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Booyah Breakdown

Booyah Breakdown: Donkey Distress

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The Congressional elections are over, and the Republicans are out. The Democrats have majorities in both the House and Senate for the first time since 1994.

And their big win has many market players concerned.

Cramer, in particular, said in a column after the elections "this is a P/E-lowering event for certain because the Democrats have historically sided with the consumer, not the shareholder, and that will only be exacerbated by the wilderness perspective that the Democrats bring to the table."

Hmmm. No surprise, many readers wanted more explanation of that statement.

Before we dissect it, it's important to point out that Cramer also emphasized on "Mad Money" that while Democrats are viewed as a negative for stocks, he believes investors should stay in the game.

After all, take a step back and look at the big picture on Wall Street. Stocks have been on a tear over the last six years. The fundamentals are solid and many companies are still undervalued. Overall, the market is in good shape.

Now, move on down to D.C. and remember how long it takes to change things. We could be heading back to the voting booths before the Dems get even one of their proposals approved.

So don't panic. Nothing is going to happen overnight.

Now before we dive into Cramer's comment, let's get a quick P/E refresher.

The price-to-earnings ratio basically tells you the price an investor is willing to pay for $1of the company's earnings. So if you buy a company that has a P/E of $10, that means you are willing to pay $10 for every $1 of earnings that the company generates. You're betting on the company's potential growth.

As an example, these days, people are willing to pay more for Internet stocks because they're still expecting big growth, hence their very high P/Es. Same goes for the health care sector.

To calculate the P/E ratio, you must divide your company's current stock price by its earnings per share. So, if your company's EPS is $2, and the stock is selling for $20 per share, that would make the P/E ratio $10 ($20 divided by $2). (You can read more about P/E ratios, and Cramer's view on investing in high P/E companies in a previous Booyah Breakdown column.)

How Low Can You Go?

Many people believe that under a Democratic Congress, legislation may be implemented that could lower earnings and that would, in turn, hurt stock prices.

But how?

While the Democrats have many proposals on the table, let's look at minimum wage as an example. The Democrats have talked about raising the minimum wage for some time now. And sure, that would be great for low-end workers. But from a company's standpoint (and don't email me and call me heartless), it hurts the bottom line. More money has to be paid out to employees.

Or let's say the Dems push through a bunch of environmental regulations. Companies will be forced to spend more money to meet these environmental regulations. And again, that money comes out of the bottom line and therefore depresses earnings. So there goes the stock price.

Then look at the tax situation. Most companies are valued on an after-tax basis. That means earnings are calculated after the company pays its tax bill.

If the Democrats raise corporate taxes or take away tax incentives, which they have said they'd do, then there will be less money left over after paying Uncle Sam. That, again, translates into lower earnings and lower overall valuations, says Richard Coppa, president and founder of Wealth Health, a financial planning firm in Roseland, N.J.

And those are just a few examples of how earnings would get hurt. Of course, any number of Democratic plans, such as a shift in the Iraq war strategy, may also help the broader market and thus improve stock prices.

Sectors That Could Get Stung

There are a few specific industries that are viewed as particularly vulnerable.

For instance, the donkey party would like companies to explore more alternative-energy sources. That would mean companies will need to invest money in alternative research. Not only would that squeeze profit margins, but alternative-energy sources would decrease the long-term demand for oil, says Brad Sorensen, the head sector analyst at Schwab's Center for Investment Research. So the energy stocks may feel some pain down the road.

Of course, oil prices are strong these days and the winter is coming, which tends to push prices up even higher, reminds Fred Ruffy, an analyst at Optionetics, an investor-education Web site. Not to mention there's a huge demand for oil in China. There is also the ever-present OPEC wild card. The Democrats aren't the only force controlling the energy sector -- so don't let them scare you too much.

The Democrats also will attempt to revamp health care.

They believe the drug companies make too much money, so they'll likely demand that the government use its bargaining power to buy drugs, and thereby push drug prices down.

This could really hurt the drug companies because they'll have little negotiating power against the government, says Ashok Ahuja of Icor, a Westport, Conn., firm that operates a technology hedge fund.

On the flipside, biotech stocks may come out on top, especially those involved in stem cells, cancer and multiple sclerosis research, since the Dems are big supporters. That's why you saw stem cell stocks such as **Aastrom Biosciences** (ASTM) , **Stemcells** (STEM) and **Geron** (GERN) move higher on Wednesday.

Sometimes, Slow is Good

Keep in mind, President Bush can veto anything he doesn't like, so all we really might see in Congress is gridlock.

So, for now, remember that in the short-term, there won't be a big change in the economy, says Ruffy. And as long as there were no fundamental changes in the companies you hold in your portfolio, there's probably no need to jump the gun and reallocate.

But you do need to start paying attention to what goes on in Washington, as Cramer noted in his post-election column. We didn't really need to over the last six years, as far as the market is concerned, because things were pretty predictable. Well, now they're not. And no one, especially the market, likes uncertainty.

Tracy Byrnes is an award-winning writer specializing in tax and accounting issues. As a freelancer, she has written columns for wsj.com and the New York Post and her work has appeared in SmartMoney and on CBS MarketWatch. Prior to freelancing, she spent four years as a senior writer for TheStreet.com. Before that, she was an accountant with Ernst & Young. She has a B.A. in English and economics from Lehigh University and an M.B.A. in accounting from Rutgers University. Byrnes appreciates your feedback; click here to send her an email.