

Flaherty & Crumrine PREFERRED INCOME OPPORTUNITY FUND INC
Form N-30B-2
October 26, 2018
FLAHERTY & CRUMRINE PREFERRED INCOME OPPORTUNITY FUND

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

Preferreds performed well in the third fiscal quarter¹, bringing total return for the year just back into positive territory. While these returns have not kept pace with returns in recent years, preferreds continue to outperform certain areas of the fixed income market. Total return² on net asset value (“NAV”) was 2.3% for the quarter, and 0.3% for the first nine months of fiscal 2018. Total return on market price over the same periods was 12.5% and 5.1%, respectively.

By most accounts, it has been a challenging year for corporate bond investments. As the current economic cycle has matured, interest rates rose modestly and credit spreads gradually widened. The yield curve flattened as the Federal Reserve methodically raised its benchmark rate while the long end of the Treasury yield curve moved up only modestly given a limited increase in broad-based inflation and subdued expectations for long-term economic growth. Over the first nine months of the Fund’s fiscal year, the Bloomberg Barclays U.S. Aggregate Index returned -0.5%, while the Bloomberg Barclays Long U.S. Credit Index returned -2.7%.

Preferreds outperformed these fixed-income benchmarks for a few key reasons. First, duration is moderate for many preferreds – and for the Fund’s portfolio specifically. We won’t repeat the merits of fixed-to-float preferreds here, but as previously discussed they offer attractive yields with intermediate duration. Owning both fixed-rate and fixed-to-float preferreds allows for management of portfolio duration despite the long-term nature of the Fund’s investments.

Second, an issuer’s preferreds generally yield more than its corporate bonds. The Fund’s strategy is to identify investment-grade issuers and invest down the capital structure (into preferreds) to earn extra yield for what is, in most cases, similar default risk. For issuers with solid credit quality, preferreds have consistently outperformed corporate bonds over a credit cycle. Over time, higher yields can make up for a lot of principal change and dampen effects of higher interest rates.

Outperformance of preferreds over other fixed income securities has been even better when considered after-tax. If shareholders missed our discussion on taxes in the semi-annual report dated May 31, 2018, we encourage a read. Most preferreds offer tax-advantaged income, which further enhances the extra yield earned for subordination (i.e. being lower in the capital structure than senior debt).

We believe the case for preferreds as an income investment remains largely intact, with a combination of higher relative yields, tax advantages, and benign credit conditions. Returns may be bumpy as markets navigate a late-cycle economy (albeit one that’s currently showing few signs of weakness) and an active Federal Reserve. For fixed-income investors, however, preferreds’ combination of credit quality, intermediate duration and yield should remain attractive.

Sincerely,

The Flaherty & Crumrine Portfolio Management Team

September 30, 2018

¹ June 1, 2018 – August 31, 2018

² Following the methodology required by the Securities and Exchange Commission, total return assumes dividend reinvestment.

Flaherty & Crumrine Preferred Income Opportunity Fund Incorporated

PORTFOLIO OVERVIEW

August 31, 2018 (Unaudited)

Fund Statistics

Net Asset Value	\$ 11.35	
Market Price	\$ 11.97	
Premium	5.46	%
Yield on Market Price	6.62	%
Common Stock Shares Outstanding	12,525,035	

Security Ratings % of Net Assets†**

A	1.2	%
BBB	54.8	%
BB	32.9	%
Below “BB”	0.9	%
Not Rated***	8.7	%

Portfolio Rating Guidelines % of Net Assets†

Security Rated Below Investment Grade By All*****	33.2	%
Issuer or Senior Debt Rated Below Investment Grade by All*****	1.7	%

**Ratings are from Moody’s Investors Service, Inc. “Not Rated” securities are those with no ratings available from Moody’s.

***Excludes common stock and money market fund investments and net other assets and liabilities of 1.5%.

****Security rating below investment grade by all of Moody’s, Standard & Poor’s, and Fitch Ratings.

*****Security rating and issuer’s senior unsecured debt or issuer rating are below investment grade by all of Moody’s, S&P, and Fitch. The Fund’s investment policy currently limits such securities to 15% of Net Assets.

Industry Categories* % of Net Assets†

Top 10 Holdings by Issuer	% of Net Assets†
JPMorgan Chase & Co	4.7 %

MetLife Inc	4.2 %
Wells Fargo & Company	4.2 %
Morgan Stanley	3.9 %
PNC Financial Services Group	3.9 %
BNP Paribas	3.2 %
Enbridge Energy Partners	3.1 %
Fifth Third Bancorp	3.0 %
Liberty Mutual Group	2.8 %
HSBC PLC	2.7 %

	% of Net Assets*****†
Holdings Generating Qualified Dividend Income (QDI) for Individuals	61 %
Holdings Generating Income Eligible for the Corporate Dividends Received Deduction (DRD)	44 %

*****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.

†Net Assets includes assets attributable to the use of leverage.

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Flaherty & Crumrine Preferred Income Opportunity Fund Incorporated

PORTFOLIO OF INVESTMENTS

August 31, 2018 (Unaudited)

Shares/\$ Par Value

Preferred Securities[§] —

94.3%

Banking — 55.4%

\$ 1,817,000	Australia & New Zealand Banking Group Ltd., 6.75% to 06/15/26 then ISDA5 + 5.168%, 144A****	\$ 1,889,680 ** ⁽¹⁾⁽²⁾
\$ 2,200,000	Banco Bilbao Vizcaya Argentaria SA, 6.125% to 11/16/27 then SW5 + 3.87%	1,946,054 ** ⁽¹⁾⁽²⁾
\$ 490,000	Banco Mercantil del Norte SA, 7.625% to 01/06/28 then T10Y + 5.353%, 144A****	499,555 ** ⁽²⁾
	Bank of America Corporation:	
\$ 2,100,000	5.875% to 03/15/28 then 3ML + 2.931%, Series FF	2,102,625 * ⁽¹⁾
\$ 300,000	6.30% to 03/10/26 then 3ML + 4.553%, Series DD	321,750 *
	Barclays Bank PLC:	
\$ 930,000	7.75%, to 09/15/23 then SW5 + 4.842%	940,509 ** ⁽²⁾
\$ 2,848,000	7.875% to 03/15/22 then SW5 + 6.772%, 144A****	2,963,427 ** ⁽²⁾