



Dodd Consulting, LLC

Executive Benefits • Employee Benefits
Wealth Preservation and Insurance Planning

QUARTERLY ECONOMIC NEWS

Second Quarter 2012

Keeping up with the controversies and issues ailing the economy can be exasperating and disheartening, but it is never boring. J.P. Morgan’s major trading losses, Facebook’s fumbled IPO, and the Greek elections grabbed headlines in the second quarter. Greece’s right-wing New Democracy party, a proponent of the harsh European Union (EU) bailout deal, narrowly edged out its opponents, sending a sigh of relief across markets worldwide. The vote was being watched closely amid fears that Greece’s exit from the EU could cause ripples for the global economy. Some would say that the timing of Germany’s victory over Greece in the European Soccer championship was stranger than fiction. Facebook’s IPO was widely anticipated, but a last minute decision by the company’s Chief Financial Officer (CFO) to increase the IPO price range and boost the number of shares offered to investors impacted the stock’s performance on the first day of trading. When initially questioned about the potential risks associated with large derivatives positions in the bank’s portfolio, Jamie Dimon, J.P. Morgan’s Chief Executive Officer (CEO), referred to the media attention as a “tempest in a teapot”. Indeed, the situation landed him in hot water.

Investment Scorecard

Concerns about the stability of the eurozone, slowing growth in China and India, and weak reports on overall economic activity in the U.S. continued to stifle investor enthusiasm in the second quarter. Global markets gave up most of the gains achieved during the first quarter. Equities had a disappointing showing in April and May, but a better-than-expected June provided a significant boost. The Dow Jones Industrial Average (DJIA) and the S&P 500 both posted respectable gains for June. Strong June results were not enough to offset losses from April and May, and weak overall performance dominated the quarter. The following table highlights the average annual returns for various indices:

Index	2nd Qtr	1 Year	5 Year	10 Year
S&P 500 (Composite Total Return)	-2.90%	5.28%	0.19%	5.31%
Russell 2000	-3.47%	-2.08%	0.54%	7.00%
MSCI EAFE (Price)	-8.37%	-16.67%	-8.85%	2.40%
Barclays Aggregate Bond	1.92%	6.93%	6.71%	5.41%

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.

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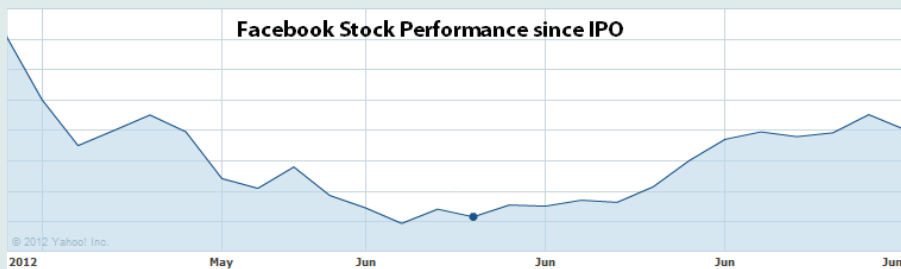
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Tempest in a Teapot?

On May 10, J.P. Morgan Chase announced the bank had suffered a \$2 billion trading loss, and potentially could face additional losses on the positions in the second quarter due to market volatility. The bets, assembled by a trader in the London extension of J.P. Morgan’s chief investment office (CIO), were intended to hedge exposure in the bank’s portfolio. Following the May 10 announcement, shareholder lawsuits were filed alleging the bank misled investors by downplaying its investment exposure and the potential risks involved in the trades. J.P. Morgan’s stock price dropped sharply, falling nearly 10% after the losses were reported. J.P. Morgan’s CEO, Jamie Dimon, was called to testify about the trading losses before the Senate and the House Financial Services Committee. On June 19, Dimon testified that: “In hindsight, CIO’s traders did not have the requisite understanding of the risks they took. When the positions began to experience losses in March and early April, they incorrectly concluded that those losses were the result of anomalous and temporary market movements, and therefore were likely to reverse themselves [...] We will lose some of our shareholders’ money– and for that, we feel terrible–but no client, customer or taxpayer money was impacted by this incident.” This incident rekindled the debate over the Volcker rule, the portion of the Dodd-Frank Act which would prohibit banks from engaging in speculative bets with their own money. The rule is purported to go into effect in July 2014.

Facebook IPO Woes

The long awaited Facebook IPO finally became a reality with the stock's first day of trading taking place on May 18. The stock's shaky start may have seemed inevitable to those privy to the dealings leading up to the main event. Indeed, expectations had already started to shift in response to Facebook's decision to increase the IPO range to \$34-\$38 per share, up from \$28-\$35. On May 16, the social media giant then disclosed a 25% increase in the number of shares to be offered. These bold announcements came on the heels of a May 9 regulatory filing which disclosed a potential threat to the company's growth: Facebook's mobile site was seeing moderate growth in ads that did not live up to expectations. The diminishing revenue forecasts and simultaneous increased valuation that transpired during the ten days leading up to Facebook's IPO dampened the stock's outlook. The problems kept piling on following NASDAQ's gaffes during early trading. NASDAQ, the stock exchange selected to host Facebook, experienced significant technical difficulties, including errors in providing order confirmations, during the stock's first day of trading. Investors at all levels were left unsure of how many Facebook shares they had acquired, or would be acquiring, and the share price did not benefit from these unknowns. Within one week of trading, Facebook and the investment banks that assisted with the IPO were sued over their handling of the deal. It will take some time to determine who, if anyone, committed wrongdoing. Regardless of how the waves settle, it has become abundantly clear that Facebook has made quite the splash.



Fiscal Cliff

In the last few months, the idea that the United States is on the edge of a “fiscal cliff” has gathered steam. The “fiscal cliff” refers to large spending cuts and tax increases scheduled to occur automatically in early 2013 if Congress cannot agree on fiscal reform. Automatic spending cuts were triggered late last year when a special congressional committee tasked with cutting an additional \$1.2 trillion from the deficit announced that it had failed to reach an agreement by their established deadline. The cuts are designed to be split evenly between domestic and military programs. Also set to expire at the end of 2012 are the Bush-era tax cuts (lower rates in effect for the past decade) and the payroll tax cut. In an election year, it is unlikely any legislation will be enacted; however, Congress may vote to temporarily extend Bush-era tax levels for all taxpayers to allow for more time to reach a sensible compromise. The importance of fiscal reform was underscored during the Joint Economic Committee hearing on the U.S. economic outlook and policy held June 7 on Capitol Hill. Federal Reserve Chairman Ben Bernanke said economic growth and job creation would benefit from the reformation of policies on taxes and government spending. Major ratings agencies also reiterated

their position that the U.S. could see its credit rating downgraded again in 2013 if Congress does not enact a workable fiscal consolidation plan.

Economic Outlook

According to the second estimate published by the Bureau of Economic Analysis, real gross domestic product (GDP) increased at an annual rate of 1.9 percent in the first quarter of 2012. In the fourth quarter of 2011, real GDP increased 3.0 percent. The Federal Reserve Beige Book published in June reported that overall economic activity in the U.S. expanded at a moderate pace during the reporting period from early April to late May. This report, published eight times per year, compiles information on current economic conditions in each Federal Reserve District (twelve in total). While the economy has been expanding modestly, job growth has slowed recently and unemployment remains elevated. On June 20, the Federal Reserve announced that they would continue “Operation Twist”, the program that exchanges short-term debt for longer-term government bonds, through the end of 2012. The intention is to lower long-term interest rates to spur borrowing, without having to inject more money into the economy.

On the housing market front, data from the S&P/Case-Shiller Home Price Indices showed that, on average, home prices increased 1.3% in the month of April for both the 10- and 20-City Composites. This was welcome news after seven consecutive months of falling home prices as measured by those indices. The National Association of Realtors reported that limited supply of housing inventory curtailed existing-home sales in May, but home prices are generally on the uptrend. Sales of newly built, single-family homes rose 7.6 percent in May, according to recently released data from HUD and the U.S. Census Bureau. A few months do not make a trend, but there are signs that a housing recovery is gaining traction.



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DODD CONSULTING, LLC

One Landmark Square, 8th Floor, Stamford, CT 06901-2603

Phone: (203) 504-3633 Fax: (203) 504-3639 Email: info@doddconsulting.net

Website: www.doddconsulting.net

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