

Edgar Filing: PREFERRED INCOME OPPORTUNITY FUND INC - Form N-Q

PREFERRED INCOME OPPORTUNITY FUND INC

Form N-Q

October 27, 2003

PREFERRED INCOME OPPORTUNITY FUND INCORPORATED

Dear Shareholder:

The Preferred Income Opportunity Fund turned in a banner quarter despite an extremely difficult market for fixed income securities. The Fund earned 2.6% on net asset value ("NAV") during its third fiscal quarter. For the first three fiscal quarters of 2003, the return on NAV was a remarkable 22.9%.

The extraordinary jump in intermediate and long-term interest rates during the quarter provided a textbook case for why we hedge against a substantial rise in interest rates. The yields on 10-year and 30-year U.S. Treasuries rose 1.10% and 0.86%, respectively, during the period. An investor in these securities would have suffered total return LOSSES of 7.8% on the 10-year and 10.9% on the 30-year.

Given the magnitude of the weakness in the fixed-income markets, it is no surprise that the performance of the market price for the Fund's shares lagged the performance of the NAV. For the quarter, the return on market was -2.5%. Since the beginning of the fiscal year, the market return was a much more impressive +12.7%.

This was clearly one of the worst three months the bond market has ever experienced, and without the Fund's hedging strategy the results would have been much worse. In some ways, hedging is a lot like buying an insurance policy - you pay a premium, but don't expect to collect very often. When you need it, however, you are awfully glad you have it! During the past quarter we certainly needed the hedge; WITHOUT IT, THE RETURN ON NAV WOULD HAVE BEEN 4.8 PERCENTAGE POINTS LOWER.

Interest in preferred securities remains high, but on balance there has not been a lot of new supply. As you would expect, these conditions have resulted in the yields on preferreds narrowing versus the yields on Treasury notes and bonds. Despite this, when compared to historical relationships, preferred securities still appear attractively priced at present.

We are always on the lookout for the best values within the preferred securities market. For some period of time now, we have determined that traditional preferred stock (the type which pays dividends that may be taxed at lower rates for corporations and individuals) should comprise a larger portion of the Fund's investment portfolio. Of course, in the future, fully taxable hybrid preferred securities may become more attractive and make up a bigger part of the portfolio.

A lot of investors have inquired about the percentage of the Fund's distributions which are dividends (as opposed to interest). Because of the way the tax rules work, that number cannot be calculated until the end of the fiscal year. We have added a section on the Fund's web site, www.preferredincome.com, which shows the breakdown between dividends, income and capital gains from prior years.

We strongly encourage shareholders to participate in the Fund's Dividend Reinvestment and Cash Purchase Plan ("DRIP"). It provides a steady, reliable approach to building wealth.

Sincerely,

/S/ Donald F. Crumrine

/S/ Robert M. Ettinger

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Donald F. Crumrine
Chairman of the Board

Robert M. Ettinger
President

September 30, 2003

Preferred Income Opportunity Fund Incorporated
SUMMARY OF INVESTMENTS
AUGUST 31, 2003 (UNAUDITED)

| | VALUE (000'S) ----- |
|--|---------------------------|
| ADJUSTABLE RATE PREFERRED SECURITIES | |
| Utilities | \$ 62 |
| Banking | 19,84 |
| Financial Services | 52 |
| TOTAL ADJUSTABLE RATE | 20,99 |
| FIXED RATE PREFERRED SECURITIES | |
| Utilities | 77,95 |
| Banking | 30,52 |
| Financial Services | 24,92 |
| Insurance | 20,10 |
| Oil and Gas | 10,30 |
| Miscellaneous Industries | 4,02 |
| TOTAL FIXED RATE | 167,84 |
| INVERSE FLOATING RATE PREFERRED SECURITIES | 1,52 |
| TOTAL PREFERRED STOCKS AND SECURITIES | 190,36 |
| CORPORATE DEBT SECURITIES | 39 |
| COMMON STOCKS AND CONVERTIBLE SECURITIES | 5,91 |
| PURCHASED PUT OPTIONS | 3,06 |
| MONEY MARKET FUNDS | 11,64 |
| TOTAL INVESTMENTS | 211,39 |
| OTHER ASSETS AND LIABILITIES (NET) | 1,16 |
| TOTAL NET ASSETS AVAILABLE TO COMMON AND PREFERRED STOCK | \$212,56 |

FINANCIAL DATA
PER SHARE OF COMMON STOCK (UNAUDITED)

| DIVIDEND PAID | NET ASSET VALUE | NYSE CLOSING PRICE |
|------------------|--------------------|-----------------------|
|------------------|--------------------|-----------------------|

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| | | | |
|-------------------------------|---------|---------|---------|
| December 31, 2002 Extra | \$0.107 | \$10.72 | \$12.21 |
| December 31, 2002 | 0.073 | 10.72 | 12.21 |
| January 31, 2003 | 0.073 | 11.46 | 12.65 |
| February 28, 2003 | 0.073 | 11.46 | 12.57 |
| March 31, 2003 | 0.073 | 11.58 | 13.00 |
| April 30, 2003 | 0.073 | 11.76 | 12.59 |
| May 31, 2003 | 0.073 | 12.34 | 12.94 |
| June 30, 2003 | 0.073 | 12.60 | 12.60 |
| July 31, 2003 | 0.073 | 12.43 | 12.02 |
| August 31, 2003 | 0.073 | 12.44 | 12.40 |

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STATEMENT OF CHANGES IN NET ASSETS AVAILABLE TO COMMON STOCK(1)
NINE MONTHS ENDED AUGUST 31, 2003 (UNAUDITED)

OPERATIONS:

Net investment income
 Net realized gain on investments sold during the period
 Change in net unrealized appreciation of investments held during the period
 Distributions to Money Market Cumulative PreferredTM Stock Shareholders from net investment
 income, including changes in accumulated undeclared distributions

Net increase in net assets from operations

DISTRIBUTIONS:

Dividends paid from net investment income to Common Stock Shareholders (2)
 Distributions paid from net realized capital gains to Common Stock Shareholders

Total Distributions

FUND SHARE TRANSACTIONS:

Increase from Common Stock Transactions

NET INCREASE IN NET ASSETS AVAILABLE TO COMMON STOCK FOR THE PERIOD

NET ASSETS AVAILABLE TO COMMON STOCK:

Beginning of period

End of period

FINANCIAL HIGHLIGHTS(1)
NINE MONTHS ENDED AUGUST 31, 2003 (UNAUDITED)
FOR A COMMON SHARE OUTSTANDING THROUGHOUT THE PERIOD.

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PER SHARE OPERATING PERFORMANCE:

Net asset value, beginning of period

INVESTMENT OPERATIONS:

Net investment income

Net realized gain and unrealized appreciation on investments

DISTRIBUTIONS TO MMP* SHAREHOLDERS:

From net investment income (including change in accumulated undeclared dividends on MMP*) ..

From net realized capital gains

Total from investment operations after distribution to MMP* Shareholders

DISTRIBUTIONS TO COMMON STOCK SHAREHOLDERS:

From net investment income

From net realized capital gains

Total distributions to Common Stock Shareholders

Net asset value, end of period

Market value, end of period

Common shares outstanding, end of period

RATIOS TO AVERAGE NET ASSETS AVAILABLE TO COMMON STOCK SHAREHOLDERS:

Net investment income

Operating expenses

SUPPLEMENTAL DATA:++

Portfolio turnover rate fiscal year to date

Total net assets available to Common and Preferred Stock, end of period (in 000's)

Ratio of operating expenses to total average net assets including MMP*

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DIRECTORS

Martin Brody

Donald F. Crumrine, CFA

Robert M. Ettinger, CFA

David Gale

Morgan Gust

Robert F. Wulf, CFA

OFFICERS

Donald F. Crumrine, CFA

Chairman of the Board
and Chief Executive Officer

Robert M. Ettinger, CFA

President

Peter C. Stimes, CFA

Chief Financial and Accounting
Officer, Vice President
and Treasurer

Robert E. Chadwick, CFA

Vice President and Secretary

Bradford S. Stone

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Vice President

INVESTMENT ADVISER

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

QUESTIONS CONCERNING YOUR SHARES OF PREFERRED
INCOME OPPORTUNITY FUND?

- o If your shares are held in a Brokerage Account, contact your Broker.
- o 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

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.

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INCOME
OPPORTUNITY
FUND

QUARTERLY
REPORT

AUGUST 31, 2003

web site: www.preferredincome.com