To the Shareholders of Flaherty & Crumrine Preferred Income Opportunity Fund:

Total return on net asset value ("NAV")[1] was -4.7% during the third fiscal quarter[2], reducing total return on NAV fiscal year-to-date to +2.3%. In addition, during the quarter the Fund, like many other closed-end income-oriented funds, saw the relationship between its market price and NAV swing from a premium to a discount, resulting in total return on market value of -10.6%. Clearly, this represented a setback in what had been a sustained period of positive returns in both the Fund's NAV and market valuation. During the quarter, prices of all fixed-income securities, including preferred securities, declined and yields increased as markets reacted swiftly to expectations that the Federal Reserve might taper its quantitative easing earlier than anticipated.

Virtually all sectors of the fixed-income market turned in negative results during the quarter. U.S. Treasury 10-year notes and 30-year bonds experienced the largest declines with total returns of -4.6% and -6.5%, as their yields increased by 0.7% and 0.4%, respectively. Long-term corporate bonds performed moderately better than long-term U.S. Treasuries, with a total return of -4.7% for the Barclays Long U.S. Corporate Bond Index. Even including the impact of expenses and leverage, the Fund's NAV performed as well as *unlevered* total returns on those other long-term segments of fixed-income markets.

The quarter began with the Federal Open Market Committee ("FOMC") having just indicated that it might begin tapering the pace of its program of securities purchases sooner than the market was expecting. Longer-term interest rates moved higher with a fair amount of consistency throughout the quarter, as markets digested the news and adjusted expectations for future monetary policy actions. Markets are driven by *expectations* more than actual results, and while we believe the market priced in more risk than was justified based on the outlook for growth in the U.S. economy, uncertainty surrounding a potential change in policy outlook led investors to reduce portfolio duration substantially. At its September meeting, the FOMC surprised the market yet again by continuing its program of securities purchases without tapering its pace. Since then, we have seen some recovery in fixed-income markets. Although we do not expect long-term Treasury rates to decline significantly, interest-rate risk premiums still appear high, providing investors with some protection against eventual removal of highly accommodative monetary policy.

The preferred securities market was not immune to the change in outlook for interest rates and a desire by many investors to reduce duration in their portfolios. In many cases, spreads on preferred securities widened relative to Treasuries, adding to price declines already associated with higher rates. Retail preferred securities were particularly weak as we witnessed meaningful reductions in the sizes of preferred-securities exchange-traded funds—which had grown in size to represent about 9% of the retail market at the beginning of this quarter. Preferred securities issued in the early part of the year, most with very low coupons, were among the worst performers. Fortunately, we weren't tempted by many of those new issues—much preferring the higher coupons available in the secondary market. Institutional preferred securities fared much better, and as they have a larger allocation in the portfolio they were partially responsible for limiting negative returns during the quarter.

---

[1] Following the methodology required by the SEC, total return assumes dividend reinvestment and includes income and principal change, plus the impact of the Fund's leverage and expenses.

[2] June 1st—August 31st.

Creditworthiness of most preferred-securities issuers continues to improve. Corporate earnings are growing at a moderate pace and corporate leverage remains low. Banks' problem loans are declining, capital levels are healthy (especially in the U.S.) and new lending is slowly picking up. Rising home prices are bolstering consumer balance sheets and trimming foreclosure losses. These favorable credit developments should continue to benefit preferred securities.

While prices have fallen, market conditions for preferred securities remain healthy. Higher interest rates and wider spreads have resulted in a material slowdown in issuer redemptions. For the year, redemptions are still running ahead of new supply, with the preferred-securities market shrinking more than $10 billion, but the pace of redemptions slowed significantly this past quarter—with the Fund seeing approximately 90% of its redemptions this fiscal year occurring during the first half. This recent slowdown in issuer redemptions has been welcome news on the income side of the equation, as the Fund is able to keep more of the higher-coupon preferred securities longer than we expected earlier in the year.

After a long wait, we now have largely final rules on the regulatory treatment of preferred securities issued by banks, foreign and domestic. Crafted in response to the financial crisis, new legislation and regulations shift loss burdens towards investors and away from taxpayers (government support). Under the new rules, banks will have an incentive to replace "debt-like" preferred securities with ones that have more characteristics of equity (deeper subordination, non-cumulative dividends, and no maturity date). The new rules include various implementation schedules, depending on the jurisdiction, with most being fully implemented within the next 3-8 years.

To conform to the new rules, we estimate U.S. banks will need to issue an additional $60 billion or more of new preferred stock. That is certainly a big number compared to $73 billion of currently outstanding bank preferred stock. While we think issuance will be manageable and spread out over several years, it will influence preferred securities' prices when it happens. We are also likely to see more contingent capital issued in the coming years, as issuers look to fill different buckets of loss-absorbing capital required under the new rules. This market has so far been limited in size and breadth, but it is likely to grow and is part of the ongoing evolution of the broader subordinated capital market.

Looking ahead, moderate economic growth should provide a constructive environment for preferred-securities investors. We anticipate that economic growth will be fast enough to facilitate continued improvement in corporate and household balance sheets and better loan performance, while being slow enough to restrain inflation and keep monetary policy accommodative for some time. Spreads on preferred securities should recover as fears of further rapid increases in long-term interest rates recede and investors refocus on steadily improving credit conditions. Volatility is likely to remain elevated over the coming months, but we believe the preferred-securities market has priced in a good amount of risk related to the end of quantitative easing.

As always, we encourage you to visit the Fund's website www.preferredincome.com.

Sincerely,

Donald F. Crumrine
Chairman

Robert M. Ettinger
President

September 30, 2013