

## *FLAHERTY & CRUMRINE PREFERRED INCOME OPPORTUNITY FUND*

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

During the third fiscal quarter of 2011<sup>1</sup>, total return on net asset value<sup>2</sup> of the Fund was -2.6%; the fiscal year-to-date return was a more pleasing +8.2%. Prior to this most recent quarter, the Fund had nine consecutive quarters of positive returns.

There was good news on the Fund's dividend during the quarter – a combination of very low borrowing cost on the Fund's leverage and relatively high income earned from the Fund's investment portfolio led to another increase in your monthly dividend. The new rate of \$0.0755 (beginning in August) is 2.7% higher than the previous level.

The Federal Reserve has indicated short-term interest rates are likely to stay at present levels at least through mid-2013. The Fund's borrowing rate is not directly tied to the Fed's short-term rate target, but the correlation is high, so borrowing costs should remain at or near current levels over the same period.

On the flip side, however, the task of projecting portfolio income has become more difficult, due both to the sharp decline in interest rates and changes in the regulatory environment in which many preferred issuers operate. For instance, bank regulators here and abroad have yet to issue final guidelines for bank capital; until they do, it is hard to predict when issuers may call outstanding preferreds. We think eventually portfolio income could fall (as higher dividend paying securities are called), but we are working hard to minimize the impact.

Conditions in financial markets are largely a tale of two houses – an ongoing economic drag from the residential housing market and a struggle of governments to get their financial houses in order. While there is a detailed discussion of these topics in our Quarterly Economic Update on the Fund's website, our thoughts are summarized here.

The drop in home prices and rise in foreclosures have eroded household wealth, pushed up savings, and slowed consumer spending, thus short-circuiting the cyclical recovery the economy normally would experience coming out of a deep recession. The resulting sluggish economic growth has encouraged companies to focus on reducing debt, lowering costs, and improving productivity. This has led to an unusual combination of strong profit growth and improving credit quality for corporations, but little improvement in employment. Finally, rising savings, limited demand for new investment, and highly accommodative monetary policy have pushed US Treasury rates to 60-year lows. As long as households seek to reduce indebtedness, which we expect will continue for some time, these conditions are likely to persist.

At the same time, the deleveraging that began in the household sector has spread to the government sector. Investors are questioning governments' ability and willingness to sustain current budgets and obligations, most visibly in the sovereign debt crisis boiling over in Europe. The uncertainty over how that situation will be resolved – and its short and long-term impact on the global economy – has sent many investors to the sidelines and out of risky assets. Although politicians are moving toward resolution of these issues, the solutions are often unpopular, and progress is likely to be slow.

---

<sup>1</sup> June 1, 2011 – August 31, 2011

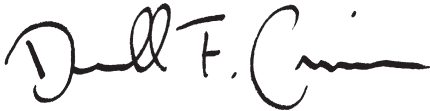
<sup>2</sup> Following the methodology required by the SEC, total return includes income and principal change, plus the impact of the Fund's leverage and expenses.

As of August 31, 12% of the Fund's portfolio consisted of securities issued or guaranteed by banks and insurance companies based in Europe. Each of these companies has operations throughout the world, but is tied most closely to economic conditions in the Eurozone. We believe these issuers are well capitalized and well managed, and therefore better able to handle market turbulence.

At the end of the day, we believe long-term investors will continue to earn attractive returns on preferred securities, although there may be some bumps along the way. We will continue to manage the Fund as we always have – in quiet times and in crisis – with a disciplined eye on credit fundamentals, relative value and risk management.

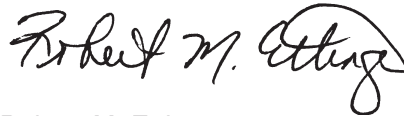
We encourage you to visit the Fund's website [www.preferredincome.com](http://www.preferredincome.com) for a more in-depth discussion of conditions in the preferred markets as well as the broader economy.

Sincerely,

A handwritten signature in black ink, appearing to read "Donald F. Crumrine". The signature is fluid and cursive, with a large initial "D" and "C".

Donald F. Crumrine  
Chairman

October 14, 2011

A handwritten signature in black ink, appearing to read "Robert M. Ettinger". The signature is cursive and somewhat stylized, with a large initial "R" and "E".

Robert M. Ettinger  
President