

# PREFERRED INCOME OPPORTUNITY FUND INCORPORATED

Dear Shareholder:

In the face of unusually difficult market conditions, the Preferred Income Opportunity Fund produced a total return of -1.3% on net asset value in the first fiscal quarter ending February 29, 2000. This made us feel like the prizefighter that, after being punched around for twelve rounds, figured he had won because he was hardly bleeding.

For starters, preferred yields rose over the course of the quarter, causing their prices to decline. The Fund's preferred portfolio actually produced a positive total return after taking income into account. This was a small victory, however, which left us still in need of help from our hedges — help that we did not get.

Treasury bonds with longer maturity dates took a very different path during the quarter with yields falling and prices rising. When we hedge the Fund's preferred portfolio, we set ourselves up to benefit from lower Treasury bond prices. Since Treasuries went the other way, the Fund lost money on its hedges. This more than offset the small amount we made on our preferreds.

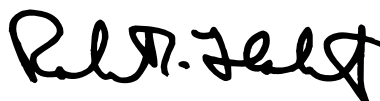
Our hedging strategies do not depend on preferreds and Treasuries marching in lockstep, but we do expect that they will both reflect major changes in interest rates over time. It is unusual for them to move in opposite directions as they did in the last fiscal quarter. Precisely because the unusual does occasionally happen, however, we limit the Fund's exposure to the Treasury bond market going against us by hedging with purchased put options (on Treasury bond futures contracts). The potential losses on such purchased puts, even in truly awful markets, is limited to the amount the Fund pays for them.

Long term Treasury bonds were inspired to go off on their own by the prospect of large buy-backs of such issues in the market funded by anticipated federal budget surpluses. This is hardly new news, but conflicting statements by Treasury officials in January may have led investors to wonder whether the buy-backs would be handled as delicately as previously supposed. Whatever the cause may have been, Treasuries soared thereafter, leaving in the dust other sectors of the fixed income markets, including preferreds. It is ironic that this occurred just as the Y2K bug and the flight to Treasuries caused by it in the last half of 1999 were starting to fade from memory.

We believe that the recent cross currents have created some bargains. Traditional preferreds eligible for the Dividends Received Deduction available to corporate investors are quite attractive compared to their valuations in recent years. Also, \$25 par value hybrid preferreds originally marketed to individual investors have never really recovered from the extremes created by year-end tax loss selling. Our prizefighter is still on his feet and looking for opportunities.

We are getting lots of activity on our new web site, [www.preferredincome.com](http://www.preferredincome.com). Please check it out and let us know what you think.

Sincerely,



Robert T. Flaherty  
*Chairman of the Board*

March 14, 2000

## SUMMARY OF INVESTMENTS

February 29, 2000 (Unaudited)

	<u>Value (000's)</u>	<u>Percent of Total Net Assets</u>
<b>Adjustable Rate Preferred Stocks</b>		
Utilities .....	\$ 7,815	4.1%
Banking .....	9,123	4.8
Financial Services .....	166	0.1
Total Adjustable Rate .....	<u>17,104</u>	<u>9.0</u>
<b>Fixed Rate Preferred Stocks and Securities</b>		
Utilities .....	58,732	31.1
Banking .....	34,994	18.6
Financial Services .....	28,855	15.3
Insurance .....	15,368	8.2
Oil and Gas .....	14,472	7.7
Miscellaneous Industries .....	3,240	1.7
Total Fixed Rate .....	<u>155,661</u>	<u>82.6</u>
<b>TOTAL PREFERRED STOCKS AND SECURITIES</b> .....	<u>172,765</u>	<u>91.6</u>
<b>COMMON STOCKS</b>		
Utilities .....	3,388	1.8
<b>REPURCHASE AGREEMENT</b> .....	10,000	5.3
<b>COMMERCIAL PAPER</b> .....	996	0.5
<b>PURCHASED PUT OPTIONS</b> .....	<u>1,677</u>	<u>0.9</u>
<b>TOTAL INVESTMENTS</b> .....	<u>188,826</u>	<u>100.1</u>
<b>OTHER ASSETS AND LIABILITIES (Net)</b> .....	<u>(118)</u>	<u>(0.1)</u>
<b>TOTAL NET ASSETS</b> .....	<u>\$188,708</u>	<u>100.0%</u>

## FINANCIAL DATA

### Per Share of Common Stock (Unaudited)

	<u>Dividend Paid</u>	<u>Net Asset Value</u>	<u>NYSE Closing Price</u>	<u>Dividend Reinvestment Price (1)</u>
December 31, 1999 .....	\$0.5800	\$10.82	\$10.4375	\$10.55
January 31, 2000 .....	0.0680	10.76	9.6250	9.73
February 29, 2000 .....	0.0680	10.61	9.5000	9.54

(1) Whenever the net asset value per share of the Fund's common stock is less than or equal to the market price per share on the payment date, new shares issued will be valued at the higher of net asset value or 95% of the then current market price. Otherwise, the reinvestment shares of common stock will be purchased in the open market.

**STATEMENT OF CHANGES IN NET ASSETS**<sup>(1)</sup>**Three Months Ended February 29, 2000 (Unaudited)**

<b>OPERATIONS:</b>	
Net investment income . . . . .	\$ 3,181,029
Net realized gain on investments sold . . . . .	298,697
Net unrealized depreciation of investments during the period . . . . .	<u>(4,501,164)</u>
Net decrease in net assets from operations . . . . .	(1,021,438)
<b>DISTRIBUTIONS:</b>	
Dividends paid from net investment income to MMP* Shareholders . . . . .	(1,154,094)
Distributions paid from net realized capital gains to MMP* Shareholders (3) . . . . .	(191,425)
Dividends paid from net investment income to Common Stock Shareholders (2) . . . . .	(3,271,564)
Distributions paid from net realized capital gains to Common Stock Shareholders (3) . . . . .	(4,712,758)
<b>NET DECREASE IN NET ASSETS:</b> . . . . .	(10,351,279)
<b>NET ASSETS:</b>	
Beginning of period . . . . .	<u>199,059,509</u>
End of period . . . . .	<u>\$188,708,230</u>

**FINANCIAL HIGHLIGHTS**<sup>(1)</sup>**Three Months Ended February 29, 2000 (Unaudited)**  
**For a Common share outstanding throughout the period.**

<b>OPERATING PERFORMANCE:</b>	
Net asset value, beginning of period . . . . .	\$ 11.50
Net investment income . . . . .	0.29
Net realized gain and unrealized depreciation on investments . . . . .	<u>(0.39)</u>
Net decrease in net asset value resulting from investment operations . . . . .	(0.10)
<b>DISTRIBUTIONS:</b>	
Dividends paid from net investment income to MMP* Shareholders . . . . .	(0.10)
Distributions paid from net realized capital gains to MMP* Shareholders (3) . . . . .	(0.02)
Dividends paid from net investment income to Common Stock Shareholders (2) . . . . .	(0.29)
Distributions paid from net realized capital gains to Common Stock Shareholders (3) . . . . .	(0.42)
Change in accumulated undeclared dividends on MMP* . . . . .	0.04
Total distributions . . . . .	<u>(0.79)</u>
Net asset value, end of period . . . . .	\$ 10.61
Market value, end of period . . . . .	\$ 9.50
Common shares outstanding, end of period . . . . .	<u>11,151,287</u>
<b>RATIOS TO AVERAGE NET ASSETS AVAILABLE TO COMMON STOCK SHAREHOLDERS:</b>	
Net investment income . . . . .	7.47%**
Operating expenses . . . . .	1.47%**
<b>SUPPLEMENTAL DATA:</b>	
Portfolio turnover rate . . . . .	16%
Ratio of operating expenses to total average net assets including MMP* . . . . .	0.93%**

(1) These tables summarize the three months ended February 29, 2000 and should be read in conjunction with the Fund's audited financial statements, including footnotes, in its Annual Report dated November 30, 1999.

(2) Includes dividends earned, but not paid out, in prior fiscal year.

(3) Paid from capital gains realized, but not paid out, in prior fiscal year.

\* Money Market Cumulative Preferred™ Stock.

\*\* Annualized.

**Directors**

Martin Brody  
Donald F. Crumrine, CFA  
Robert T. Flaherty, CFA  
David Gale  
Morgan Gust  
Robert F. Wulf, CFA

**Officers**

Robert T. Flaherty, CFA  
Chairman of the Board  
and President  
Donald F. Crumrine, CFA  
Vice President  
and Secretary  
Robert M. Ettinger, CFA  
Vice President  
Peter C. Stimes, CFA  
Vice President  
and Treasurer

**Investment Adviser**

Flaherty & Crumrine Incorporated  
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**Questions concerning your shares of Preferred  
Income Opportunity Fund?**

- If your shares are held in a Brokerage Account, contact your Broker.
- If you have physical possession of your shares in certificate form, contact the Fund's Transfer Agent & Shareholder Servicing Agent —  
PFPC Inc.  
P.O. Box 1376  
Boston, MA 02104  
1-800-331-1710

**This report is sent to shareholders of Preferred Income Opportunity Fund Incorporated for their information. It is not a Prospectus, circular or representation intended for use in the purchase or sale of shares of the Fund or of any securities mentioned in this report.**



## Quarterly Report

February 29, 2000