



MCM

Third Quarter 2010

Quarterly Economic News

The incessant push and pull of the economic recovery has become hard to bear. As we head into election season, the focus of many debates revolves around how to solve economic and political uncertainties. Sluggish economic growth, persistently high unemployment and a weak housing market held back the third quarter. Positive news in the manufacturing sector propelled the stock markets upward: the Institute for Supply Management (ISM)'s Report on Business stated that economic activity in the manufacturing sector expanded in September (54.4%) for the 14th consecutive month (a reading above 50 percent indicates that the manufacturing economy is generally expanding). As a leading economic indicator, overall stock market performance is also telling of the current state of the economy. The following table shows the average annual returns for various indices:

Index	3rd Qrt	1 Year	5 Year	10 Year
S&P 500 (Composite Total Return)	11.30%	10.17%	0.64%	-0.43%
Russell 2000	11.29%	13.35%	1.60%	4.00%
MSCI EAFE (Net)	16.48%	3.27%	1.97%	2.55%
Barclays Aggregate Bond	1.84%	7.13%	6.12%	6.18%

The S&P 500 is a commonly used measure of common stock total return performance, the Russell 2000 is a commonly used measure of small capitalization stocks, the MSCI EAFE is a commonly used measure of common stock total return performance of international markets, and the Barclay's Aggregate Bond Index is a commonly used measure of the bond market.

All referenced indices are unmanaged and not available for direct investment.

Past performance is not a guarantee of future results.

Recession Is Over?

The recession that began in December 2007 officially ended in June 2009; or so says the National Bureau of Economic Research's Business Cycle Dating Committee, a non-partisan, non-profit research group who determines benchmarks for U.S. recessions. The public's reaction to NBER's September 20th announcement ranged from indignation, to incomprehension, to stunned silence. There has been little relief in this announcement and considerable skepticism from both political parties on Capitol Hill. NBER clarified its position by stating that "the committee did not conclude that economic conditions since [June 2009] have been favorable or that the economy has returned to operating at normal capacity". In essence, NBER's findings are simply that the period of falling economic activity (as measured by indicators such as real GDP, real income, employment, industrial production and wholesale-retail sales) has come to an end.

Tightening the Belt

American poet Ogden Nash wrote that "some debts are fun when you are acquiring them, but none are fun when you set about retiring them". With the U.S. deficit growing, the general sentiment is that a "tightening of the belt" is inevitable in order to get back on

Wall Street Reform

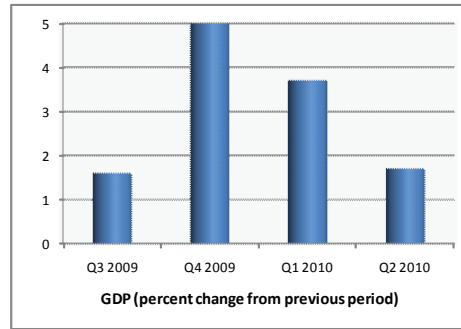
In late July, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") into law. The stated aim of this bill is to promote the financial stability of the United States by improving accountability and transparency in the financial system, to end "too big to fail", to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes (H.R.4173.ENR). One of the lesser-known elements of the Dodd-Frank Act is the writing of rules that could temper executive compensation across multiple industries. The Act requires that publicly-owned companies include in their annual proxy statement a non-binding resolution seeking shareholder approval of named executive officer compensation (often referred to as Say-on-Pay) at shareholder meetings at least once every three years.

The "Wall Street Bill" was hotly debated in both the House and the Senate. Senator Richard Shelby (R-Ala.), who serves on the Senate Banking Committee, recently announced that Republicans plan to revisit the bill if they gain control of Congress after the November elections. In a statement made during a Committee hearing on implementing the Dodd-Frank Act, Senator Shelby summed up the Republican Party's concerns by saying that "by adding another level of bureaucracy to our already cumbersome financial structure, Dodd-Frank could potentially create an even more complex and dysfunctional system".

track. A Reuters/Ipsos poll released in late September found that a majority of Americans believe reducing the deficit and cutting taxes are ways to improve the tough economy and believe it will help create jobs (57 percent of Americans want the government to cut the deficit despite the hard economic times, while 39 percent support deficit spending to stimulate the economy). The deficit increase has largely been caused by turmoil in the financial markets, by recessionary spending intended to boost the economy, and by the cost of enacting federal policies to curb economic troubles. In its Long-Term Budget Outlook published in June, the Congressional Budget Office projects that federal debt will reach 62 percent of GDP by the end of this year— up from 40 percent at the end of 2008. On a positive note, AIG and the U.S. government reached a deal for the repayment of the billions of dollars AIG received during the credit crisis. The deal is expected to close by the end of Q1, 2011. AIG received the largest portion of the bailout funds during the financial crisis that peaked in 2008.

GDP News

Real GDP increased at an annual rate of 1.7 percent for April to June 2010, following an increase of 3.7 percent in the first quarter.



Where the deficit is concerned, when GDP growth slows, government tax receipts also decrease. Concurrently, government spending increases to finance programs such as unemployment benefits. Second quarter growth is well shy of the 2.5 percent consensus estimates, weighed down by weak consumer spending activity and a sharp acceleration in imports. According to the Office of Economic Policy, consumer spending accounts for the largest portion of the GDP. On a seasonally adjusted basis, the Consumer Price Index (CPI) increased

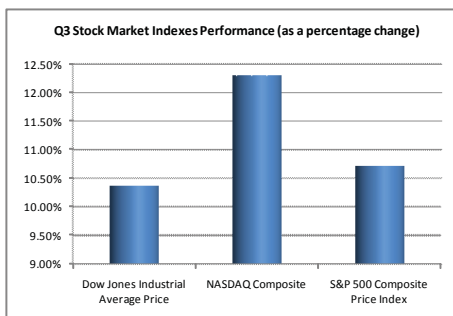
0.3 percent in August, following a 0.3 percent increase in July. The CPI is one of the most frequently used statistics for identifying periods of inflation or deflation: a large rise in CPI during a short period of time typically denotes periods of inflation and large drops in CPI during a short period of time usually mark periods of deflation.

Are We Confident?

The Consumer Confidence Index (CCI) published by The Conference Board measures the degree of optimism that consumers feel about the overall state of the economy and their personal financial situation (reference point is 1985=100). The CCI, based on a survey of 5,000 U.S. households, was up 2.5 points in August, standing at 53.5. Typically, when confidence is high, consumers are making more purchases, and when confidence is low, consumers tend to save more than they spend. The index is seen as a leading economic indicator of the relative health of the economy and is generally correlated to GDP growth. As the quarter came to a close, The Conference Board announced that the index was revised downward to 48.5 for the month of September, which is the lowest level since February of this year.

The Bulls Are Back In Town

After dismal stock market performance during the summer months, positive economic reports sent stocks soaring in early September. Even with investors pulling back to lock in profits on the final day of the third quarter, the DJIA rose 7.9 percent for the month in its strongest September performance since 1939.



This September surge brought the DJIA back in the black, up 3.6 percent year-to-date. The bond market rallied in the third quarter as investors continued to flow money into fixed income. Despite high

activity, bond returns were modest compared to gains in stocks with the DJIA up 10.4 percent for the quarter. High-yield corporate bonds returned 6.5 percent, investment-grade bonds returned 4.9 percent, and Treasury debt returned 2.7 percent according to Bank of America Merrill Lynch indexes. The Federal Reserve hinted at the possibility of purchasing long-term U.S Treasury securities to bolster the economy.

End of Quarter Recap

Although we have not seen major improvement in the labor market, positive news was posted by the Labor Department as third quarter came to a close. For the week ending September 25, initial unemployment claims fell by 16,000 to 453,000, which is more than what economists had predicted, and the four-week moving average fell to its lowest level since July 24.

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