FLAHERTY & CRUMRINE TOTAL RETURN FUND INC
Form N-30B-2
October 28, 2013

FLAHERTY & CRUMRINE TOTAL RETURN FUND

To the Shareholders of Flaherty & Crumrine Total Return Fund:

Total return on net asset value (NAV)[1] was -4.9% during the third fiscal quarter[2], reducing total return on NAV fiscal year-to-date to +2.5%. In addition, during the quarter the Fund, like many other closed-end income-oriented funds, saw the relationship between its market price and NAV swing from a premium to a discount, resulting in total return on market value of -6.8%. Clearly, this represented a setback in what had been a sustained period of positive returns in both the Fund s NAV and market valuation. During the quarter, prices of all fixed-income securities, including preferred securities, declined and yields increased as markets reacted swiftly to expectations that the Federal Reserve might taper its quantitative easing earlier than anticipated.

Virtually all sectors of the fixed-income market turned in negative results during the quarter. U.S. Treasury 10-year notes and 30-year bonds experienced the largest declines with total returns of -4.6% and -6.5%, as their yields increased by 0.7% and 0.4%, respectively. Long-term corporate bonds performed moderately better than long-term U.S. Treasuries, with a total return of -4.7% for the Barclays Long U.S. Corporate Bond Index. Even including the impact of expenses and leverage, the Fund s NAV performed as well as *unlevered* total returns on those other long-term segments of fixed-income markets.

The quarter began with the Federal Open Market Committee (FOMC) having just indicated that it might begin tapering the pace of its program of securities purchases sooner than the market was expecting. Longer-term interest rates moved higher with a fair amount of consistency throughout the quarter, as markets digested the news and adjusted expectations for future monetary policy actions. Markets are driven by *expectations* more than actual results, and while we believe the market priced in more risk than was justified based on the outlook for growth in the U.S. economy, uncertainty surrounding a potential change in policy outlook led investors to reduce portfolio duration substantially. At its September meeting, the FOMC surprised the market yet again by continuing its program of securities purchases without tapering its pace. Since then, we have seen some recovery in fixed-income markets. Although we do not expect long-term Treasury rates to decline significantly, interest-rate risk premiums still appear high, providing investors with some protection against eventual removal of highly accommodative monetary policy.

The preferred securities market was not immune to the change in outlook for interest rates and a desire by many investors to reduce duration in their portfolios. In many cases, spreads on preferred securities widened relative to Treasuries, adding to price declines already associated with higher rates. Retail preferred securities were particularly weak as we witnessed meaningful reductions in the sizes of preferred-securities exchange-traded funds which had grown in size to represent about 9% of the retail market at the beginning of this quarter. Preferred securities issued in the early part of the year, most with very low coupons, were among the worst performers. Fortunately, we weren t tempted by many of those new issues much preferring the higher coupons available in the secondary market. Institutional preferred securities fared much better, and as they have a larger allocation in the portfolio they were partially responsible for limiting negative returns during the quarter.

Creditworthiness of most preferred-securities issuers continues to improve. Corporate earnings are growing at a moderate pace and corporate leverage remains low. Banks problem loans are declining,

[1] Following the methodology required by the SEC, total return assumes dividend reinvestment and includes income and principal change, plus the impact of the Fund s leverage and expenses.

[2] June 1st August 31st.

capital levels are healthy (especially in the U.S.) and new lending is slowly picking up. Rising home prices are bolstering consumer balance sheets and trimming foreclosure losses. These favorable credit developments should continue to benefit preferred securities.

While prices have fallen, market conditions for preferred securities remain healthy. Higher interest rates and wider spreads have resulted in a material slowdown in issuer redemptions. For the year, redemptions are still running ahead of new supply, with the preferred-securities market shrinking more than $10 billion, but the pace of redemptions slowed significantly this past quarter with the Fund seeing approximately 90% of its redemptions this fiscal year occurring during the first half. This recent slowdown in issuer redemptions has been welcome news on the income side of the equation, as the Fund is able to keep more of the higher-coupon preferred securities longer than we expected earlier in the year.

After a long wait, we now have largely final rules on the regulatory treatment of preferred securities issued by banks, foreign and domestic. Crafted in response to the financial crisis, new legislation and regulations shift loss burdens towards investors and away from taxpayers (government support). Under the new rules, banks will have an incentive to replace debt-like preferred securities with ones that have more characteristics of equity (deeper subordination, non-cumulative dividends, and no maturity date). The new rules include various implementation schedules, depending on the jurisdiction, with most being fully implemented within the next 3-8 years.

To conform to the new rules, we estimate U.S. banks will need to issue an additional $60 billion or more of new preferred stock. That is certainly a big number compared to $73 billion of currently outstanding bank preferred stock. While we think issuance will be manageable and spread out over several years, it will influence preferred securities prices when it happens. We are also likely to see more contingent capital issued in the coming years, as issuers look to fill different buckets of loss-absorbing capital required under the new rules. This market has so far been limited in size and breadth, but it is likely to grow and is part of the ongoing evolution of the broader subordinated capital market.

Looking ahead, moderate economic growth should provide a constructive environment for preferred-securities investors. We anticipate that economic growth will be fast enough to facilitate continued improvement in corporate and household balance sheets and better loan performance, while being slow enough to restrain inflation and keep monetary policy accommodative for some time. Spreads on preferred securities should recover as fears of further rapid increases in long-term interest rates recede and investors refocus on steadily improving credit conditions. Volatility is likely to remain elevated over the coming months, but we believe the preferred-securities market has priced in a good amount of risk related to the end of quantitative easing.

As always, we encourage you to visit the Fund s website www.preferredincome.com.

Sincerely,

Donald F. Crumrine
Chairman

Robert M. Ettinger
President

September 30, 2013

Flaherty & Crumrine Total Return Fund Incorporated

PORTFOLIO OVERVIEW

August 31, 2013 (Unaudited)

Fund Statistics	
Net Asset Value	$ 19.38
Market Price	$ 18.25
Discount	5.83%
Yield on Market Price	8.94%
Common Stock Shares Outstanding	9,897,817

Moody s Ratings	**% of Net Assets**
A	1.6%
BBB	61.6%
BB	29.7%
Below BB	0.7%
Not Rated*	4.7%
Below Investment Grade**	19.0%

* Does not include net other assets and liabilities of 1.7%.
** Below investment grade by all of Moody s, S&P and Fitch.

Industry Categories **% of Net Assets**

Top 10 Holdings by Issuer	**% of Net Assets**
Liberty Mutual Group	5.3%
MetLife	4.1%
HSBC PLC	4.1%
Banco Santander, S.A.	4.0%
Goldman Sachs Group	3.8%
Unum Group	3.6%
Wells Fargo & Company	3.3%
Barclays Bank PLC	3.2%
Axis Capital Holdings Ltd	3.0%

XL Group PLC	2.7%

	% of Net Assets* **
Holdings Generating Qualified Dividend Income (QDI) for Individuals	43%
Holdings Generating Income Eligible for the Corporate Dividend Received Deduction (DRD)	25%

*** 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 Total Return Fund Incorporated

PORTFOLIO OF INVESTMENTS

August 31, 2013 (Unaudited)

Shares/$ Par		Value
Preferred Securities 88.2%		
	Banking 33.7%	
6,700	Astoria Financial Corp., 6.50% Pfd., Series C	$ 156,596*
	Banco Bilbao Vizcaya Argentaria, S.A.:	
$ 2,050,000	BBVA International Preferred, 5.919%	1,834,750**[1][2][3]
	Banco Santander, S.A.	
439,755	Banco Santander, 10.50% Pfd., Series 10	11,839,304**[1][3]
	Bank of America:	
25,000	Countrywide Capital V, 7.00% Pfd. 11/01/36	627,563
	Barclays Bank PLC:	
$ 3,600,000	Barclays Bank PLC, 6.278%	3,267,623**[1][3]
81,750	Barclays Bank PLC, 7.10% Pfd.	2,033,940**[3]
8,800	Barclays Bank PLC, 7.75% Pfd., Series 4	220,880**[3]
150,000	Barclays Bank PLC, 8.125% Pfd., Series 5	3,787,500**[1][3]
$ 3,775,000	BNP Paribas, 7.195%, 144A****	3,746,688**[1][2][3]
	Citigroup:	
81,550	Citigroup Capital XIII, 7.875% Pfd.	2,240,081[1][2]
	CoBank ACB:	
12,500	CoBank ACB, 6.125% Pfd., Series G, 144A****	1,178,516*
25,000	CoBank ACB, 6.25% Pfd., 144A****	2,555,470*
$ 10,000,000	Colonial BancGroup, 7.114%, 144A****	15,000[4][5]
30,500	Cullen/Frost Bankers, Inc., 5.375% Pfd., Series A	669,521*
	Fifth Third Bancorp:	
$ 2,150,000	Fifth Third Capital Trust IV, 6.50% 04/15/37	2,141,937[1][2]
	First Horizon:	
875	First Tennessee Bank, Adj. Rate Pfd., 3.75%[6], 144A****	644,492*
3	FT Real Estate Securities Company, 9.50% Pfd., 144A****	3,301,875
140,750	First Niagara Financial Group, Inc., 8.625% Pfd.	3,919,015*[1]
12,137	First Republic Bank, 6.70% Pfd.	296,416*
	Goldman Sachs Group:	
$ 4,000,000	Goldman Sachs, Capital I, 6.345% 02/15/34	3,838,664[1]
	HSBC PLC:	
$ 2,600,000	HSBC Capital Funding LP, 10.176%, 144A****	3,682,250[1][3]
172,000	HSBC Holdings PLC, 8.00% Pfd., Series 2	4,670,884**[1][3]
$ 200,000	HSBC USA Capital Trust I, 7.808% 12/15/26, 144A****	204,000
$ 275,000	HSBC USA Capital Trust II, 8.38% 05/15/27, 144A****	279,463[1]
39,109	HSBC USA, Inc., 6.50% Pfd., Series H	974,060*[1]
	ING Groep NV:	
30,000	ING Groep NV, 6.375% Pfd.	687,300**[3]
50,000	ING Groep NV, 7.05% Pfd.	1,233,625**[3]
31,425	ING Groep NV, 7.20% Pfd.	782,561**[3]
57,500	ING Groep NV, 7.375% Pfd.	1,453,600**[3]
9,078	ING Groep NV, 8.50% Pfd.	231,671**[3]

Flaherty & Crumrine Total Return Fund Incorporated

PORTFOLIO OF INVESTMENTS (Continued)

August 31, 2013 (Unaudited)

Shares/$ Par		Value
Preferred Securities (Continued)		
	Banking (Continued)	
	JPMorgan Chase:	
$ 750,000	JPMorgan Chase & Company, 6.00%, Series R	$ 716,250*
$ 6,500,000	JPMorgan Chase & Company, 7.90%, Series I	7,173,270*(1)
900	KeyCorp, 7.75% Pfd., Series A	113,288*
$ 1,000,000	Lloyds Banking Group PLC, 6.657%, 144A****	915,000**(3)
$ 2,700,000	M&T Bank Corporation, 6.875%, 144A****	2,741,453*
	Morgan Stanley:	
11,250	Morgan Stanley Capital Trust VI, 6.60% Pfd. 02/01/46	279,844
74,845	PNC Financial Services, 6.125% Pfd., Series P	1,907,238*(1)
$ 2,515,000	RaboBank Nederland, 11.00%, 144A****	3,274,610(1)(3)
	Royal Bank of Scotland:	
5,000	Royal Bank of Scotland Group PLC, 6.40%, Pfd., Series M	101,800**(3)
10,000	Royal Bank of Scotland Group PLC, 6.60%, Pfd., Series S	208,300**(3)
	Sovereign Bancorp:	
3,000	Sovereign REIT, 12.00% Pfd., Series A, 144A****	3,886,620
23,000	US Bancorp, 6.50%, Pfd.	601,595*
	Wells Fargo:	
$ 600,000	First Union Capital II, 7.95% 11/15/29	721,456(1)
3,015	Wells Fargo & Company, 7.50% Pfd., Series L	3,415,241*(1)
198,700	Wells Fargo & Company, 8.00% Pfd., Series J	5,651,326*(1)
	Zions Bancorporation:	
$ 1,500,000	Zions Bancorporation, 7.20%, Series J	1,496,250*(1)
125,000	Zions Bancorporation, 7.90% Pfd., Series F	3,470,625 *(1)
		99,189,411
	Financial Services 2.4%	
	Credit Suisse Group:	
$ 2,180,000	Claudius, Ltd. - Credit Suisse AG, 7.875%, Series B, 144A****	2,329,875(3)
$ 2,300,000	General Electric Capital Corp., 7.125%, Series A	2,539,860*(1)
	HSBC PLC:	
94,897	HSBC Finance Corporation., 6.36% Pfd., Series B	2,229,368*
		7,099,103
	Insurance 25.9%	
	Ace Ltd.:	
$ 1,550,000	Ace Capital Trust II, 9.70% 04/01/30	2,181,625(1)(2)(3)
$ 1,875,000	Aon Corporation, 8.205% 01/01/27	2,302,961
75,000	Arch Capital Group, Ltd., 6.75% Pfd., Series C	1,816,410**(1)(3)
10,000	Aspen Insurance Holdings Ltd., 5.95%, Pfd.	241,750**(3)

Flaherty & Crumrine Total Return Fund Incorporated

PORTFOLIO OF INVESTMENTS (Continued)

August 31, 2013 (Unaudited)

Shares/$ Par		Value
Preferred Securities (Continued)		
	Insurance (Continued)	
	AXA SA:	
$ 1,516,000	AXA SA, 6.379%, 144A****	$ 1,485,680**(1)(2)(3)
$ 500,000	AXA SA, 8.60% 12/15/30	593,750(3)
358,650		