To the Shareholders of the Flaherty & Crumrine Preferred Income Opportunity Fund ("PFO"):

The investment environment has been challenging during the first half of fiscal 2006 as long-term interest rates increased substantially. Despite this challenging environment, we are pleased to report the Fund's interest rate hedging strategy has brought the Fund through the weak bond market to date in relatively good shape. During the most recent fiscal quarter ended May 31st, the Fund's total return on Net Asset Value ("NAV") declined 1.5%[(1)]. Viewed over the first two fiscal quarters of 2006, the total return on NAV *increased* by a respectable 2.2%[(1)]. For a further discussion of the Fund's recent NAV performance, please see the following Q&A section.

As shown in the table below, over longer time periods the Fund has produced consistently strong results based on NAV. For comparison purposes, we have included the average total return earned on all funds in the Lipper Domestic Investment Grade Bond Funds category[(3)]. Because the investment strategies including the interest rate hedge we use in the Fund typically differ significantly from those of the bond funds, we believe that PFO provides a superior way of accomplishing a similar income objective.

TOTAL RETURN PER YEAR ON NET ASSET VALUE[(1)]
FOR PERIODS ENDED MAY 31, 2006

	One Year	Three Years	Five Years	Ten Years	Life of Fund[(2)]
Flaherty & Crumrine Preferred Income Opportunity Fund	0.4%	6.4%	9.9%	8.9%	9.7%
Lipper Domestic Investment Grade Bond Funds[(3)]	1.6%	3.9%	6.0%	6.8%	6.8%

(1) Based on data published by Lipper Inc. in each calendar month during the relevant periods. Distributions are assumed to be reinvested at NAV in accordance with Lipper's practice, which differs from the procedures used elsewhere in this report.
(2) Since inception on February 13, 1992.
(3) Includes all U.S. Government bond, mortgage bond and term trust and investment grade bond funds in Lipper's closed-end fund database at each point in time.

Long-term interest rates have been on the rise since last September, but the trend accelerated during the past fiscal quarter. We began the quarter with yields on long-term U.S. Treasury bonds hovering around 4.6%; by the end of May, these yields were above 5.3%. When interest rates move like this, the impact on bond prices is dramatic – the price of long-term Treasuries declined by more than 9% during the quarter.

It is precisely for times like these that the Fund employs its "safety net" hedging strategy. Rising long-term interest rates cause the value of the Fund's investments to decline, but the Fund's interest rate hedges help moderate the impact, limiting the net decline in the Fund's NAV.

Recall that our hedge positions are analogous to an insurance policy. We make regular "premium" payments to buy protection against rising long-term interest rates. In order to keep the cost of these payments down, we typically structure the hedge with a “deductible,” meaning some portion of the loss must be absorbed by the Fund before we can collect on the policy. If long-term interest rates increase significantly, the hedge position will help offset the decline in the value of the portfolio. This was the experience during the 2nd fiscal quarter.

In addition to helping protect the value of the portfolio in a weak fixed-income market, the hedging strategy also helps support the Fund’s dividend through reinvestment of the hedge profits in income-producing securities. Please see the following Q&A section for more on how the hedging strategies affect the Fund’s NAV and distributable income.

Good news for Fund shareholders arrived in the recently adopted tax bill, which extended the 15% and 5% tax brackets on “Qualified Dividend Income” (“QDI”) and long-term capital gains through 2010. Recall that over the last several years, a significant percentage of the Fund’s income has been eligible as QDI. While we can’t predict that this percentage will remain as high in the future, extension of these lower brackets will certainly benefit shareholders.

Neither fish nor fowl, with characteristics of both debt and equity, preferred securities can serve a wide range of financing needs. At the same time, these mixed characteristics leave room for differing opinions on how to view preferreds. Whether investor or issuer, credit agency or regulator, accountants or the IRS; all have different approaches for treating preferred securities. For a discussion of these mixed characteristics and how we attempt to benefit from them, please take a look at the update on the preferred market in the following Q&A section.

We hope investors will take advantage of the Fund’s website, www.preferredincome.com. It contains a wide range of useful and up-to-date information about the Fund. In addition, some of the topics mentioned above are analyzed in greater depth in the Frequently Asked Questions section of the website.

Sincerely,

Donald F. Crumrine
Chairman of the Board

Robert M. Ettinger
President

July 10, 2006

QUESTIONS & ANSWERS

What were the components of the Fund's total return on net asset value?

One method we have used in the past to better communicate the Fund's net asset value (NAV) performance is to begin with the total return on the Fund's securities portfolio, and progressively adjust for the impact of hedging, expenses and leverage to arrive at the total return based on NAV (which includes all of these factors). As mentioned in the shareholder's letter, the bond market weakened significantly over the three months ended May 31st, accelerating the sell off which began last year. While preferred securities performed much better than long-term U.S. Treasuries and many other sectors of the fixed-income market, the Fund's unhedged securities portfolio still produced a negative total return of -2.5% during the recent fiscal quarter, and only +1.3% over the fiscal year-to-date.

The bright spot so far this fiscal year has been the degree to which the interest rate hedge helped insulate the Fund's portfolio from a more significant decline due to the recent rise in long-term interest rates. During the Fund's 2nd fiscal quarter, the hedge improved results by +2.1%. During the Fund's 1st fiscal quarter, long-term interest rates actually declined and the interest rate hedge cost the Fund money. Consequently, over the full fiscal year-to-date, the hedge improved results by +1.4%.

The benefit of leverage and the cost of the Fund's expenses generally offset each other to some extent, and they have again this year. However, as the cost of the Fund's leverage has increased over the past two years (see the Q&A regarding leverage below), less incremental income on the Fund's leveraged investments is available to offset the expense burden. In both the 2nd fiscal quarter and fiscal year-to-date, this was true. The total returns on NAV of -1.5% for the quarter and +2.2% for the fiscal year-to-date discussed in the shareholders' letter were below those of the hedged investment portfolio because the total returns on NAV include the impact of leverage and expenses.

Could you remind me again the purpose of the interest rate hedge?

The interest rate hedge has two purposes. The first is to help offset a decline in the value of the Fund's securities portfolio (and therefore its NAV) caused by a significant rise in long-term interest rates. The Fund purchases out-of-the-money put options on US Treasury futures whose price movements are correlated (albeit not perfectly) with those of the Fund's securities portfolio.

During a period of rising long-term interest rates, the Fund will initially experience a reduction in NAV, as the hedge tightens and only partially offsets the decline in the value of the securities portfolio. However, if interest rates continue to increase, the put options and/or related derivatives would be expected to appreciate in value and offset an increasing proportion of the decline in the value of the Fund's investments. As with insurance premiums paid on a house, these types of hedging instruments expire worthless if long-term interest rates either fall or do not change much, analogous to paying for insurance when the house doesn't burn down.

The second purpose of the safety-net hedge is to generate additional income following a significant increase in long-term interest rates. This can be achieved by investing realized gains from the interest rate hedge in additional income producing securities. If long-term interest rates increase sufficiently, the additional income received helps support and possibly increase the Fund's monthly dividend rate.

Please update me on developments in the preferred market.

As we have previously discussed with readers, the preferred market consists of two main segments – "traditional" preferred stock that pays dividends eligible as Qualified Dividend Income ("QDI") and taxable or "hybrid" preferred securities that pay fully taxable interest. These two preferred market segments have always existed in a grey area on an issuer's balance sheet between debt and equity, and differing viewpoints over their status have been a constant theme as far back as we can remember. Early last year, Moody's Investors Services attempted to reduce the confusion by clarifying their credit rating treatment for securities issued in each segment. Their doing so prompted significant growth in the preferred market, but confusion returned as various regulators (representing both issuers and purchasers) have applied different approaches to characterizing these newer preferreds. The result has been a great deal of volatility in preferred securities' prices.

There is nothing unusual going on here. As long as clever Wall Street bankers continue to cook up variants on the two basic segments, confusion will persist. And in confusion lies opportunity, as the turmoil contributes to the preferred market's inefficiency and allows us to attempt to benefit from these inefficiencies to add value to the Fund. Recently, we've taken advantage of this confusion (and its impact on market valuation relationships) to scale back the allocation to traditional preferreds and increase our holdings of hybrid preferreds. We look forward to being able to continue to take advantage of the preferred market's inefficiencies in the future.

Are there any federal tax advantages to investing in preferred securities?

Yes, and these benefits have been recently extended until 2010. The Jobs and Growth Tax Relief Reconciliation Act of 2003 lowered the maximum rate paid by individuals on QDI to 15% or 5% (depending on an individual's income). As mentioned in the shareholder's letter, the recently adopted Tax Increase Protection and Reconciliation Act of 2005 extends these lowered QDI rates from 2008 until 2010. Prior to 2003, dividend income was typically taxed at the same rate as ordinary income.

To be eligible for the lower tax rate as QDI, the dividend must be paid from a company's after-tax income. For this reason, it is important to understand the difference between taxable (or "hybrid") preferred securities and traditional preferred stock. Hybrid preferreds pay interest, which the issuer can deduct from revenue in determining its taxable income. Traditional preferreds pay dividends, which are distributed from income after corporate taxes have been paid. Because of the different tax treatment, hybrid preferred securities normally have a higher yield than traditional preferred stocks.

For the investor, interest from hybrids is taxed as ordinary income, while dividends from traditional preferreds may be taxed at the new, lower rate. As a result, an investor in a low tax bracket or an IRA investor is more likely to purchase taxable preferreds for the higher pre-tax income, while an investor in a high tax bracket may prefer the QDI issue for the higher after-tax income. But this isn't always the case. The market tends to offset the tax impact pretty effectively, and securities that pay QDI will usually yield less (before taxes) than those that pay interest.

Of course, it is important to remember the composition of the portfolio and the income distributions can change from one year to the next, and the QDI portions of one year's distributions may not be the same (or even similar) to another year's.

Does leverage benefit the Fund even when the U.S. Treasury yield curve is flat or inverted?

Yes, as long as short-term U.S. Treasury interest rates are not dramatically above long-term rates, the Fund continues to benefit from the use of leverage in a flat or inverted yield curve.

Leverage is the use of borrowed funds to improve one's rate of return from an investment with a corresponding increase in risk. PFO acquires its additional funds to enhance the total return of the portfolio through the issuance of Money Market Cumulative Preferred™ Stock (MMP®).

Generally, the rate paid on the MMP® is well below the rate the Fund can earn on the investment portfolio and, due to a tax advantage for qualified MMP® investors, the rate the Fund pays on the MMP® is relatively low compared with other means of financing. The additional cash flow generated by leverage enhances the income available for distribution to Common Stock Shareholders.

The incremental income is greatest when the "spread" between the income generated by the portfolio and the rate paid on the MMP® is wide. However, the converse is also true; as the U.S Treasury yield curve "flattens" (short-term rates and long-term rates approach equality), the amount of additional income generated by the leverage will decrease. The Fund still benefits from additional income generated by the leverage, just not as much as when the Treasury yield curve is steeper. Of course, nothing is that simple. The Fund's income is determined by several factors, the cost of leverage being only one.

In the case of an inverted U.S. Treasury yield curve (short-term rates are higher than long-term rates) the Fund should continue to benefit from the use of leverage. Preferred securities generally trade at yields higher than the Treasury yields, commonly referred to as the "credit spread". So, although the Treasury curve may be inverted, the preferred securities in the portfolio will ordinarily continue to have a higher return than the short-term rates the Fund pays for its leverage.

Can I reinvest dividends directly into the Fund and is there any benefit over purchasing shares in the open market?

The answer to both questions is yes. The Fund's Dividend Reinvestment Plan (the "DRIP") provides a means of acquiring additional shares of the Fund without paying the full market premium, if any. When the market price is above NAV, new shares will be issued to participants in the Plan at the higher of NAV or 95% of the then current market price. Participating shareholders can therefore receive a discount on their reinvested shares of up to 5% of the market price.

If the market price of the shares is below the NAV, the Plan purchases shares in the open market. The brokerage commission charged for acquiring these shares is competitive with most "discount" brokers.

Shareholders should be aware that not all broker-dealers participate in the Fund's dividend reinvestment plan. If your shares are held in a brokerage account, ask your broker if his/her firm is set up to participate. If you hold your shares in certificate form, or if you would just like more information, call PFPC Inc., at 1-800-331-1710.

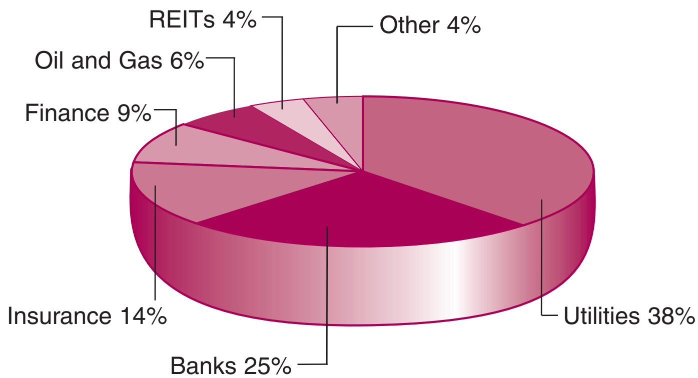
Please visit the Frequently Asked Questions section on the Fund's website at www.preferredincome.com for further discussion on the above topics as well as other information about the Fund.

PORTFOLIO OVERVIEW

May 31, 2006 (Unaudited)

Fund Statistics on 05/31/06		
Net Asset Value	$	12.00
Market Price	$	11.05
Discount		7.92%
Yield on Market Price		7.06%
Common Shares Outstanding		11,695,372

Industry Categories **% of Portfolio**



Moody's Ratings	% of Portfolio
AAA	0.2%
AA	1.4%
A	18.3%
BBB	48.3%
BB	19.0%
Not Rated	10.9%
Below Investment Grade*	20.9%

*** Below investment grade by both Moody's and S&P.**

Top 10 Holdings by Issuer	% of Portfolio
Interstate Power & Light	5.0%
Entergy Louisiana	4.3%
Lehman Brothers	3.6%
Xcel Energy	3.5%
Cobank	3.0%
EOG Resources	3.0%
North Fork Bancorporation	3.0%
HSBC	3.0%
Alabama Power	2.9%
Principal Financial Group	2.9%

	% of Portfolio**
Holdings Generating Qualified Dividend Income (QDI) for Individuals	68%
Holdings Generating Income Eligible for the Corporate Dividends Received Deduction (DRD)	63%

** **This does not reflect year-end results or actual tax categorization of Fund distributions. These percentages can, and do, change, perhaps significantly, depending on market conditions. Investors should consult their tax advisor regarding their personal situation.**

PORTFOLIO OF INVESTMENTS

May 31, 2006 (Unaudited)

Shares/$ Par			Value
Preferred Securities — 94.7%			
	Banking — 24.6%		
20,000	ABN AMRO Capital Fund Trust V, 5.90% Pfd.	$	450,000**(1)
$ 3,000,000	Astoria Capital Trust I, 9.75% 11/01/29 Capital Security, Series B		3,441,750
	Auction Pass-Through Trust, Cl B:		
9	Series 2006-5, Variable Rate Pfd., 144A****		240,750*
9	Series 2006-6, Variable Rate Pfd.,144A****		240,750*
	Cobank, ACB:		
45,000	7.00% Pfd., 144A****		2,312,100*
75,000	Adj. Rate Pfd., 144A****		4,064,250*
$ 500,000	Comerica (Imperial) Capital Trust I, 9.98% 12/31/26 Capital Security, Series B		543,195
4,500	FBOP Corporation, Adj. Rate Pfd., 144A****		4,533,750*
$ 2,250,000	First Hawaiian Capital I, 8.343% 07/01/27 Capital Security, Series B		2,388,240(1)
	First Republic Bank:		
200,000	6.25% Pfd.		4,852,000*
5,000	6.70% Pfd.		123,000*
22,500	First Republic Preferred Capital Corporation II, 8.75% Pfd., Series B, 144A****		584,775
7,400	Fleet Capital Trust VII, 7.20% Pfd. 12/15/31		187,849
10,000	Fleet Capital Trust VIII, 7.20% Pfd. 03/15/32		254,950
$ 4,349,000	GreenPoint Capital Trust I, 9.10% 06/01/27 Capital Security		4,653,169
$ 3,500,000	HBOS Capital Funding LP, 6.85% Pfd.		3,414,145(1)
5,000	HSBC Series II, Variable Inverse Pfd., Pvt.		5,570,000*
	HSBC USA, Inc.:		
19,500	6.50% Pfd., Series H		489,450*
3,250	$2.8575 Pfd.		146,884*
6,000	JPMorgan Chase Capital X, 7.00% Pfd. 02/15/32, Series J		150,360
$ 1,350,000	Keycorp Institutional Capital B, 8.25% 12/15/26 Capital Security		1,419,322
$ 1,500,000	North Fork Capital Trust I, 8.70% 12/15/26 Capital Security		1,579,050
16,000	PFGI Capital Corporation, 7.75% Pfd.		412,320
$ 1,700,000	RBS Capital Trust B, 6.80% Pfd.		1,662,591**(1)
10	Roslyn Real Estate, 8.95% Pfd., Series C, 144A****		1,040,969
33,100	Sovereign Bancorp, 7.30% Pfd., Series C		848,188*
57,875	Sovereign Capital Trust V, 7.75% Pfd. 05/22/36		1,455,556
8,600	USB Capital VII, 5.875% Pfd. 08/15/35		187,910
56,800	USB Capital VIII, 6.35% Pfd. 12/29/65		1,340,196
6,000	USB Capital X, 6.50% Pfd. 04/12/66		143,340
$ 3,100,000	Washington Mutual Preferred Funding, Variable Rate Pfd., 144A****		2,976,791
			51,707,600

The accompanying notes are an integral part of the financial statements.

PORTFOLIO OF INVESTMENTS (Continued)

May 31, 2006 (Unaudited)

Shares/$ Par		Value
Preferred Securities — (continued)		
	Financial Services — 9.1%	
159,505	Lehman Brothers Holdings, Inc., 5.94% Pfd., Series C	$ 7,590,843*
3,000	Merrill Lynch Series II STRIPES Custodial Receipts, Pvt.	2,973,000*
9,200	Morgan Stanley Capital Trust IV, 6.25% Pfd.	213,394
101,800	Morgan Stanley Capital Trust VI, 6.60% Pfd.	2,463,051
	SLM Corporation:	
94,150	6.97% Pfd., Series A	5,077,980*
7,500	Adj. Rate Pfd., Series B	783,750*
		19,102,018
	Insurance — 12.9%	
20,000	ACE Ltd., 7.80% Pfd., Series C	512,200**(1)
25,000	Aegon NV, 6.50% Pfd.	598,875**(1)
	Arch Capital Group Ltd.:	
10,000	7.875% Pfd., Series B	244,950**(1)
29,750	8.00% Pfd.	742,114**(1)
	Axis Capital Holdings:	
55,150	7.25% Pfd., Series A	1,347,314**(1)
9,300	Variable Rate Pfd., Series B	927,489(1)
16,000	Berkley W.R. Capital Trust II, 6.75% Pfd., 07/26/45	371,280
22,000	Endurance Specialty Holdings, 7.75% Pfd.	524,590**(1)
15,850	Everest Re Capital Trust II, 6.20% Pfd., Series B	337,129(1)
10,000	Lincoln National Corporation, 6.75% Pfd. 04/20/66	237,150
140,000	MetLife Inc., 6.50% Pfd., Series B	3,454,500*
4,900	PartnerRe Capital Trust I, 7.90% Pfd. 12/31/31	124,950**(1)
1,930	PartnerRe Ltd., 6.75% Pfd., Series C	45,008**(1)
228,500	Principal Financial Group, 6.518% Pfd.	6,076,957*
$ 5,734,000	Provident Financing Trust I, 7.405% 03/15/38 Capital Security	5,320,149
$ 1,000,000	Renaissancere Capital Trust, 8.54% 03/01/27 Capital Security, Series B	1,052,880(1)
	Renaissancere Holdings Ltd.:	
25,000	6.08% Pfd., Series C	526,250**(1)
6,000	7.30% Pfd., Series B	146,040**(1)
9,000	8.10% Pfd., Series A	225,450**(1)
115,500	Scottish Re Group Ltd., 7.25% Pfd.	2,887,500**(1)
8,480	St. Paul Capital Trust I, 7.60% Pfd. 10/15/50	214,290
$ 560,000	USF&G Capital, 8.312% 07/01/46 Capital Security, 144A****	646,702
22,850	XL Capital Ltd., 8.00% Pfd., Series A	585,874**(1)
		27,149,641

The accompanying notes are an integral part of the financial statements.

PORTFOLIO OF INVESTMENTS (Continued)

May 31, 2006 (Unaudited)

Shares/$ Par		Value
Preferred Securities — (continued)		
	Utilities — 37.3%	
	Alabama Power Company:	
4,980	4.60% Pfd.	$ 404,227*
6,485	4.72% Pfd.	540,136*
868	4.92% Pfd.	75,360*
225,000	5.30% Pfd.	5,085,000*
6,000	Baltimore Gas & Electric Company, 6.70% Pfd., Series 1993	623,670*
1,628	Central Hudson Gas & Electric Corporation, 4.35% Pfd., Series D, Pvt.	126,463*
3,798	Central Maine Power Company, 4.75% Pfd.	302,644*
11,119	Central Vermont Public Service Corporation, 8.30% Sinking Fund Pfd., Pvt.	1,154,986*
	Connecticut Light & Power Company:	
2,050	4.50% Pfd., Series 1956	75,266*
10,000	4.50% Pfd., Series 1963, Pvt.	362,300*
25,000	5.28% Pfd., Series 1967	1,082,125*
883	$2.04 Pfd., Series 1949	29,395*
2,900	$2.20 Pfd., Series 1949	104,110*
9,652	$3.24 Pfd.	504,993*
2,000	Consolidated Edison Company of New York, 4.65% Pfd., Series C	169,320*
7,500	Dayton Power and Light Company, 3.90% Pfd., Series C	466,987*
$ 1,500,000	Dominion Resources Capital Trust III, 8.40% 01/15/31 Capital Security	1,679,505
	Duquesne Light Company:	
15,030	3.75% Pfd.	462,097*
25,775	6.50% Pfd.	1,313,881*
5,000	Energy East Capital Trust I, 8.25% Pfd.	126,575
	Entergy Arkansas, Inc.:	
2,840	4.56% Pfd.	205,502*
3,050	4.56% Pfd., Series 1965	220,698*
1,435	6.08% Pfd.	131,346*
90,000	6.45% Pfd.	2,276,100*
2,441	Entergy Gulf States, Inc., 7.56% Pfd.	224,682*
	Entergy Louisiana, Inc.:	
299	5.16% Pfd.	31,322*
943	6.44% Pfd.	97,657*
36,000	6.95% Pfd., 144A****	3,655,080*
4,174	7.36% Pfd.	434,722*
182,383	8.00% Pfd., Series 92	4,597,875*

The accompanying notes are an integral part of the financial statements.

PORTFOLIO OF INVESTMENTS (Continued)

May 31, 2006 (Unaudited)

Shares/$ Par		Value
	Preferred Securities — (continued)	
	Utilities — (continued)	
	Entergy Mississippi, Inc.:	
4,616	4.36% Pfd.	$ 306,295*
5,000	4.92% Pfd.	374,400*
4,400	Florida Power Company, 4.75% Pfd.	369,578*
	Great Plains Energy, Inc.:	
1,625	4.20% Pfd.	115,416*
2,000	4.35% Pfd.	147,130*
24,000	Gulf Power Company, 6.00% Pfd., Series 1	2,364,720*
	Hawaiian Electric Company, Inc.:	
2,471	5.00% Pfd., Series D	41,686*
7,438	5.00% Pfd., Series E	125,479*
1,383	5.00% Pfd., Series I	23,331*
$ 3,750,000	Houston Light & Power Capital Trust II, 8.257% 02/01/37 Capital Security	3,931,837
30,500	Indianapolis Power & Light Company, 5.65% Pfd.	2,653,042*
340,000	Interstate Power & Light Company, 8.375% Pfd., Series B	10,609,700*
2,588	New York State Electric & Gas, $4.50 Pfd., Series 1949	199,561*
	Ohio Power Company:	
3,018	4.20% Pfd.	223,755*
1,251	4.40% Pfd.	97,165*
	Pacific Enterprises:	
13,680	$4.36 Pfd.	1,060,679*
24,985	$4.50 Pfd.	1,999,425*
15,730	$4.75 Pfd., Series 53	1,328,634*
	Pacific Gas & Electric Co.:	
7,600	4.50% Pfd., Series H	141,322*
41,500	5.00% Pfd., Series D	864,445*
83,000	5.00% Pfd., Series E	1,772,880*
	PacifiCorp:	
5,672	$4.56 Pfd.	431,611*
6,708	$4.72 Pfd.	528,356*
10,500	$7.48 Sinking Fund Pfd.	1,071,420*
1,250	PECO Energy Company, $4.30 Pfd., Series B	92,250*
15,142	Portland General Electric, 7.75% Sinking Fund Pfd.	1,545,922*
14,020	Public Service Electric & Gas Company, 5.28% Pfd., Series E	1,254,229*
70,210	San Diego Gas & Electric Company, $1.70 Pfd.	1,821,247*
8,900	Savannah Electric & Power Company, 6.00% Pfd.	225,926*

The accompanying notes are an integral part of the financial statements.

PORTFOLIO OF INVESTMENTS (Continued)

May 31, 2006 (Unaudited)

Shares/$ Par		Value
Preferred Securities — (continued)		
	Utilities — (continued)	
	South Carolina Electric & Gas Company:	
13,974	5.125% Purchase Fund Pfd., Pvt.	$ 718,124*
7,774	6.00% Purchase Fund Pfd., Pvt.	395,774*
	Southern California Edison:	
57,646	4.08% Pfd.	1,003,617*
5,000	4.24% Pfd.	88,950*
60,000	Southern Union Company, 7.55% Pfd.	1,557,900*
$ 750,000	TXU Electric Capital V, 8.175% 01/30/37 Capital Security	779,269
5,700	Union Electric Company, 4.56% Pfd.	460,246*
	Virginia Electric & Power Company:	
1,665	$4.04 Pfd.	116,267*
2,470	$4.20 Pfd.	179,310*
1,673	$4.80 Pfd.	140,013*
2,878	$6.98 Pfd.	295,412*
12,500	$7.05 Pfd.	1,279,063*
11,200	Virginia Power Capital Trust, 7.375% Pfd. 07/30/42	281,736
2,262	Washington Gas & Light Company, $4.25 Pfd.	170,555*
12,863	Wisconsin Power & Light Company, 6.20% Pfd.	1,318,393*
	Xcel Energy, Inc.:	
15,000	$4.08 Pfd., Series B	1,101,600*
20,040	$4.10 Pfd., Series C	1,478,952*
35,510	$4.11 Pfd., Series D	2,627,030*
17,750	$4.16 Pfd., Series E	1,329,120*
10,000	$4.56 Pfd., Series G	820,800*
		78,427,596
	Oil and Gas — 4.6%	
8,000	Devon Energy Corporation, 6.49% Pfd., Series A	803,680*
6,125	EOG Resources, Inc., 7.195% Pfd., Series B	6,363,752*
$ 1,650,000	KN Capital Trust III, 7.63% 04/15/28 Capital Security	1,484,159
10,000	Lasmo America Limited, 8.15% Pfd., 144A****	1,069,500*[(1)]
		9,721,091

The accompanying notes are an integral part of the financial statements.

PORTFOLIO OF INVESTMENTS (Continued)

May 31, 2006 (Unaudited)

Shares/$ Par		Value
	Preferred Securities — (continued)	
	Real Estate Investment Trust (REIT) — 4.4%	
	BRE Properties, Inc.:	
20,000	6.75% Pfd., REIT, Series D	$ 474,200
18,900	8.08% Pfd., REIT, Series B	481,288
	Duke Realty Corporation:	
12,500	6.50% Pfd., REIT, Series K	289,313
20,000	6.625% Pfd., REIT, Series J	470,500
10,000	Equity Office Property Trust, 7.75% Pfd., REIT, Series G	251,500
1,000	Equity Residential Properties, 8.29% Pfd., REIT, Series K	57,870
50,000	HRPT Properties Trust, 7.125% Pfd., REIT, Series C	1,218,250
10,000	PS Business Parks, Inc., 7.00% Pfd., REIT, Series H	239,300
	Public Storage, Inc.:	
13,600	6.18% Pfd., REIT, Series D	294,644
103,875	6.45% Pfd., REIT, Series F	2,357,443
7,500	6.75% Pfd., REIT, Series E	177,450
30,000	7.125% Pfd., REIT	735,000
40,000	Realty Income Corporation, 7.375% Pfd., REIT, Series D	1,008,600
	Regency Centers Corporation:	
6,000	6.70% Pfd., REIT	138,600
40,000	7.25% Pfd., REIT	983,400
		9,177,358
	Miscellaneous Industries — 1.8%	
13,600	E.I. Du Pont de Nemours and Company, $4.50 Pfd., Series B	1,082,900*
35,000	Ocean Spray Cranberries, Inc., 6.25% Pfd., 144A****	2,700,950*
26,000	Touch America Holdings, $6.875 Pfd.	—†*
		3,783,850
	Total Preferred Securities (Cost $193,129,070)	199,069,154
	Corporate Debt Securities — 3.3%	
	Financial Services — 0.4%	
36,300	Saturns-GS, 6.00% 02/15/33, Series GS	805,860

The accompanying notes are an integral part of the financial statements.

PORTFOLIO OF INVESTMENTS (Continued)

May 31, 2006 (Unaudited)

Shares/$ Par		Value
Corporate Debt Securities — (continued)		
	Insurance — 1.2%	
$ 900,000	Farmers Exchange Capital, 7.20% 07/15/48, 144A****	$ 861,615
$ 1,750,000	Liberty Mutual Insurance, 7.697% 10/15/97, 144A****	1,654,371
		2,515,986
	Utilities — 0.5%	
$ 1,000,000	Duquesne Light Holdings, 6.25% 08/15/35	900,755
10,000	Entergy Louisiana LLC, 7.60% 04/01/32	254,250
		1,155,005
	Oil and Gas — 1.2%	
97,900	Nexen, Inc., 7.35% Subordinated Notes	2,461,696(1)
	Total Corporate Debt Securities (Cost $7,263,192)	6,938,547
Option Contracts — 1.2%		
1,355	September Put Options on September U.S. Treasury Bond Futures, Expiring 08/25/06	2,554,609†
	Total Option Contracts (Cost $2,802,145)	2,554,609

The accompanying notes are an integral part of the financial statements.

PORTFOLIO OF INVESTMENTS (Continued)

May 31, 2006 (Unaudited)

Shares/$ Par			Value
Money Market Fund — 0.2%			
498,837	BlackRock Provident Institutional, TempFund		$ 498,837
	Total Money Market Fund (Cost $498,837)		498,837
Total Investments (Cost $203,693,244***)		99.4%	209,061,147
Other Assets And Liabilities (Net)		0.6%	1,236,328
Total Net Assets Available to Common and Preferred Stock		100.0%‡	$ 210,297,475
Money Market Cumulative Preferred™ Stock (MMP®) Redemption Value			(70,000,000)
Total Net Assets Available To Common Stock			$ 140,297,475

* Securities eligible for the Dividends Received Deduction and distributing Qualified Dividend Income.

** Securities distributing Qualified Dividend Income only.

*** Aggregate cost of securities held.

**** Securities exempt from registration under Rule 144A of the Securities Act of 1933. These securities may be resold in transactions exempt from registration to qualified institutional buyers. These securities have been determined to be liquid under the guidelines established by the Board of Directors.

(1) Foreign Issuer.

† Non-income producing.

‡ The percentage shown for each investment category is the total value of that category as a percentage of net assets available to Common and Preferred Stock.

ABBREVIATIONS:

Pfd. — Preferred Securities
Pvt. — Private Placement Securities
REIT — Real Estate Investment Trust

STATEMENT OF ASSETS AND LIABILITIES

May 31, 2006 (Unaudited)

ASSETS:		
Investments, at value (Cost $203,693,244)		$209,061,147
Dividends and interest receivable		1,590,264
Prepaid expenses		169,846
Total Assets		210,821,257
LIABILITIES:		
Dividends payable to Common Stock Shareholders	$ 98,164	
Investment advisory fee payable	100,478	
Administration, Transfer Agent and Custodian fees payable	44,786	
Professional fees payable	41,404	
Directors' fees payable	4,575	
Accrued expenses and other payables	24,837	
Accumulated undeclared distributions to Money Market Cumulative Preferred™ Stock Shareholders	209,538	
Total Liabilities		523,782
Money Market Cumulative Preferred™ Stock (700 shares outstanding) redemption value		70,000,000
NET ASSETS AVAILABLE TO COMMON STOCK		$140,297,475
NET ASSETS AVAILABLE TO COMMON STOCK consist of:		
Distributions in excess of net investment income		$ (456,456)
Accumulated net realized gain on investments sold		5,821
Unrealized appreciation of investments		5,367,903
Par value of Common Stock		116,954
Paid-in capital in excess of par value of Common Stock		135,263,253
Total Net Assets Available to Common Stock		$140,297,475
NET ASSET VALUE PER SHARE OF COMMON STOCK:		
Common Stock (11,695,372 shares outstanding)		$ 12.00

The accompanying notes are an integral part of the financial statements.

STATEMENT OF OPERATIONS

For the Six Months Ended May 31, 2006 (Unaudited)

INVESTMENT INCOME:		
Dividends†		$ 5,658,769
Interest		1,290,220
Total Investment Income		6,948,989
EXPENSES:		
Investment advisory fee	$593,648	
Administrator's fee	105,089	
Money Market Cumulative Preferred™ Stock broker commissions and auction agent fees	100,972	
Professional fees	63,065	
Insurance expense	91,619	
Transfer Agent fees	31,186	
Directors' fees	39,130	
Custodian fees	12,360	
Chief Compliance Officer fees	19,694	
Other	41,953	
Total Expenses		1,098,716
NET INVESTMENT INCOME		5,850,273
REALIZED AND UNREALIZED GAIN/(LOSS) ON INVESTMENTS		
Net realized gain on investments sold during the period		5,263,246
Change in net unrealized appreciation/depreciation of investments held during the period		(6,666,925)
NET REALIZED AND UNREALIZED LOSS ON INVESTMENTS		(1,403,679)
DISTRIBUTIONS TO MONEY MARKET CUMULATIVE PREFERRED™ STOCK SHAREHOLDERS:		
From net investment income (including changes in accumulated undeclared distributions)		(1,346,515)
NET INCREASE IN NET ASSETS TO COMMON STOCK RESULTING FROM OPERATIONS		$ 3,100,079

† For Federal income tax purposes, a significant portion of this amount may not qualify for the inter-corporate dividends received deduction ("DRD") or as qualified dividend income ("QDI") for individuals.

The accompanying notes are an integral part of the financial statements.

STATEMENTS OF CHANGES IN NET ASSETS AVAILABLE TO COMMON STOCK[1]

	Six Months Ended May 31, 2006 (Unaudited)	Year Ended November 30, 2005
OPERATIONS:		
Net investment income	$ 5,850,273	$ 11,145,051
Net realized gain on investments sold during the period	5,263,246	4,238,243
Change in net unrealized appreciation/depreciation of investments held during the period	(6,666,925)	(4,421,911)
Distributions to MMP®* Shareholders from net investment income, including changes in accumulated undeclared distributions	(1,346,515)	(1,937,548)
Net increase in net assets resulting from operations	**3,100,079**	**9,023,835**
DISTRIBUTIONS:		
Dividends paid from net investment income to Common Stock Shareholders[1]	(4,750,823)	(10,602,545)
Total Distributions to Common Stock Shareholders	**(4,750,823)**	**(10,602,545)**
FUND SHARE TRANSACTIONS:		
Increase from shares issued under the Dividend Reinvestment and Cash Purchase Plan	231,696	1,150,181
Net increase in net assets available to Common Stock resulting from Fund share transactions	**231,696**	**1,150,181**
NET DECREASE IN NET ASSETS AVAILABLE TO COMMON STOCK FOR THE PERIOD	**$ (1,419,048)**	**$ (428,529)**
NET ASSETS AVAILABLE TO COMMON STOCK:		
Beginning of period	$141,716,523	$142,145,052
Net decrease in net assets during the period	(1,419,048)	(428,529)
End of period (including distributions in excess of net investment income of ($456,456) and ($209,391), respectively)	$140,297,475	$141,716,523

* Money Market Cumulative Preferred™ Stock.
[1] May include income earned, but not paid out, in prior fiscal year.

The accompanying notes are an integral part of the financial statements.

FINANCIAL HIGHLIGHTS

For a Common share outstanding throughout each period.

Contained below is per share operating performance data, total investment returns, ratios to average net assets and other supplemental data. This information has been derived from information provided in the financial statements and market price data for the Fund's shares.

	Six Months Ended May 31, 2006 (Unaudited)	Year Ended November 30, 2005	2004	2003	2002	2001
PER SHARE OPERATING PERFORMANCE:						
Net asset value, beginning of period	$ 12.14	$ 12.27	$ 12.59	$ 10.78	$ 11.60	$ 10.68
INVESTMENT OPERATIONS:						
Net investment income	0.50	0.96	0.98	1.02	1.07	1.10
Net realized and unrealized gain/(loss) on investments	(0.11)	(0.01)	(0.27)	1.85	(0.87)	0.89
DISTRIBUTIONS TO MMP®* SHAREHOLDERS:						
From net investment income	(0.12)	(0.17)	(0.09)	(0.08)	(0.11)	(0.25)
Total from investment operations	0.27	0.78	0.62	2.79	0.09	1.74
DISTRIBUTIONS TO COMMON STOCK SHAREHOLDERS:						
From net investment income	(0.41)	(0.91)	(0.94)	(0.98)	(0.91)	(0.82)
Total distributions to Common Stock Shareholders	(0.41)	(0.91)	(0.94)	(0.98)	(0.91)	(0.82)
Net asset value, end of period	$ 12.00	$ 12.14	$ 12.27	$ 12.59	$ 10.78	$ 11.60
Market value, end of period	$ 11.05	$ 11.53	$ 13.53	$ 13.51	$ 11.72	$ 11.27
Total investment return based on net asset value**	2.34%****	6.36%	4.68%	26.57%	0.63%	16.97%
Total investment return based on market value **	(0.78%)****	(8.40%)	7.57%	24.92%	12.61%	26.95%
RATIOS TO AVERAGE NET ASSETS AVAILABLE TO COMMON STOCK SHAREHOLDERS:						
Total net assets, end of period (in 000's)	$140,297	$ 141,717	$142,145	$144,303	$122,258	$129,792
Operating expenses	1.54%***	1.53%	1.52%	1.54%	1.56%	1.61%
Net investment income †	6.30%***	6.30%	7.11%	7.85%	8.67%	7.63%
SUPPLEMENTAL DATA:††						
Portfolio turnover rate	34%****	57%	28%	28%	29%	41%
Total net assets available to Common and Preferred Stock, end of period (in 000's)	$210,297	$ 211,717	$212,145	$214,411	$192,361	$200,228
Ratio of operating expenses to total average net assets available to Common and Preferred Stock	1.03%***	1.03%	1.03%	1.02%	1.00%	1.03%

* Money Market Cumulative Preferred™ Stock.
** Assumes reinvestment of distributions at the price obtained by the Fund's Dividend Reinvestment and Cash Purchase Plan.
*** Annualized.
**** Not Annualized.
† The net investment income ratios reflect income net of operating expenses and payments to MMP®* Shareholders.
†† Information presented under heading Supplemental Data includes MMP®*.

The accompanying notes are an integral part of the financial statements.

FINANCIAL HIGHLIGHTS (Continued)

Per Share of Common Stock (Unaudited)

	Total Dividends Paid	Net Asset Value	NYSE Closing Price	Dividend Reinvestment Price (1)
December 31, 2005	$0.0705	$12.24	$11.09	$11.43
January 31, 2006	0.0705	12.28	12.63	12.28
February 28, 2006	0.0705	12.38	12.39	12.38
March 31, 2006	0.0650	12.25	11.46	11.54
April 30, 2006	0.0650	12.11	11.22	11.27
May 31, 2006	0.0650	12.00	11.05	11.20

(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.

The accompanying notes are an integral part of the financial statements.

FINANCIAL HIGHLIGHTS (Continued)

The table below sets out information with respect to Money Market Cumulative Preferred™ Stock currently outstanding.

Date	Total Shares Outstanding (1)	Asset Coverage Per Share (2)	Involuntary Liquidating Preference Per Share (3)	Average Market Value Per Share (1)(3)
05/31/06*	700	$300,724	$100,000	$100,000
11/30/05	700	302,788	100,000	100,000
11/30/04	700	303,137	100,000	100,000
11/30/03	700	306,301	100,000	100,000
11/30/02	700	274,802	100,000	100,000
11/30/01	700	286,040	100,000	100,000

(1) See note 6.
(2) Calculated by subtracting the Fund's total liabilities (excluding the MMP®) from the Fund's total assets and dividing that amount by the number of MMP® shares outstanding.
(3) Excludes accumulated undeclared dividends.
* Unaudited

NOTES TO FINANCIAL STATEMENTS (Unaudited)

1. Organization

Flaherty & Crumrine Preferred Income Opportunity Fund Incorporated (the "Fund") was incorporated as a Maryland corporation on December 10, 1991, and commenced operations on February 13, 1992 as a diversified, closed-end management investment company under the Investment Company Act of 1940, as amended (the "1940 Act"). The Fund's investment objective is to provide its common shareholders with high current income consistent with the preservation of capital.

2. Significant Accounting Policies

The following is a summary of significant accounting policies consistently followed by the Fund in the preparation of its financial statements. The preparation of financial statements is in conformity with accounting principles generally accepted in the United States of America and requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities in the financial statements and the reported amounts of increases and decreases in net assets from operations during the reporting period. Actual results could differ from those estimates.

Portfolio valuation: The net asset value of the Fund's Common Stock is determined by the Fund's Administrator no less frequently than on the last business day of each week and month. It is determined by dividing the value of the Fund's net assets available to Common Stock by the number of shares of Common Stock outstanding. The value of the Fund's net assets attributable to Common Stock is deemed to equal the value of the Fund's total assets less (i) the Fund's liabilities and (ii) the aggregate liquidation value of the outstanding Money Market Cumulative Preferred™ Stock ("MMP®").

Securities listed on a national securities exchange are valued on the basis of the last sale on such exchange on the day of valuation, except as described hereafter. In the absence of sales of listed securities and with respect to (a) securities for which the most recent sale prices are not deemed to represent fair market value and (b) unlisted securities (other than money market instruments), securities are valued at the mean between the closing bid and asked prices when quoted prices for investments are readily available. Investments in over-the-counter derivative instruments, such as interest rate swaps and options thereon ("swaptions"), are valued at the prices obtained from the broker/dealer or bank that is the counterparty to such instrument, subject to comparison of such valuation with a valuation obtained from a broker/dealer or bank that is not a counterparty to the particular derivative instrument. Investments for which market quotations are not readily available or for which management determines that the prices are not reflective of current market conditions are valued at fair value as determined in good faith by or under the direction of the Board of Directors of the Fund, including reference to valuations of other securities which are comparable in quality, maturity and type. Investments in money market instruments, which mature in 60 days or less, are valued at amortized cost. Investments in money market funds are valued at the net asset value of such funds.

Securities transactions and investment income: Securities transactions are recorded as of the trade date. Realized gains and losses from securities sold are recorded on the identified cost basis. Dividend income is recorded on ex-dividend dates. Interest income is recorded on the accrual basis. The Fund also amortizes premiums and accretes discounts on certain fixed income securities.

NOTES TO FINANCIAL STATEMENTS (Unaudited) (Continued)

Options: Purchases of options are recorded as an investment, the value of which is marked-to-market at each valuation date. When the Fund enters into a closing sale transaction, the Fund will record a gain or loss depending on the difference between the purchase and sale price. The risks associated with purchasing options and the maximum loss the Fund would incur are limited to the purchase price originally paid.

When the Fund writes an option, an amount equal to the premium received by the Fund is recorded as a liability, the value of which is marked-to-market at each valuation date. When a written option expires, the Fund realizes a gain equal to the amount of the premium originally received. When the Fund enters into a closing purchase transaction, the Fund realizes a gain (or loss if the cost of the closing purchase transaction exceeds the premium received when the option was written) without regard to any unrealized gain or loss on the underlying security, and the liability related to such option is eliminated. When a call option is exercised, the Fund realizes a gain or loss from the sale of the underlying security and the proceeds from such sale are increased by the amount of the premium originally received. When a put option is exercised, the amount of the premium originally received will reduce the cost of the security which the Fund purchased upon exercise.

The risk in writing a call option is that the Fund may forego the opportunity for profit if the market price of the underlying security increases and the option is exercised. The risk in writing a put option is that the Fund may incur a loss if the market price of the underlying security decreases and the option is exercised.

Repurchase agreements: The Fund may engage in repurchase agreement transactions. The Fund's investment adviser reviews and approves the eligibility of the banks and dealers with which the Fund may enter into repurchase agreement transactions. The value of the collateral underlying such transactions is at least equal at all times to the total amount of the repurchase obligations, including interest. The Fund maintains possession of the collateral through its custodian and, in the event of counterparty default, the Fund has the right to use the collateral to offset losses incurred. There is the possibility of loss to the Fund in the event the Fund is delayed or prevented from exercising its rights to dispose of the collateral securities.

Federal income taxes: The Fund intends to continue to qualify as a regulated investment company by complying with the requirements under subchapter M of the Internal Revenue Code of 1986, as amended, applicable to regulated investment companies and intends to distribute substantially all of its taxable net investment income to its shareholders. Therefore, no federal income tax provision is required.

Dividends and distributions to shareholders: The Fund expects to declare dividends on a monthly basis to shareholders of Common Stock ("Shareholders"). Distributions to Shareholders are recorded on the ex-dividend date. Any net realized short-term capital gains will be distributed to Shareholders at least annually. Any net realized long-term capital gains may be distributed to Shareholders at least annually or may be retained by the Fund as determined by the Fund's Board of Directors. Capital gains retained by the Fund are subject to tax at the capital gains corporate tax rate. Subject to the Fund qualifying as a regulated investment company, any taxes paid by the Fund on such net realized long-term capital gains may be used by the Fund's Shareholders as a credit against their own tax liabilities.

Income and capital gain distributions are determined and characterized in accordance with income tax regulations which may differ from generally accepted accounting principles. These differences are primarily due to (1) differing treatments of income and gains on various investment securities held by the Fund, including timing differences, (2) the attribution of expenses against certain components of taxable investment income, and (3) federal regulations requiring proportionate allocation of income and gains to all classes of shareholders.

Distributions from net realized gains for book purposes may include short-term capital gains, which are included as ordinary income for tax purposes, and may exclude amortization of premium on certain fixed income securities, which are not reflected in ordinary income for tax purposes. The tax character of distributions paid, including changes in accumulated undeclared distributions to MMP® Shareholders, during 2006 and 2005 was as follows:

	Distributions paid in fiscal year 2006		Distributions paid in fiscal year 2005	
	Ordinary Income	Long-Term Capital Gains	Ordinary Income	Long-Term Capital Gains
Common	N/A	N/A	$10,602,545	$0
Preferred	N/A	N/A	$1,937,548	$0

As of November 30, 2005, the components of distributable earnings (i.e., ordinary income and capital gain/loss) available to Common and Preferred Stock Shareholders, on a tax basis, were as follows:

Capital (Loss) Carryforward	Undistributed Ordinary Income	Undistributed Long-Term Gain	Net Unrealized Appreciation/(Depreciation)
($5,431,581)	$222,609	$0	$12,208,984

At November 30, 2005, the composition of the Fund's $5,431,581 accumulated realized capital losses was $2,297,260, $982,343, $1,457,692 and $694,286 in 2000, 2001, 2002 and 2004, respectively. These losses may be carried forward and offset against any future capital gains through 2008, 2009, 2010 and 2012, respectively.

Excise tax: The Internal Revenue Code of 1986, as amended, imposes a 4% nondeductible excise tax on the Fund to the extent the Fund does not distribute by the end of any calendar year at least (1) 98% of the sum of its net investment income for that year and its capital gains (both long-term and short-term) for its fiscal year and (2) certain undistributed amounts from previous years. The Fund paid $16,000 of Federal excise taxes attributable to calendar year 2005 in March 2006.

NOTES TO FINANCIAL STATEMENTS (Unaudited) (Continued)

3. Investment Advisory Fee, Administration Fee, Transfer Agent Fee, Custodian Fee, Directors' Fees and Chief Compliance Officer Fee

Flaherty & Crumrine Incorporated (the "Adviser") serves as the Fund's investment adviser. The Fund pays the Adviser a monthly fee at an annual rate of 0.625% of the value of the Fund's average monthly total net assets available to Common and Preferred Stock up to $100 million and 0.50% of the value of the Fund's average monthly total net assets available to Common and Preferred Stock in excess of $100 million.

For purposes of calculating the fees to the Adviser, Administrator and Custodian, the Fund's average weekly total managed assets means the total assets of the Fund minus the sum of accrued liabilities. For purposes of determining total managed assets, the liquidation preference of any preferred shares issued by the Fund is not treated as a liability.

PFPC Inc., a member of the PNC Financial Services Group, Inc. ("PNC Financial Services"), serves as the Fund's Administrator. As Administrator, PFPC Inc. calculates the net asset value of the Fund's shares attributable to Common Stock and generally assists in all aspects of the Fund's administration and operation. As compensation for PFPC Inc.'s services as Administrator, the Fund pays PFPC Inc. a monthly fee at an annual rate of 0.10% of the first $200 million of the Fund's average weekly total managed assets, 0.04% of the next $300 million of the Fund's average weekly total managed assets, 0.03% of the next $500 million of the Fund's average weekly total managed assets and 0.02% on the Fund's average weekly total managed assets above $1 billion.

PFPC Inc. also serves as the Fund's Common Stock dividend-paying agent and registrar (Transfer Agent). As compensation for PFPC Inc.'s services, the Fund pays PFPC Inc. a fee at an annual rate of 0.02% of the first $150 million of the Fund's average weekly net assets attributable to Common Stock, 0.0075% of the next $350 million of the Fund's average weekly net assets attributable to Common Stock, and 0.0025% of the Fund's average weekly net assets attributable to Common Stock above $500 million, plus certain out of pocket expenses. For the purpose of calculating such fee, the Fund's average weekly net assets attributable to Common Stock are deemed to be the average weekly value of the Fund's total assets minus the sum of the Fund's liabilities and accumulated dividends, if any, on Fund preferred shares. For this calculation, the Fund's liabilities are deemed to include the aggregate liquidation preference of any outstanding Fund preferred shares.

PFPC Trust Company ("PFPC Trust") serves as the Fund's custodian. PFPC Trust is an indirect subsidiary of PNC Financial Services. As compensation for PFPC Trust's services as custodian, the Fund pays PFPC Trust a monthly fee at the annual rate of 0.010% of the first $200 million of the Fund's average weekly total managed assets, 0.008% of the next $300 million of the Fund's average weekly total managed assets, 0.006% of the next $500 million of the Fund's average weekly total managed assets and 0.005% of the Fund's average weekly total managed assets above $1 billion.

The Fund currently pays each Director who is not a director, officer or employee of the Adviser a fee of $9,000 per annum, plus $500 for each in-person meeting of the Board of Directors or any committee and $150 for each telephone meeting. The Audit Committee Chairman receives an additional annual fee of $2,500. The Fund also reimburses all Directors for travel and out-of-pocket expenses incurred in connection with such meetings.

NOTES TO FINANCIAL STATEMENTS (Unaudited) (Continued)

The Fund currently pays the Adviser a fee of $37,500 per annum for Chief Compliance Officer services and reimburses out-of-pocket expenses incurred in connection with providing services in this role.

4. Purchases and Sales of Securities

For the six months ended May 31, 2006, the cost of purchases and proceeds from sales of securities excluding short-term investments, aggregated $75,350,913 and $70,958,520 respectively.

At May 31, 2006, the aggregate cost of securities for federal income tax purposes was $203,519,088, the aggregate gross unrealized appreciation for all securities in which there is an excess of value over tax cost was $12,023,570 and the aggregate gross unrealized depreciation for all securities in which there is an excess of tax cost over value was $6,481,511.

5. Common Stock

At May 31, 2006, 240,000,000 shares of $0.01 par value Common Stock were authorized.

Common Stock transactions were as follows:

	Six Months Ended 5/31/06		Year Ended 11/30/05	
	Shares	Amount	Shares	Amount
Shares issued under the Dividend Reinvestment and Cash Purchase Plan	18,787	$ 231,696	90,012	$ 1,150,181

6. Money Market Cumulative Preferred™ Stock (MMP®)

The Fund's Articles of Incorporation authorize the issuance of up to 10,000,000 shares of $0.01 par value preferred stock. The MMP® is senior to the Common Stock and results in the financial leveraging of the Common Stock. Such leveraging tends to magnify both the risks and opportunities to Common Stock Shareholders. Dividends on shares of MMP® are cumulative.

The Fund is required to meet certain asset coverage tests with respect to the MMP®. If the Fund fails to meet these requirements and does not correct such failure, the Fund may be required to redeem, in part or in full, MMP® at a redemption price of $100,000 per share plus an amount equal to the accumulated and unpaid dividends on such shares in order to meet these requirements. Additionally, failure to meet the foregoing asset requirements could restrict the Fund's ability to pay dividends to Common Stock Shareholders and could lead to sales of portfolio securities at inopportune times.

If the Fund allocates any net gains or income ineligible for the Dividends Received Deduction to shares of the MMP®, the Fund is required to make additional distributions to MMP® Shareholders or to pay a higher dividend rate in amounts needed to provide a return, net of tax, equal to the return had such originally paid distributions been eligible for the Dividends Received Deduction.

NOTES TO FINANCIAL STATEMENTS (Unaudited) (Continued)

An auction of the MMP® is generally held every 49 days. Existing MMP® Shareholders may submit an order to hold, bid or sell such shares at par value on each auction date. MMP® Shareholders may also trade shares in the secondary market, if any, between auction dates.

At May 31, 2006, 700 shares of MMP® were outstanding at the annualized rate of 3.90%. The dividend rate, as set by the auction process, is generally expected to vary with short-term interest rates. These rates may vary in a manner unrelated to the income received on the Fund's assets, which could have either a beneficial or detrimental impact on net investment income and gains available to Common Stock Shareholders. While the Fund expects to structure its portfolio holdings and hedging transactions to lessen such risks to Common Stock Shareholders, there can be no assurance that such results will be attained.

7. Portfolio Investments, Concentration and Investment Quality

The Fund invests primarily in a diversified portfolio of preferred securities. This includes traditional preferred stocks eligible for the inter-corporate dividends received deduction ("DRD") and fully taxable (hybrid) preferred securities. Under normal markets conditions, at least 80% of the value of the Fund's net assets will be invested in preferred securities. Also, under normal market conditions, the Fund invests at least 25% of its assets in securities issued by companies in the utility industry and a significant percentage, but no more than 25% of its assets, in securities issued by companies in the banking industry. The Fund's portfolio may therefore be subject to greater risk and market fluctuation than a portfolio of securities representing a broader range of investment alternatives.

The Fund may invest up to 25% of its assets at the time of purchase in securities rated below investment grade. These securities must be rated at least either "Ba3" by Moody's Investors Service, Inc. or "BB-" by Standard & Poor's or, if unrated, judged to be comparable in quality by the Adviser, in either case, at the time of purchase. However, these securities must be issued by an issuer having a class of senior debt rated investment grade outstanding.

The Fund may invest up to 15% of its assets in common stocks and, under normal market conditions, up to 20% of its assets in debt securities. Certain of its investments in hybrid, i.e., fully taxable, preferred securities will be subject to the foregoing 20% limitation to the extent that, in the opinion of the Adviser, such investments are deemed to be debt-like in key characteristics. Typically, a security will not be considered debt-like (a) if an issuer can defer payment of income for eighteen months or more without triggering an event of default and (b) if such issue is a junior and fully subordinated liability of an issuer or its ultimate guarantor.

In addition to foreign money market securities, the Fund may invest up to 30% of its total assets in the securities of companies organized or having their principal place of business outside the United States. All foreign securities held by the Fund will be denominated in U.S. dollars.

8. Special Investment Techniques

The Fund may employ certain investment techniques in accordance with its fundamental investment policies. These may include the use of when-issued and delayed delivery transactions. Securities purchased or sold on a when-issued or delayed delivery basis may be settled within 45 days after the date of the transaction. Such transactions may expose the Fund to credit and market valuation risk greater than that associated with regular trade settlement procedures. The Fund may also enter into transactions, in accordance with its investment policies, involving any or all of the following: short sales of securities, futures contracts, interest rate swaps, swap futures, options on futures contracts, options on securities, swaptions and certain credit derivative transactions, including, but not limited to, the purchase and sale of credit protection. As in the case of when-issued securities, the use of over-the-counter derivatives, such as interest rate swaps, swaptions, and credit default swaps may expose the Fund to greater credit, operations, liquidity, and valuation risk than is the case with regulated, exchange traded futures and options. These transactions are used for hedging or other appropriate risk-management purposes, or, under certain other circumstances, to increase return. No assurance can be given that such transactions will achieve their desired purposes or will result in an overall reduction of risk to the Fund.

9. Securities Lending

The Fund may lend up to 15% of its total assets (including the value of the loan collateral) to certain qualified brokers in order to earn additional income. The Fund receives compensation in the form of fees or interest earned on the investment of any cash collateral received. The Fund also continues to receive interest and dividends on the securities loaned. The Fund receives collateral in the form of cash or securities with a market value at least equal to the market value of the securities on loan, including accrued interest. In the event of default or bankruptcy by the borrower, the Fund could experience delays and costs in recovering the loaned securities or in gaining access to the collateral. The Fund has the right under the lending agreement to recover the securities from the borrower on demand.

ADDITIONAL INFORMATION (Unaudited)

Dividend Reinvestment and Cash Purchase Plan

Under the Fund's Dividend Reinvestment and Cash Purchase Plan (the "Plan"), a shareholder whose Common Stock is registered in their own name will have all distributions reinvested automatically by PFPC Inc. as agent under the Plan, unless the shareholder elects to receive cash. Distributions with respect to shares registered in the name of a broker-dealer or other nominee (that is, in "street name") may be reinvested by the broker or nominee in additional shares under the Plan, but only if the service is provided by the broker or nominee, unless the shareholder elects to receive distributions in cash. A shareholder who holds Common Stock registered in the name of a broker or other nominee may not be able to transfer the Common Stock to another broker or nominee and continue to participate in the Plan. Investors who own Common Stock registered in street name should consult their broker or nominee for details regarding reinvestment.

The number of shares of Common Stock distributed to participants in the Plan in lieu of a cash dividend is determined in the following manner. Whenever the market price per share of the Fund's Common Stock is equal to or exceeds the net asset value per share on the valuation date, participants in the Plan will be issued new shares valued at the higher of net asset value or 95% of the then current market value. Otherwise, PFPC Inc. will buy shares of the Fund's Common Stock in the open market, on the New York Stock Exchange or elsewhere, on or shortly after the payment date of the dividend or distribution and continuing until the ex-dividend date of the Fund's next distribution to holders of the Common Stock or until it has expended for such purchases all of the cash that would otherwise be payable to the participants. The number of purchased shares that will then be credited to the participants' accounts will be based on the average per share purchase price of the shares so purchased, including brokerage commissions. If PFPC Inc. commences purchases in the open market and the then current market price of the shares (plus any estimated brokerage commissions) subsequently exceeds their net asset value most recently determined before the completion of the purchases, PFPC Inc. will attempt to terminate purchases in the open market and cause the Fund to issue the remaining dividend or distribution in shares. In this case, the number of shares received by the participant will be based on the weighted average of prices paid for shares purchased in the open market and the price at which the Fund issues the remaining shares. These remaining shares will be issued by the Fund at the higher of net asset value or 95% of the then current market value.

Plan participants are not subject to any charge for reinvesting dividends or capital gains distributions. Each Plan participant will, however, bear a proportionate share of brokerage commissions incurred with respect to PFPC Inc.'s open market purchases in connection with the reinvestment of dividends or capital gains distributions. For the six months ended May 31, 2006, $1,086 in brokerage commissions were incurred.

The automatic reinvestment of dividends and capital gains distributions will not relieve Plan participants of any income tax that may be payable on the dividends or capital gains distributions. A participant in the Plan will be treated for Federal income tax purposes as having received, on the dividend payment date, a dividend or distribution in an amount equal to the cash that the participant could have received instead of shares.

In addition to acquiring shares of Common Stock through the reinvestment of cash dividends and distributions, a shareholder may invest any further amounts from $100 to $3,000 semi-annually at the then current market price in shares purchased through the Plan. Such semi-annual investments are subject to any brokerage commission charges incurred by PFPC Inc. under the Plan.

A shareholder whose Common Stock is registered in his or her own name may terminate participation in the Plan at any time by notifying PFPC Inc. in writing, by completing the form on the back of the Plan account statement and forwarding it to PFPC Inc., or by calling PFPC Inc. directly. A termination will be effective immediately if notice is received by PFPC Inc. not less than 10 days before any dividend or distribution record date. Otherwise, the termination will be effective, and only with respect to any subsequent dividends or distributions, on the first day after the dividend or distribution has been credited to the participant's account in additional shares of the Fund. Upon termination and according to a participant's instructions, PFPC Inc. will either (a) issue certificates for the whole shares credited to the shareholder's Plan account and a check representing any fractional shares or (b) sell the shares in the market. Shareholders who hold Common Stock registered in the name of a broker or other nominee should consult their broker or nominee to terminate participation.

The Plan is described in more detail in the Fund's Plan brochure. Information concerning the Plan may be obtained from PFPC Inc. at 1-800-331-1710.

Proxy Voting Policies and Proxy Voting Record on Form N-PX

The Fund files Form N-PX with its complete proxy voting record for the 12 months ended June 30th no later than August 31st of each year. The Fund filed its latest Form N-PX with the Securities and Exchange Commission ("SEC") on August 17, 2005. This filing, as well as the Fund's proxy voting policies and procedures, are available (i) without charge, upon request, by calling the Fund's transfer agent at 1-800-331-1710 and (ii) on the SEC's website at www.sec.gov. In addition, the Fund's proxy voting policies and procedures are available on the Fund's website at www.preferredincome.com.

Portfolio Schedule on Form N-Q

The Fund files a complete schedule of portfolio holdings with the SEC for the first and third fiscal quarters on Form N-Q, the latest of which was filed for the quarter ended February 28, 2006. The Fund's Form N-Q is available on the SEC's website at www.sec.gov or may be viewed and obtained from the SEC's Public Reference Room in Washington D.C. Information on the operation of the Public Reference Section may be obtained by calling 1-800-SEC-0330.

ADDITIONAL INFORMATION (Unaudited) (Continued)

Portfolio Management Team

In managing the day-to-day operations of the Fund, the Adviser relies on the expertise of its team of money management professionals, consisting of Messrs. Crumrine, Ettinger, Stone and Chadwick. The professional backgrounds of each member of the management team are included in the "Information about Fund Directors and Officers" section of this report.

Certifications

Donald F. Crumrine, as the Fund's Chief Executive Officer, has certified to the New York Stock Exchange that, as of May 22, 2006, he was not aware of any violation by the Fund of applicable NYSE corporate governance listing standards. The Fund's reports to the SEC on Forms N-CSR and N-Q contain certifications by the Fund's principal executive officer and principal financial officer that relate to the Fund's disclosure in such reports and that are required by rule 30a-2(a) under the 1940 Act.

Meeting of Shareholders

On April 21, 2006, the Fund held its Annual Meeting of Shareholders (the "Meeting") for the following purposes: election of a Director of the Fund ("Proposal 1") and approval of an amendment to the Fund's Articles Supplementary Creating and Fixing the Rights of the Money Market Cumulative Preferred™ Stock ("Articles Supplementary") relating to the removal of the requirement that potential buyers of the Fund's Money Market Cumulative Preferred™ Stock execute a "Master Purchaser's Letter" ("Proposal 2"). All proposals were approved by the shareholders and the results of the voting are as follows:

Proposal 1: Election of Director.

Name	For	Withheld
Common Stock		
David Gale	9,710,869	144,678

Donald F. Crumrine, Morgan Gust, Karen H. Hogan, and Robert F. Wulf continue to serve in their capacities as Directors of the Fund.

Proposal 2: Amendment to the Articles Supplementary relating to the removal of the Master Purchaser's Letter Requirement

Name	For	Against	Withheld
Common Stock	9,566,627	133,518	155,402
Preferred Stock	475	—	—

Information about Fund Directors and Officers

The business and affairs of the Fund are managed under the direction of the Fund's Board of Directors. Information pertaining to the Directors and officers of the Fund is set forth below.

Name, Address, and Age	Position(s) Held with Fund	Term of Office and Length of Time Served*	Principal Occupation(s) During Past Five Years	Number of Funds in Fund Complex Overseen by Director	Other Directorships Held by Director
NON-INTERESTED DIRECTORS:					
David Gale Delta Dividend Group, Inc. 220 Montgomery Street Suite 426 San Francisco, CA 94104 Age: 57	Director	Class I Director since January 1997	President & CEO of Delta Dividend Group, Inc. (investments).	4	Metromedia International Group, Inc. (telecommunications). Flaherty & Crumrine Preferred Income Fund, Flaherty & Crumrine/ Claymore Preferred Securities Income Fund and Flaherty & Crumrine/ Claymore Total Return Fund.
Morgan Gust Giant Industries, Inc. 23733 N. Scottsdale Road Scottsdale, AZ 85255 Age: 59	Director	Class III Director since February 1992	President of Giant Industries, Inc. (petroleum refining and marketing) since March 2002, and for more than five years prior thereto, Executive Vice President, and various other Vice President positions at Giant Industries, Inc.	4	CoBiz, Inc. (financial services); Flaherty & Crumrine Preferred Income Fund, Flaherty & Crumrine/ Claymore Preferred Securities Income Fund and Flaherty & Crumrine/ Claymore Total Return Fund.

* The Fund's Board of Directors is divided into three classes, each class having a term of three years. Each year the term of office of one class expires and the successor or successors elected to such class serve for a three year term. The three year term for each class expires as follows:

Class I Director – three year term expires at the Fund's 2009 Annual Meeting of Shareholders; director may continue in office until his successor is duly elected and qualified.
Class II Directors – three year term expires at the Fund's 2007 Annual Meeting of Shareholders; directors may continue in office until their successors are duly elected and qualified.
Class III Directors – three year term expires at the Fund's 2008 Annual Meeting of Shareholders; directors may continue in office until their successors are duly elected and qualified.

ADDITIONAL INFORMATION (Unaudited) (Continued)

Name, Address, and Age	Position(s) Held with Fund	Term of Office and Length of Time Served*	Principal Occupation(s) During Past Five Years	Number of Funds in Fund Complex Overseen by Director	Other Directorships Held by Director
NON-INTERESTED DIRECTORS:					
Karen H. Hogan† 301 E. Colorado Boulevard Suite 720 Pasadena, CA 91101 Age: 45	Director	Class III Director since April 2005	Retired; Community Volunteer; from September 1985 to January 1997, Senior Vice President of Preferred Stock Origination at Lehman Brothers and previously, Vice President of New Product Development.	4	Flaherty & Crumrine Preferred Income Fund, Flaherty & Crumrine/ Claymore Preferred Securities Income Fund and Flaherty & Crumrine/ Claymore Total Return Fund.
Robert F. Wulf 3560 Deerfield Drive South Salem, OR 97302 Age: 69	Director	Class II Director since February 1992	Financial Consultant; Trustee, University of Oregon Foundation; Trustee, San Francisco Theological Seminary.	4	Flaherty & Crumrine Preferred Income Fund, Flaherty & Crumrine/ Claymore Preferred Securities Income Fund and Flaherty & Crumrine/ Claymore Total Return Fund.

* The Fund's Board of Directors is divided into three classes, each class having a term of three years. Each year the term of office of one class expires and the successor or successors elected to such class serve for a three year term. The three year term for each class expires as follows:

Class I Director – three year term expires at the Fund's 2009 Annual Meeting of Shareholders; director may continue in office until his successor is duly elected and qualified.

Class II Directors – three year term expires at the Fund's 2007 Annual Meeting of Shareholders; directors may continue in office until their successors are duly elected and qualified.

Class III Directors – three year term expires at the Fund's 2008 Annual Meeting of Shareholders; directors may continue in office until their successors are duly elected and qualified.

† As a Director, represents holders of shares of the Fund's Money Market Cumulative Preferred™ Stock.

ADDITIONAL INFORMATION (Unaudited) (Continued)

Name, Address, and Age	Position(s) Held with Fund	Term of Office and Length of Time Served*	Principal Occupation(s) During Past Five Years	Number of Funds in Fund Complex Overseen by Director	Other Directorships Held by Director
INTERESTED DIRECTOR:					
Donald F. Crumrine†, †† 301 E. Colorado Boulevard Suite 720 Pasadena, CA 91101 Age: 58	Director, Chairman of the Board and Chief Executive Officer	Class II Director since February 1992	Chairman of the Board and Director of Flaherty & Crumrine Incorporated.	4	Flaherty & Crumrine Preferred Income Fund, Flaherty & Crumrine/ Claymore Preferred Securities Income Fund and Flaherty & Crumrine/ Claymore Total Return Fund.

* The Fund's Board of Directors is divided into three classes, each class having a term of three years. Each year the term of office of one class expires and the successor or successors elected to such class serve for a three year term. The three year term for each class expires as follows:

Class I Director – three year term expires at the Fund's 2009 Annual Meeting of Shareholders; director may continue in office until his successor is duly elected and qualified.
Class II Directors – three year term expires at the Fund's 2007 Annual Meeting of Shareholders; directors may continue in office until their successors are duly elected and qualified.
Class III Directors – three year term expires at the Fund's 2008 Annual Meeting of Shareholders; directors may continue in office until their successors are duly elected and qualified.

† As a Director, represents holders of shares of the Fund's Money Market Cumulative Preferred™ Stock.
†† "Interested person" of the Fund as defined in the Investment Company Act of 1940. Mr. Crumrine is considered an "interested person" because of his affiliation with Flaherty & Crumrine Incorporated which acts as the Fund's investment adviser.

ADDITIONAL INFORMATION (Unaudited) (Continued)

Name, Address, and Age	Position(s) Held with Fund	Term of Office and Length of Time Served	Principal Occupation(s) During Past Five Years
OFFICERS:			
Robert M. Ettinger 301 E. Colorado Boulevard Suite 720 Pasadena, CA 91101 Age: 47	President	Since October 2002	President and Director of Flaherty & Crumrine Incorporated.
R. Eric Chadwick 301 E. Colorado Boulevard Suite 720 Pasadena, CA 91101 Age: 31	Chief Financial Officer, Vice President and Treasurer	Since October 2002	Vice President and Director of Flaherty & Crumrine Incorporated; prior to August 2001, portfolio manager of Flaherty & Crumrine Incorporated.
Chad C. Conwell 301 E. Colorado Boulevard Suite 720 Pasadena, CA 91101 Age: 33	Chief Compliance Officer, Vice President and Secretary	Since July 2005	Chief Compliance Officer of Flaherty & Crumrine Incorporated since September 2005, and since July 2005, Vice President of Flaherty & Crumrine Incorporated; from September 1998 through June 2005, Attorney with Paul, Hastings, Janofsky & Walker LLP.
Bradford S. Stone 392 Springfield Avenue Mezzanine Suite Summit, NJ 07901	Vice President and Assistant Treasurer	Since July 2003	Vice President and Director of Flaherty & Crumrine Incorporated; from June 2001 to April 2003, Director of U.S. Market Strategy at Barclays Capital.
Christopher D. Ryan 301 E. Colorado Boulevard Suite 720 Pasadena, CA 91101 Age: 38	Vice President	Since April 2005	Vice President of Flaherty & Crumrine Incorporated since February 2004; October 2002 to February 2004, Product Analyst of Flaherty & Crumrine Incorporated. From 1999 to 2002, graduate student.
Laurie C. Lodolo 301 E. Colorado Boulevard Suite 720 Pasadena, CA 91101 Age: 42	Assistant Compliance Officer, Assistant Treasurer and Assistant Secretary	Since July 2004	Assistant Compliance Officer of Flaherty & Crumrine Incorporated since August 2004; since February 2004, Secretary of Flaherty & Crumrine Incorporated; since January 1987, Account Administrator of Flaherty & Crumrine Incorporated.

BOARD CONSIDERATION AND APPROVAL OF CONTINUANCE OF INVESTMENT ADVISORY AGREEMENT

During the six month period ended May 31, 2006, the Board of Directors of the Fund approved the continuation of the investment advisory agreement with the Adviser (the "Agreement"). The following paragraphs summarize the material information and factors considered by the Board, including the Independent Directors, as well as their conclusions relative to such factors.

Nature, Extent and Quality of Services

The Board members reviewed in detail the nature and extent of the services provided by the Adviser and the quality of those services over the past year and since inception. The Board members noted that these services included managing the Fund's investment program, as well as providing significant administrative services beyond what the Agreement required. The Board members noted that the Adviser also provided, generally at its expense: office facilities for use by the Fund; personnel responsible for supervising the performance of administrative, accounting and related services; and investment compliance monitoring. The Board members also considered the Adviser's sound financial condition and the Adviser's commitment to its business, as evidenced by its hiring additional personnel as the business has grown. The Board members evaluated the Adviser's services based on their direct experience serving as Directors for many years, focusing on (i) the Adviser's knowledge of the preferred securities market generally and the sophisticated hedging strategies the Fund employs and (ii) the Adviser's culture of compliance. The Board members reviewed the personnel responsible for providing services to the Fund and observed that, based on their experience and interaction with the Adviser: (1) the Adviser's personnel exhibited a high level of personal integrity, diligence and attention to detail in carrying out their responsibilities under the Agreement; (2) the Adviser was responsive to requests of the Board and its personnel were available between Board meetings to answer questions from Board members; and (3) the Adviser had kept the Board apprised of developments relating to the Fund. The Board members also considered the continued efforts undertaken by the Adviser to maintain an effective compliance program. The Board members concluded that the nature and extent of the services provided were reasonable and appropriate in relation to the Fund's investment goals and strategies, the corporate and regulatory environment in which the Fund operates, and the level of services provided by the Adviser, and that the quality of the Adviser's service continues to be high.

Investment Performance

The Board members considered the Fund's performance since inception, including its performance in recent fiscal periods, to determine whether the Fund had met its investment objective. The Board members determined that the Fund had done so, especially in light of existing extraordinary market conditions, which include rising short-term rates and a relatively flat yield curve, conditions that reduce hedging benefits. In reaching this conclusion, the Board members reviewed the Fund's performance compared to relevant indices and funds thought to be generally comparable to the Fund, considered the costs and benefits of the Fund's hedging strategy in the relevant market environment and examined the differences between the Fund and certain funds in the comparison group, including the significant positions in common equities of a number of preferred stock funds. The Board members noted the Fund's adherence to its respective investment mandate. The Board members also considered that recent relative underperformance was attributable largely to the Fund's stated hedging strategies, which have been a central aspect of the Fund since inception.

Profitability

The Board members considered the Adviser's methodology for determining its profitability with respect to the Fund, and the Adviser's profit margin on an after-tax basis attributable to managing the Fund. The Board members concluded that the profitability to the Adviser was not excessive based on the considerable services it provides to the Fund, the Fund's relative performance over time, its success in meeting the Fund's investment objective and the Fund's relatively low expense ratio compared to funds with similar investment objectives and strategies. The Board members also considered that the Adviser provided, at a lower cost, services to separate account clients and determined that the difference was justified in light of the additional services and costs associated with managing registered investment companies, such as the Fund. The Board members accepted the Adviser's statement that it did not realize material indirect benefits from its relationship with the Fund and did not obtain soft dollar credits from securities trading.

Economies of Scale

The Board members noted that the Fund, as a closed-end investment company, was not expected to increase materially in size; thus, the Adviser would not benefit from economies of scale. The Board members considered whether economies of scale could be realized because the Adviser advises other similar funds. Based on their experience, the Board members accepted the Adviser's explanation that significant economies of scale would not be realized because of the complexity of managing preferred securities for separate funds and other portfolios. Nonetheless, the Board members noted that the Fund's advisory fee schedule declines as assets increase beyond a certain level (commonly known as a "breakpoint"), and that breakpoints provide for a sharing with shareholders of benefits derived as a result of economies of scale arising from increased assets. Accordingly, the Board members determined that the existing advisory fee levels reflect possible economies of scale.

In light of their discussions and considerations as described above, the Board members made the following determinations as to the Fund:

- the nature and extent and quality of the services provided by the Adviser are reasonable and appropriate and the quality of the services is high;
- the Fund's overall performance was satisfactory, given market conditions;
- the fee paid to the Adviser was reasonable in light of (i) comparative performance and expense and advisory fee information, (ii) the cost of the services provided and profits to be realized, and (iii) the benefits derived or to be derived by the Adviser from the relationship with the Fund; and
- there were not at this time significant economies of scale to be realized by the Adviser in managing the Fund's assets, and the fee was structured to provide for a sharing of the benefits of economies of scale.

Based on these conclusions, the Board members determined that approval of the Agreement was in the best interests of the Fund and its shareholders.

[This page intentionally left blank]

[This page intentionally left blank]

Directors

Donald F. Crumrine, CFA
Chairman of the Board
David Gale
Morgan Gust
Karen H. Hogan
Robert F. Wulf, CFA

Officers

Donald F. Crumrine, CFA
Chief Executive Officer
Robert M. Ettinger, CFA
President
R. Eric Chadwick, CFA
Chief Financial Officer,
Vice President and Treasurer
Chad C. Conwell
Chief Compliance Officer,
Vice President and Secretary
Bradford S. Stone
Vice President and
Assistant Treasurer
Christopher D. Ryan, CFA
Vice President
Laurie C. Lodolo
Assistant Compliance Officer,
Assistant Treasurer and
Assistant Secretary

Investment Adviser

Flaherty & Crumrine Incorporated
e-mail: flaherty@pfdincome.com

Questions concerning your shares of Flaherty & Crumrine 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 43027
Providence, RI 02940-3027
1-800-331-1710

Flaherty & Crumrine
PREFERRED INCOME
OPPORTUNITY FUND

Semi–Annual Report

May 31, 2006

www.preferredincome.com