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While it may now be "old news", any financial issue that threatens to undermine the world's largest economy is worth at least another look. I'm talking, of course about the "fiscal cliff".

As we all now know, a compromise was reached on a few of the issues that made up "the cliff" (the most significant being the permanent extension of tax cuts for the approximately 99% of Americans who earn less than $400,000 per year) – with U.S politicians agreeing to leave the balance of things for another day.

The equity markets rallied smartly the day after the deal was announced. Why such a positive reaction?

I believe part of it was just a good old-fashioned "relief rally". Since 2008, just about every financial or economic forecast seems to build in some probability of a doomsday scenario. When it (inevitably) doesn't come to fruition, UP go the markets.

A couple of other factors may have contributed to the positive reaction of the markets. The first was the "bump" for those in the highest U.S. income tax bracket - 36% to 39.5%. Not the nicest Christmas present (especially when a capital gains tax increase goes along with it), but it's definitely in the tolerable category. Compare that to the disgraceful 75% tax grab being foisted on high-income earners in France. It could have been a lot worse.

And then there's the fact that the G.O.P. actually agreed to a tax increase. Just perhaps, the Republicans & Democrats can reach some sort of workable compromise on the other issues that make up "the cliff".

So, what we've got is a few more months of uncertainty leading up to the next round of negotiations, markets see-sawing wildly depending on how sentiment is leaning and then a final relief rally as a compromise is reached.

After that? Remember that after all the posturing, the most significant issues were left unresolved – like spending cuts, serious tax reform or the debt ceiling. The U.S. is not going to solve its huge fiscal problems with a slap-on-the-wrist for its "wealthy" 1%.

I suspect that 2013 won't be quite as good a year for the stock and (especially) bond markets as 2012 – which is still OK as 2012 was a surprisingly decent year. More on that in the next issue of the Fortnighter.

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