended with cumulative performance below the specified percentage (e.g. 10%) was viewed as a separate event or occurrence. If a month ended more than 10% below the previous peak and was followed by another decline, another occurrence was created. Similarly, if a month ended with positive performance, but cumulative performance remained more than 10% below the peak, it was regarded as a separate occurrence.

The reader will note that these historical recoveries have been strong. Month-end performance has declined 10% or more from a prior peak on 28 occasions since January 1989. The average percentage decline of these 28 drawdowns was -19.7%. The average time from the trough of a drawdown to a new peak was only four months, and a year later, the average profitability for 25 out of 28 periods (twelve months have not passed for the last three periods) was 52.4%.

The reader should also know that commencing in August 1992, the Financial and Metals Portfolio had an approximate 50% reduction in position size in relation to account equity. This reduction in position size has reduced the magnitude of subsequent negative performance periods in the program. Since August 1992, the average of the drawdowns greater than 10% for the Financial and Metals Portfolio was 14.4%, with an average return 12 months later of 34.1%.\* While we are pleased with the reduction in performance volatility over the past seven years, there can be no assurance that such will be the case now or in the future.

**Table 1: Drawdown Thresholds  
JWH Financial and Metals Portfolio  
January 1, 1989 through October 31, 1999**

	Drawdown Level				
	- 10% Or More	- 15% Or More	- 20% Or More	- 25% Or More	- 30% Or More
# Month-End Occurrences	28	18	10	7	3
Average Drawdown	-19.7%	-24.0%	-29.2%	-31.7%	-37.5%
# Profitable 12 Mos Later	*25	*17	All	All	All
Avg. Profit 12 Mos Later	+52.4%	+58.6%	+73.5%	+74.8%	+96.1%
Avg. Time to New Peak from Trough	4 months	4 months	4 months	4 months	4 months

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\* 12 months have not passed since the drawdown periods for November 1998 (-11%), September 1999 (-12%) and October 1999 (-19%) began. As of October 31, 1999 the post-drawdown return for the November 1998 period is -6.0%. October 1999 figures are based on estimates.

In Table 1, "# Month-End Occurrences" is a sum of the number of months in the historical composite performance record that have declined from the last monthly performance peak within each specified threshold. "Average Drawdown" is a simple average of all negative rates of return for the month-end occurrences within each specified threshold level. "# Profitable 12 Mos Later" is the number of the subsequent positive 12 month rates of return for each month-end occurrence within the specified threshold; results for the three periods since November 1998 are omitted from this sum because twelve months have not passed since these drawdown periods. "Avg. Profit 12 Mos Later" is a simple average of all subsequent 12 month returns for the month-end occurrences for each specified threshold. "Average Time to New Peak from Trough" shows, for each specified threshold level, a simple average of all month-end periods the program took to recover from each trough until the next historical performance peak.

**When evaluating the return on an investment, investors look at annual returns. Taking a long-term perspective on periods of negative performance also may make sense.**

## Drawdown Threshold Analysis

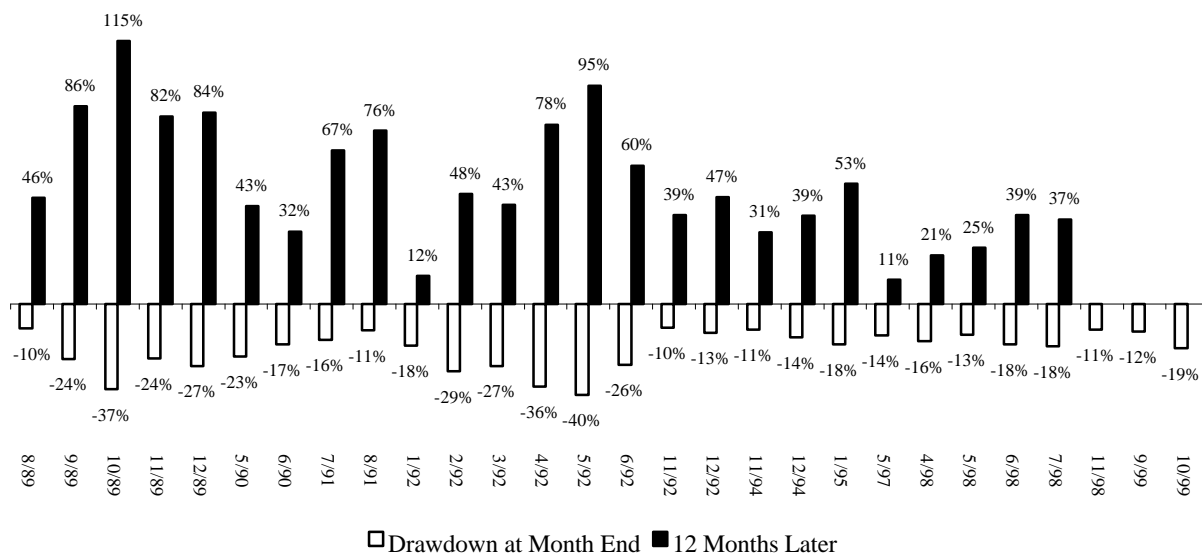
When a program is actually experiencing losses, no one can predict if the following month will be positive or if the program is headed for a prolonged drawdown.

Using drawdown threshold analysis, **Chart 1** gauges Financial and Metals Portfolio's performance from each point in a drawdown, showing for individual months the cumulative month-end drawdown that was at least 10% below its previous peak, whether or not that month was the low point of a performance cycle. Each month-end drawdown is compared to its performance 12 months later. For example, the drawdown in May 1992 was 40% below the previous peak; 12 months later, the return was 95% for the 12 month period immediately following. In all but two cases, performance over 12 months exceeded the drawdown.

As previously discussed, the Financial and Metals Portfolio had an approximate 50% reduction in position size in relation to account equity commencing in August 1992. As a result, post-1992 drawdowns have declined materially in size compared to pre-1992 drawdowns, with the maximum decline to date at 19.2% in October 1999.

**Chart 1: Drawdown Thresholds**  
**JWH Financial and Metals Portfolio**  
**January 1, 1989 through October 31, 1999**

When a program is experiencing losses and the end of the drawdown is not known, drawdown threshold analysis can be useful -- especially to prospective investors or to those wishing to add to or withdraw from their holdings.



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\* 12 months have not passed since the drawdown periods for November 1998 (-11%), September 1999 (-12%) and October 1999 (-19%) began. As of October 31, 1999 the post-drawdown return for the November 1998 period is 6.0%. October 1999 figures are based on estimates.

### **Peak-to-Peak Analysis**

Peak-to-peak analysis measures from one peak in historical performance to the next, examining the intervening period as one event. A peak-to-peak analysis is shown in **Table 2**, which presents the length of time from the peak to the trough, the percentage decline from the peak to trough (drawdown), the length of time from the trough to the new peak, and the corresponding results 12 months after the trough.

**Table 2** shows the drawdowns when the Financial and Metals Portfolio declined 10% or more from its peak. The average recovery period from a trough to a new peak was three months, with the longest period at seven months. It is also interesting to note that, even if an investor had invested at the performance peak, and immediately experienced a drawdown, in all cases, new peaks would have been reached in twelve months or less. Of course, the choice of other measuring periods would result in varying rates of return positive and negative.

**Table 2: Peak-to-Peak Analysis  
JWH Financial and Metals Portfolio  
January 1, 1989 through October 31, 1999**

Peak to Trough Dates	Months Peak to Trough	Drawdown	Months Trough To New Peak	Return 12 mos After Trough
July 99 to Oct 99	*4	-19.2%	Current	**
Oct 98 to Nov 98	2	-11.0%	7	**
Jan 98 to Jul 98	7	-18.3%	2	+37.0%
Feb 97 to May 97	4	-13.5%	2	+10.6%
July 94 to Jan 95	7	-17.5%	2	+52.6%
Sep 92 to Dec 92	4	-12.5%	2	+46.8%
Jan 92 to May 92	5	-39.5%	3	+95.4%
Oct 90 to Jul 91	10	-15.5%	2	+67.1%
May 90	1	-22.7%	3	+42.7%
June 89 to Oct 89	5	-37.2%	4	+114.7%

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\* *The Financial and Metals Portfolio has had a drawdown occurrence of greater than 10% commencing in July 1999. It is not possible to know beforehand the extent or duration of this current drawdown. October 1999 figures are based on estimates.*

\*\* *12 months have not passed since the two most recent drawdown periods began.*

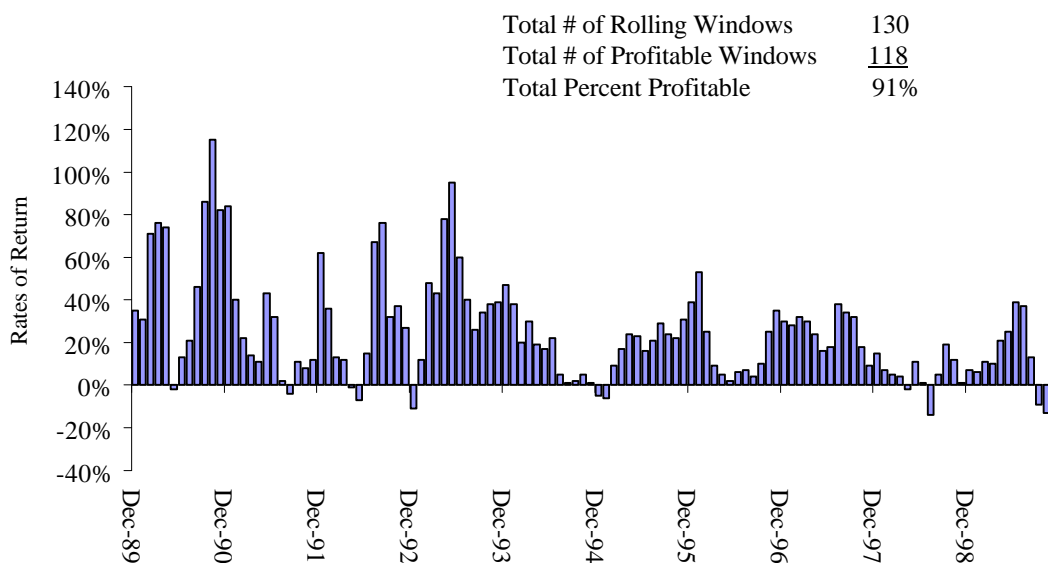
While there is no one "right time" to invest in JWH, our analysis of historical data reveals that drawdowns historically have been important investment opportunities. Of course, there can be no guarantee that an investment during the current drawdown will be profitable.

## Strong Returns Over Time

The 12-month rolling windows shown in **Chart 2** provide a long-term perspective on JWH performance. As the chart indicates, 91% of the 12-month rolling windows from January 1989 through October 1999 are positive. Moreover, the average return for all 130 rolling windows during this time is 26.7%. The chart also reflects the positive results of the program's 50% reduction in position size in relation to account equity commencing in August 1992, which has reduced the volatility of returns significantly since then. From August 1992 through October 1999, 92% of the 12-month rolling windows are positive. The average return for the 76 rolling windows for this time period is 17.5%.

**Chart 2: 12-Month Rolling Windows  
JWH Financial and Metals Portfolio  
January 1, 1989 through October 31, 1999**

Over the past ten years, the average 12-month rolling window returned 26.7%, despite periods of unfavorable performance.



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Each "rolling window" represents a 12-month period. An investment made on January 1, 1989 and held until December 31, 1989 is one rolling window. Each month during the period covered by Chart 2 represents the end of a rolling window. For example, investments made on February 1, 1989, March 1, 1989 and April 1, 1989 and then held until January 31, 1990, February 28, 1990 and March 31, 1990, respectively, are each separate rolling windows. October 1999 figures are based on estimates.

## **Notes**

JWH figures for October 1999, and all calculations utilizing October 1999 performance, are based on estimates.

The information throughout this analysis presents performance for one of the 12 JWH investment programs. Information for the other 11 programs may or may not reflect similar results. All statistics were calculated using data provided in the Financial and Metals Portfolio performance record (as shown in JWH's current disclosure document), which is the composite of the actual performance of all accounts trading the program, and does not reflect the returns or losses experienced by any individual account or fund. Certain drawdown information for individual accounts is presented in JWH's current disclosure document. Further details of past performance and definitions of terms used to state past performance are presented in JWH's current disclosure document.

The Financial and Metals Portfolio began trading client capital in October 1984. Performance for this analysis is shown for the ten year period and year-to-date performance commencing January 1989.

### **Position Size Adjustments**

Adjustments in position size in relation to account equity have been and continue to be an integral part of JWH's investment strategy. At its discretion, JWH may adjust the size of a position in relation to equity in the account that is taken in certain markets or entire investment programs. Such adjustments may be made at certain times for some investment programs but not for others. Factors which may affect the decision to adjust the size of a position in relation to account equity include ongoing research, program volatility, current market volatility, risk exposure, subjective judgement, and evaluation of these and other general market conditions. Such decisions to change the size of a position may positively or negatively affect performance and will alter risk exposure for an account. Adjustments in position size relative to account equity may lead to greater profits or losses, more frequent and larger margin calls, and greater brokerage expense. No assurance is given that such adjustments will result in profits for client accounts. JWH reserves the right to alter, at its sole discretion and without notification to clients, its policy regarding adjustments in position size relative to account equity.

During the periods covered by the preceding performance

records, and particularly since 1989, JWH has increased and decreased position size in relation to account equity in certain markets and entire programs, and also altered the composition of the markets and contracts it trades. In general, since 1992, JWH began implementing certain position size adjustments that were of a more permanent nature. While historical returns represent actual performance achieved, you should be aware that the position size relative to account equity currently utilized may be significantly different from that used during previous time periods. Investors should be aware of the following position size adjustment relative to account equity:

Financial and Metals Portfolio – reduced 50% commencing in August 1992.

In May 1992, position size adjustments were reduced by 50% for 35% of the assets in the Financial and Metals Portfolio at the request of a client. This reduction in position size materially affected the rates of return in some JWH accounts; the 1992 annual rate of return for the Financial and Metals Portfolio was negative 10.9%. If these accounts had been excluded from the performance record, the 1992 annual rate of return would have been negative 3.9%. The effect of this reduction in position size was eliminated in September 1992 when all accounts in this program underwent a reduction in position size.

### **Proprietary Capital**

During certain periods covered in the performance record, proprietary funds are included. The absence of management and incentive fees as well as reduced commissions during this time may have had a material effect on the rate of return. However, this potential material effect has decreased as client funds have composed the entire performance record from July 1987 to April 1991. In May 1991 one proprietary account, and in March 1992 a second proprietary account, began trading in this program. Both accounts are included in the performance information from their inception until August 1995. The maximum percentage of proprietary funds during this time frame was less than 0.5% and had no material impact on the rate of return.



*Visit our Web site to access performance information.*

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Although offering potential benefits, an investment with JWH is speculative, involves a high degree of risk, and is designed only for sophisticated investors who are able to bear the loss of more than their entire investment. Some, but not all, of the risk factors that should be considered prior to making an investment decision include: forward contract trading, which is not afforded the regulatory protection of exchanges or the Commodity Exchange Act and may subject an investor to greater risks than trading on U.S. exchanges; trading on non-U.S. futures exchanges, which are not regulated by any U.S. government agency and may involve certain risks not applicable to trading on U.S. exchanges; currency risks associated with foreign-denominated margin deposits; possible failure of brokerage firms or futures exchanges; and illiquid markets, which may make it more difficult to establish or liquidate a position at a given price. For more details on these and other risk factors, please refer to JWH's current disclosure document.

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