FIRST OPPORTUNITY FUND INC
Form N-CSR
June 07, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM N-CSR

CERTIFIED SHAREHOLDER REPORT OF REGISTERED

MANAGEMENT INVESTMENT COMPANIES

Investment Company Act File Number:

811-04605

First Opportunity Fund, Inc.

(Exact Name of Registrant as Specified in Charter)

Fund Administrative Services

2344 Spruce Street, Suite A

Boulder, CO 80302

(Address of Principal Executive Offices)(Zip Code)

Fund Administrative Services

2344 Spruce Street, Suite A

Boulder, CO 80302

(Name and Address of Agent for Service)

Registrant s Telephone Number, including Area Code:

(303) 444-5483

Date of Fiscal Year End: March 31

Date of Reporting Period: March 31, 2012

Item 1. Reports to Stockholders.

The Report to Stockholders is attached herewith.

First Opportunity Fund, Inc. | Letter from the Advisers

March 31, 2012 (Unaudited)

Dear Stockholders:

Before delving into a discussion of the Fund s performance, I wanted to take the opportunity to quickly introduce myself. In February of this year, I joined Rocky Mountain Advisers, LLC as a portfolio manager and will work alongside Stewart Horejsi, the Fund s other portfolio manager, in managing the Fund s portfolio. Dispensing with any further formalities, let us proceed to the Fund s performance.

The equity markets remained volatile during the Fund s fiscal year as concerns related to the European sovereign debt crisis, the debt ceiling crisis and the resulting downgrade of the United States credit rating were balanced against signs of an economic recovery. While these concerns drove the markets lower in the first half of the Fund s fiscal year, optimism on the economy won out in the in the back half resulting in a rapid market rally. This rally helped First Opportunity Fund, Inc. (the Fund) reverse negative returns in the first half of the year and deliver a 1.2% return on net assets for the 12 month period ending March 31, 2012 (the Fund s fiscal year). Unfortunately, the Fund was unable to keep pace with the rebound in the S&P 500 as it generated an 8.5% return during the same period. The Fund s underperformance relative to the S&P 500 and its other benchmarks is highlighted in the below table.

	3 mos.	6 mos.	One Year	Three Years*	Five Years*	Ten Years*	Since June 2010**
FOFI (NAV)	9.0%	12.2%	1.2%	18.1%	-5.9%	6.3%	7.9%
FOFI (Market)	13.3%	16.7%	-2.8%	17.9%	-9.9%	2.7%	6.8%
S&P 500 Index	12.6%	25.9%	8.5%	23.4%	2.0%	4.1%	17.4%
DJIA	8.8%	22.7%	10.2%	23.5%	4.2%	5.0%	18.6%
NASDAQ Composite	19.0%	28.7%	12.3%	27.7%	6.0%	6.1%	20.0%

* *Annualized*

***Annualized since June 1, 2010, when the current Advisers became investment advisers to the Fund.*

The performance data quoted represents past performance. Past performance is no guarantee of future results. Fund returns include reinvested dividends and distributions, but do not reflect the reduction of taxes that a stockholder would pay on Fund distributions or the sale of Fund shares and do not reflect brokerage commissions, if any. Returns of the S&P 500 Index, the Dow Jones Industrial Average (DJIA) and the NASDAQ Composite include reinvested dividends and distributions. The investment return and the principal value of an investment will fluctuate and shares, if sold, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted.

While we are glad the Fund finished the fiscal year with a positive absolute return during such a volatile period in the markets, we are nonetheless disappointed with the underperformance relative to the Fund s benchmarks and will strive to improve the Fund s performance going forward. To accomplish this, we believe we must first understand what drove the Fund s performance during the fiscal year.

One of the primary contributors to the Fund s performance for its fiscal year was the legacy portfolio. As a refresher for our stockholders, approximately 23.3% of the Fund s assets are managed by Wellington Management Company, LLP pursuant to a sub-advisory agreement that expires in December of 2012. These assets are referred to as the legacy portfolio and consist primarily of securities in banks and thrifts. For the period, the legacy portfolio had an 8.3% return. This compares favorably with other financial stocks during this period as measured by the NASDAQ Bank Index return of 2.7% and roughly in-line with the general market as measured by the 8.5% return on the S&P 500. Upon expiration of the sub-advisory agreement, management of the legacy portfolio will transition to the Fund s co-advisers, Rocky Mountain Advisers and Stewart Investment Advisers.

Other key contributors to performance on an absolute and relative basis were the Fund s equity positions in Johnson & Johnson, Philip Morris and PPL Corp, which each generated total returns for the period of 15.2%, 40.6% and 17.3% respectively. In addition, the Fund benefitted on an absolute basis from its two largest hedge fund positions: Bay Pond Partners, L.P. (Bay Pond) and Wolf Creek Investors (Bermuda), L.P. (Wolf Creek). The position in Bay Pond accounted for roughly 17.4% of the total portfolio and generated a 2.1% return for the period. Similarly, the position in Wolf Creek accounted for roughly 16.7% of the total portfolio and generated a 1.5% return for the period. Both of these funds are focused on securities in the financial sector and performed fairly in line with the financial company focused indexes during the same period. Unfortunately, the Fund s large weight in each of these positions combined with their low returns relative to the S&P 500 for the period were key factors in the Fund s relative underperformance.

Contributing to the Fund s underperformance relative to its benchmarks and detracting from absolute return was the Fund s elevated cash position during the period. While this aided the Fund s performance in the first half of the fiscal year, it acted as a drag on returns in the back half of the year as the market rebounded. Additional positions that detracted from performance were two of the hedge fund positions: J. Caird Partners, L.P. (J.Caird) and North River Investors (Bermuda), L.P. (North River). The position in J. Caird accounted for roughly 7.2% of the total portfolio and generated a negative 1.6% return for the period. Similarly, the position in North River accounted for roughly 5.6% of the total portfolio and generated a negative 1.9% return for the period. The Fund s equity positions in Alliance Bernstein and Freeport-McMoRan Copper also negatively impacted performance for the period as each generated total returns for the period of a negative 23.4% and a negative 9.0% respectively.

However, the largest detractor to the Fund s absolute and relative performance for the period was the Fund s position in Inergy, L.P. (Inergy). Inergy is a master limited partnership (MLP) that operates retail propane and midstream businesses and owns 75.2% of the limited partner interest and all of the general partner interest and incentive distribution rights in Inergy Midstream L.P. (Ticker: NRGM). In January, Inergy s management announced it was going to cut its distribution as the current rate was unsustainable in light of the collapse in propane demand due to the abnormally warm winter and the lower than expected performance of recent acquisitions. As the market tends to value MLPs off of their distribution yield, the reaction to this announcement was unsurprisingly quite negative. The net impact was a 48.3% decline in the Fund s Inergy position for the period. Despite the obvious disappointment in the position s decline and the realization that the initial analysis proved incorrect, we resisted the temptation to quickly sell the position out of the Fund and re-evaluated the situation based on then current factors. Based on this analysis, we believed that the market s reaction to the distribution cut was overly punitive and the valuation at the time severely undervalued Inergy s retail propane and internal midstream operations, especially if there were a return to more normal winter weather conditions. On April 26th, we received the favorable announcement that Suburban Propane Partners agreed to acquire Inergy s retail propane business for a total consideration of $1.8 billion. Inergy s unit price moved higher on the news allowing for a partial recovery of the prior price decline.

Unfortunately, we do not expect to see a full recovery of our losses in the Inergy position any time soon and our decision to maintain the Fund s position after the distribution cut related price decline proved to be a pyrrhic victory. In the end, the initial analysis on Inergy proved incorrect. As much as we believe in our investment process and philosophy, it is not infallible and we recognize that we will miss on an investment from time to time (although we try to keep this at a minimum). If there is something positive to take out of this whole episode, it is that we maintained our investment discipline. It would have been very easy to react out of disappointment in the distribution cut, in the initial analysis, in Inergy s management and the loss to the Fund and quickly sell the position when the distribution cut was announced. We then could have only given it a perfunctory mention in this letter and have moved on without giving it additional thought. However, this is not how we operate. Instead, we recognized our mistake, adjusted our analysis to the prevailing conditions and made an informed decision to hold the position. Fortunately, this decision was vindicated quicker than we expected and in a manner we did not anticipate.

It is precisely because of this discipline and the commitment to its core investment philosophy that I decided to join Rocky Mountain Advisers, LLC in February of this year. This investment philosophy is built on the core principals to, first and foremost, protect our stockholders principal investment and to generate superior returns over the long run by investing in good companies at attractive valuations. It is a philosophy that is elegant in its simplicity, but difficult in its execution due to the required temperament of patience and the ability to separate out emotion from an investment decision. When combined with rigorous fundamental research analysis steeped in value investing principals, we believe it to be the most effective investment strategy there is when correctly executed. I believe we can effectively execute this strategy, but I do not expect you to simply take me at my word. This is why another core aspect of our investment philosophy is to invest alongside our stockholders as Stewart Horejsi s family is already a fellow stockholder and I will be as soon as practicable. We hope this serves as an effective demonstration of our belief in and our ability to execute upon our investment philosophy.

I look forward to writing you again in six months and wish you a safe and happy summer.

Sincerely,

Brendon Fischer, CFA

Portfolio Manager

The views and opinions in the preceding commentary are subject to change. This material represents an assessment of the market environment at a specific point in time, should not be relied upon as investment advice and is not intended to predict or depict performance of any investment.

Portfolio weightings and other figures in the foregoing commentary are provided as of period-end, unless otherwise stated.

Note to Stockholders on Investments in Hedge Funds: The Fund s investment advisers feel it is important that stockholders be aware that the Fund has highly concentrated positions in certain hedge funds and may take concentrated positions in other securities. Concentrating investments in a fewer number of securities (including investments in hedge funds) may involve a degree of risk that is greater than a fund which has less concentrated investments spread out over a greater number of securities. For example, the value of the Fund s net assets will fluctuate significantly based on the fluctuation in the value of the hedge funds in which it invests. In addition, investments in hedge funds can be highly volatile and may subject investors to heightened risk and higher operating expenses than another closed-end fund with a different investment focus.

Note to Stockholders on the Fund s Discount. As most stockholders are aware, the Fund s shares presently trade at a significant discount to net asset value. The Fund s board of directors is aware of this, monitors the discount and periodically reviews the options available to mitigate the discount. In addition, there are several factors affecting the Fund s discount over which the board and management have little control. In the end, the market sets the Fund s share price. The Fund s investment objective, its current long exposure in the legacy portfolio of financial sector stocks and the fact that it is not traded on a national exchange are likely factors that exacerbate the discount beyond other general equity closed-end investment companies. For long-term stockholders of a closed-end fund, we believe the Fund s discount should only be one of many factors taken into consideration at the time of your investment decision.

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	Per Share of Common Stock		
	Net Asset Value	Market Price	Dividend Paid
3/31/11	$ 9.19	$ 7.25	$ 0.00
4/30/11	9.28	7.38	0.00
5/31/11	9.16	7.19	0.00
6/30/11	8.99	7.20	0.00
7/31/11	8.97	6.84	0.00
8/31/11	8.79	6.55	0.00
9/30/11	8.29	6.04	0.00
10/31/11	8.64	6.25	0.00
11/30/11	8.51	6.21	0.00
12/31/11	8.53	6.22	0.00
1/31/12	8.87	6.51	0.00
2/29/12	9.16	6.71	0.00
3/31/12	9.30	7.05	0.00

Investments as a % of Net Assets

Consolidated Portfolio of Investments | First Opportunity Fund, Inc.
March 31, 2012

Shares	Description	Value (Note 2)
LONG TERM INVESTMENTS (87.9%)		
DOMESTIC COMMON STOCKS (33.0%)		
Banks (0.2%)		
51,965	BBCN Bancorp, Inc.*	$578,370
Banks & Thrifts (9.9%)		
41,290	Alliance Bankshares Corp.*	167,637
27,800	American River Bankshares*	219,620
8,439	Ameris Bancorp*	110,888
406,400	AmeriServ Financial, Inc.*	1,064,768
30,289	Bank of Commerce Holdings	133,877
45,500	Bank of Virginia*	45,491
42,700	BCB Bancorp, Inc.	426,787
28,000	Bridge Capital Holdings*	376,880
35,498	Carolina Trust Bank*	73,481
340,815	CCF Holding Co.*(a)	85,204
43,644	Central Valley Community Bancorp*	316,419
18,860	Centrue Financial Corp.*	9,996
12,300	Citizens & Northern Corp.	246,000
60,000	Community Bank*(b)(c)(d)	6,348,600
54,100	The Connecticut Bank & Trust Co.*	457,145
65,566	Eastern Virginia Bankshares, Inc.*	236,693
4,085	Evans Bancorp, Inc.	58,416
97,200	FC Holdings, Inc.*(b)(c)(d)	
4,300	First Advantage Bancorp	56,717
39,700	First American International*(b)(c)(d)	724,922
61,678	First California Financial Group, Inc.*	359,583
14,421	First Security Group, Inc.*	43,407
66,726	First Southern Bancorp, Inc. - Class B*	600,534
193,261	Florida Capital Group*(b)(c)(d)	32,854
8,211	FNB Bancorp	118,649
155,800	Great Florida Bank - Class A*	62,320
15,300	Great Florida Bank - Class B*	6,885
61,000	Greater Hudson Bank N.A.*	283,650
179,500	Hampshire First Bank*(a)	2,683,525
8,500	Heritage Financial Corp.	115,600
199,918	Heritage Oaks Bancorp*	1,017,583
36,900	ICB Financial*	147,600
2,323	Katahdin Bankshares Corp.	28,573
126,100	Metro Bancorp, Inc.*	1,474,109
905,600	National Bancshares, Inc.*(b)(c)(d)	81,504
14,900	New England Bancshares, Inc.	155,556
4,000	North Dallas Bank & Trust Co.(d)	233,080
30,400	Oak Ridge Financial Services, Inc.*	112,480
1,900	Old Point Financial Corp.	21,185

First Opportunity Fund, Inc. Consolidated Portfolio of Investments
March 31, 2012

Shares	Description	Value (Note 2)
Banks & Thrifts (continued)		
44,800	OmniAmerican Bancorp, Inc.*	$867,328
12,000	Pacific Continental Corp.	113,040
162,590	Pilot Bancshares, Inc.*	325,180
190,540	Republic First Bancorp, Inc.*	449,674
4,500	Shore Bancshares, Inc.	31,905
83,814	Southern First Bancshares, Inc.*	569,935
79,900	Southern National Bancorp of Virginia, Inc.	519,350
302,900	Square 1 Financial, Inc.*(b)(c)(d)	1,723,501
41,122	Valley Commerce Bancorp*	390,659
57,400	Wells Fargo & Co.	1,959,636
226,000	Western Liberty Bancorp*	648,620
12,404	Xenith Bankshares, Inc.*	52,593
		26,389,639
Coal (0.5%)		
10,000	Alliance Resource Partners, LP	601,000
40,000	Penn Virginia Resource Partners, LP	873,200
		1,474,200
Diversified Financial Services (1.6%)		
16,241	Affinity Financial Corp.*(b)(c)(d)	
79,000	AllianceBernstein Holding, LP	1,233,190
276,300	Highland Financial Partners, LP*(b)(d)(e)	
60,000	Independence Financial Group, Inc.*(b)(c)(d)	370,800
70,215	Mackinac Financial Corp.*	491,505
455,100	Ocwen Structured Investments, LLC*(b)(c)(d)	341,325
25,000	South Street Securities Holdings, Inc.*(b)(d)(e)	684,750
47,960	Tiptree Financial*(b)(d)(e)	1,167,346
		4,288,916
Electric (1.2%)		
80,000	PPL Corp.	2,260,800
16,800	Public Service Enterprise Group, Inc.	514,248
12,400	SCANA Corp.	565,564
		3,340,612
Environmental Control (0.3%)		
30,000		