FLAHERTY & CRUMRINE PREFERRED INCOME OPPORTUNITY FUND

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

The start of fiscal 2009 has been a mixed bag—overall performance was negative but signs of improvement began to appear late in the Fund's 1st fiscal quarter ended February 28, 2009. During this period, the Fund's total return based on net asset value was -7.3%. The total return based on market price was +18.2%.

Since the middle of 2007, when the first signs of economic trouble appeared, financial markets throughout the world have experienced severe turmoil. The preferred market has been knocked around especially hard and, as a result, the performance of the Fund has suffered. In June 2007, the Fund's NAV was approximately $12 per share. At the end of this past fiscal period it was $4.23. In the summer of 2007, the Fund was paying a monthly dividend of $0.065 per share; it is now $0.05. In addition to managing the Fund, we are shareholders and these numbers hurt.

The temptation to rip out the rear-view mirror and concentrate on the road ahead is reinforced by the view from both. We have just experienced the worst markets in the history of the Fund, and it's not possible to know if we have seen the bottom. But if the first step towards recovery is admitting there is a problem, the massive de-leveraging of our financial system is such an admission. While painful, this will result in a much healthier economy going forward.

In the meantime, however, there is a great deal of uncertainty and fear about how much bad debt is out there and about the government's plans for dealing with it. In the tumultuous days of late February, there were very real concerns about the viability of several large financial institutions. In addition, the hodge-podge of government programs introduced since September left many scratching their heads to find any real core strategy for recovery. Talk of nationalizing the banking system took on a life of its own, and prices of securities issued by most banks (debt, preferred and common stock) all seemed to be in freefall.

On February 25th, the U.S. Treasury released details of its Capital Assistance Program; two days later, Citicorp announced a preferred for common exchange program; and in early March, several large banks announced that they were profitable in January and February. These developments muted talk of bank nationalization and financial meltdown. (Please see the Fund's website for a more detailed discussion dated February 27, 2009.)

The events of late February, along with subsequent announcements by several banks that they expect to be profitable in the 1st quarter, have enticed some investors back into the market. Equally important, efforts to kick start the economy appear to be taking hold and some degree of confidence has been restored. As discussed in the Quarterly Economic Update on the Fund's website, we expect the growth rate of the U.S. economy to once again be positive by the 4th quarter of this year.

As one would expect, for several quarters, bank issues have been the worst performing segment of the preferred market, as well as of the Fund's portfolio. Fortunately, the Fund's exposure to the banking industry was much less than it might otherwise have been—bank issues comprise about 60% of the entire preferred universe, but only 31%[1] of the portfolio as of February 28, 2009.

Other than banks, the portfolio is invested in utilities 32%, insurance 19% and energy 10%. These positions helped dampen the negative impact of the banks, but they too are trading at historically low levels. Whereas concerns about credit quality have been the key factor driving the bank market, prices in these other segments have been impacted more by a widespread desire (or need) to sell. Investors ranging from hedge funds to broker/dealer firms to closed-end funds like PFO have been caught in a

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[1] The bank component of the entire universe is based on par value, while calculation for the Fund's portfolio is based on market value.

deleveraging cycle where falling prices force sales, and sales cause prices to fall further. This trend became readily evident during the latter part of last year. Only recently has it shown signs of abating.

There are indications the market for preferred stocks has begun to stabilize. The indiscriminate selling has slowed and buyers are returning. We've been encouraged to see more rational investor behavior. For example, most companies in the utility industry are financially healthy, but until recently, investors were acting like they were all marching up to death's door. The same can be said for most insurance companies. And, in our opinion, there are still many healthy banks in the U.S., yet the market had seemed to think a bank is a bank is a bank (apologies to Gertrude Stein). In recent weeks, sanity appears to be creeping back into the market and some are viewing these anomalies as opportunities.

The depressed prices of preferred securities have also attracted the interest of issuers themselves, and in the past few weeks several have launched formal tender offers or appear to be purchasing their securities in the open market. In this environment, a company's willingness to spend cash and purchase its own securities is a meaningful indication of just how cheap the securities have gotten.

Another small but important sign of improvement was the ability of one company to raise capital by issuing preferred. FPL Capital, a subsidiary of a large public utility, sold $375 million of a new preferred security, and demand for the issue was strong. This was the first new preferred issue since last September! A vibrant new issue market would be a sure signal of the market's return to health, and while we're not there yet, we are encouraged by the response to this recent issue.

In light of ongoing weakness in the preferred market, the Fund has continued to reduce the amount of leverage it employs. As the value of the Fund's investment portfolio declined, the ratios of assets to liabilities using required measures fell and the Fund reduced leverage to maintain coverage ratios. During the last quarter, the Fund announced the redemption of $13 million of its auction preferred shares on March 10th[2]. One consequence of deleveraging over the past six months has been a reduction in the amount of income available for distribution to shareholders as dividends, and in December, the Fund reduced its dividend by 9.1%. Leverage remains an important part of the Fund's strategy for producing high current income and we have provided a more complete description on the Fund's website in a Leverage Update dated April 20, 2009.

We are optimistic about the future. By no means are we out of the woods—there are many substantial challenges ahead. A wise friend used to counsel against betting on the end of the world, pointing out that it just doesn't happen that often (and if it does, there will be bigger issues to worry about!). Much of our optimism stems from just how far prices have fallen; the likelihood of more defaults is higher than in the past, but market prices imply widespread business failures, and we will take the other side of that bet.

We hope you'll visit the Fund's website, www.preferredincome.com. Our most recent Economic Update breaks down the economic data in a useful and informative way. The website also keeps shareholders up-to-date on various issues affecting the Fund.

Sincerely,

Donald F. Crumrine
Chairman of the Board

Robert M. Ettinger
President

April 20, 2009

[2] Under the terms of the Fund's auction preferred shares, this redemption was deemed to have been effective as of February 24, 2009.