Yes, you are quite correct that $\overline{X}$ need not be complete. Notice, by the way, that the elements of your sequence are all equivalent to one another in $\overline{X}/M = \hat{X}$. To see directly that $\hat{X}$ is complete, start by realizing that the norm in that space is $\|\hat{x}\| = \lim_{n\to\infty} \|x_n\|$ where $(x_n) \in \hat{x}$. Now suppose that $(\hat{x}_n)$ is a Cauchy sequence in $\hat{X}$. Because X is isometrically isomorphic to a dense subset W of $\hat{X}$, you can find, for every n, a $(\hat{z}_n)$ in W such that $\|\hat{x}_n - \hat{z}_n\| < \frac{1}{n}$. Using the triangle inequality, you can then show that $(\hat{z}_n)$ is Cauchy, too. So take a Cauchy sequence (z_n) back in X which corresponds to this $(\hat{z}_n)$ under the isomorphism. Then let $\hat{x} \in \hat{X}$ be the class to which (z_n) belongs. Using the triangle inequality again, you can show that this $\hat{x} \in \hat{X}$ really is the limit of the sequence $(\hat{x}_n)$.