FLAHERTY & CRUMRINE TOTAL RETURN FUND INC
Form N-CSRS
July 29, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM N-CSR

CERTIFIED SHAREHOLDER REPORT OF REGISTERED MANAGEMENT

INVESTMENT COMPANIES

Investment Company Act file number 811-21380

Flaherty & Crumrine Total Return Fund Incorporated

(Exact name of registrant as specified in charter)

301 E. Colorado Boulevard, Suite 720

Pasadena, CA 91101

(Address of principal executive offices) (Zip code)

R. Eric Chadwick

Flaherty & Crumrine Incorporated

301 E. Colorado Boulevard, Suite 720

Pasadena, CA 91101

(Name and address of agent for service)

Registrant s telephone number, including area code: 626-795-7300

Date of fiscal year end: November 30

Date of reporting period: May 31, 2016

Form N-CSR is to be used by management investment companies to file reports with the Commission not later than 10 days after the transmission to stockholders of any report that is required to be transmitted to stockholders under Rule 30e-1 under the Investment Company Act of 1940 (17 CFR 270.30e-1). The Commission may use the information provided on Form N-CSR in its regulatory, disclosure review, inspection, and policymaking roles.

A registrant is required to disclose the information specified by Form N-CSR, and the Commission will make this information public. A registrant is not required to respond to the collection of information contained in Form N-CSR unless the Form displays a currently valid Office of Management and Budget (OMB) control number. Please direct comments concerning the accuracy of the information collection burden estimate and any suggestions for reducing the burden to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549. The OMB has reviewed this collection of information under the clearance requirements of 44 U.S.C. § 3507.

Item 1. Reports to Stockholders.

The Report to Shareholders is attached herewith.

FLAHERTY & CRUMRINE TOTAL RETURN FUND

To the Shareholders of Flaherty & Crumrine Total Return Fund (FLC):

What a difference a quarter makes. After beginning the fiscal year with weak performance, the preferred market recovered in remarkable fashion during the second fiscal quarter.[1] To be fair, recovery was a story for many markets during this period, but preferreds more than held their own in comparison. Total return[2] on net asset value (NAV) was 6.8% for the quarter and 4.0% for the first half of the fiscal year. Total return on market price of Fund shares over the same periods was 7.1% and 12.4%, respectively.

The table below shows Fund returns over various measurement periods, and they continue to be very good. The table includes performance of two indices, Barclays U.S. Aggregate and S&P 500, as proxies for bond and stock markets, respectively. While neither is a benchmark for Fund performance, they provide context for returns on broad asset categories.

TOTAL RETURN ON NET ASSET VALUE

FOR PERIODS ENDED MAY 31, 2016

	Actual Returns			**Average Annualized Returns**			
	Three Months	**Six Months**	**One Year**	**Three Years**	**Five Years**	**Ten Years**	**Life of Fund(1)**
Flaherty & Crumrine Total Return Fund	6.8%	4.0%	5.6%	8.0%	11.1%	9.1%	8.2%
Barclays U.S. Aggregate Index(2)	1.3%	3.1%	3.0%	2.9%	3.3%	5.0%	4.6%
S&P 500 Index(3)	9.1%	1.9%	1.7%	11.0%	11.7%	7.4%	8.2%

(1) Since inception on August 26, 2003.
(2) The Barclays U.S. Aggregate Index is an unmanaged index considered representative of the U.S. investment grade, fixed-rate bond market.
(3) The S&P 500 Index is a capitalization-weighted index of 500 common stocks. The index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

Current performance may be lower or higher than the quoted past performance, which cannot guarantee future results. In addition, NAV performance will vary from market price performance, and you may have a taxable gain or loss when you sell your shares.

Investors breathed a sigh of relief in the second fiscal quarter as earlier concerns eased. Commodity prices, such as oil and metals, not only halted their rapid declines, but in several instances rebounded to levels more than 150% above recent lows. Higher common stock prices of oil and other commodity companies, along with the stocks of banks that lend to these sectors, helped improve market sentiment broadly.

The preferred market also benefited from positive technical developments, with a marked increase in issuers redeeming securities. Issuer redemptions ($15.9 billion announced during the second fiscal quarter), combined with measured new-issue supply, provided support to prices as redemption proceeds were reinvested. Many recent redemptions were long overdue from an economic standpoint (because the

[1] March 1, 2016 May 31, 2016
[2] Following the methodology required by the Securities and Exchange Commission, total return assumes dividend reinvestment.

securities had high coupons), but issuers delayed those calls primarily due to complicated rules around regulatory capital treatment of these securities. We expect issuers to call similar legacy securities over the next several years.

Monetary policy globally appears to be in a holding pattern, albeit still at very accommodative levels. After raising its benchmark interest rate in December 2015, the Federal Reserve has continued to wait on its next rate increase. The European Union (EU) and Japan have not expanded programs in the last quarter. However, the United Kingdom s recent vote to exit the EU (so-called Brexit) may prompt easier monetary policy in the UK and possibly an increase in or extension of the European Central Bank s asset purchase program going forward.

The U.S. economy continues to be a ray of sunshine compared to most others (even if growth is still below historical norms), and it remains to be seen how long the Federal Reserve will wait on its next rate increase. Prior to Brexit, at least one rate hike seemed probable this year, perhaps beginning as soon as July. However, with both domestic and global economic uncertainty on the rise, the Fed is expected to keep monetary policy on hold until at least September and perhaps into 2017.

Taking a step back from what has been a volatile market this year, the fundamentally positive case for preferred securities remains largely unchanged. Investors around the world are searching for yield as interest rates remain low. Credit quality continues to be strong, and modest economic growth should restrain companies and households from over-borrowing despite low rates. New issue supply has been and should remain measured for preferred stocks, with a bias towards non-U.S. issuers going forward. Regulatory trends continue to bolster credit-worthiness at financial companies, which are the largest issuers of preferred securities. As we have said before, the ride may be bumpy as markets traverse much uncharted territory but we believe total returns will continue to be competitive over time for preferred investors.

In the discussion topics that follow, we dig deeper into subjects mentioned here as well as others of interest to shareholders. In addition, we encourage you to visit the Fund s website, www.preferredincome.com, for timely and important information.

Sincerely,

The Flaherty & Crumrine Portfolio Management Team

June 30, 2016

DISCUSSION TOPICS

(Unaudited)

The Fund s Portfolio Results and Components of Total Return on NAV

The table below presents a breakdown of the components that comprise the Fund s total return on NAV over both the recent six months and over the Fund s fiscal year. These components include: (a) the total return on the Fund s portfolio of securities; (b) any returns from hedging the portfolio against significant increases in long-term interest rates; (c) the impact of utilizing leverage to enhance returns to shareholders; and (d) the Fund s operating expenses. When all of these components are added together, they comprise the total return on NAV.

Components of FLC s Total Return on NAV

for the Six Months Ended May 31, 2016[1]

Total Return on Unleveraged Securities Portfolio (including principal change and income)	3.3%
Return from Interest Rate Hedging Strategy	N/A
Impact of Leverage (including leverage expense)	1.4%
Expenses (excluding leverage expense)	-0.7%
Total Return on NAV	**4.0%**

[1] Actual, not annualized.

For the six months ended May 31, 2016, the BofA Merrill Lynch 8% Constrained Core West Preferred & Jr Subordinated Securities Index^{SM} (P8JC)[2] returned 3.3%. This index reflects the various segments of the preferred securities market constituting the Fund s primary focus. Since this index return excludes all expenses and the impact of leverage, it compares most directly to the top line in the Fund s performance table above (Total Return on Unleveraged Securities Portfolio).

Total Return on Market Price of Fund Shares

While our focus is primarily on managing the Fund s investment portfolio, our shareholders actual return is comprised of the Fund s monthly dividend payments *plus* changes in the *market price* of Fund shares. During the six-month period ending May 31, 2016, total return on market price of Fund shares was 12.4%.

Historically, the preferred securities market has experienced price volatility consistent with those of other fixed-income securities. However, since mid-2007 it has become clear that preferred-security valuations, including both the Fund s NAV and the market price of its shares, can move dramatically when there is volatility in financial markets. The chart on top of page 4 contrasts the relative stability of the Fund s earlier period with the more recent volatility in both its NAV and market price. Many fixed-income asset classes experienced increased volatility over this period.

[2] The BofA Merrill Lynch 8% Constrained Core West Preferred & Jr Subordinated Securities Index^{SM} (P8JC) includes U.S. dollar-denominated investment-grade or below investment-grade, fixed rate, floating rate or fixed-to-floating rate, retail or institutionally structured preferred securities of U.S. and foreign issuers with issuer concentration capped at 8%. All index returns include interest and dividend income, and, unlike the Fund s returns, are unmanaged and do not reflect any expenses.

In a more perfect world, the market price of Fund shares and its NAV, as shown in the above chart, would track more closely. If so, any premium or discount (calculated as the difference between these two inputs and expressed as a percentage) would remain relatively close to zero. However, as can be seen in the chart below, this often has not been the case.

Although divergence between NAV and market price of a closed-end fund is generally driven by supply/demand imbalances affecting its market price, we can only speculate about why the relationship between the Fund s market price and NAV hasn t been closer.

Based on a closing price of $21.91 on June 30th and assuming its current monthly distribution of $0.136 does not change, the current annualized yield on market price of Fund shares is 7.4%. In our opinion, this distribution rate measures up favorably with most comparable fixed-income investment opportunities. Of course, there can be no guarantee that the Fund s dividend will not change based on market conditions.

U.S. Economic and Credit Outlook

The U.S. economy got off to a slow start in 2016, posting growth in inflation-adjusted gross domestic product (real GDP) of just 0.8% in the first quarter. Second quarter growth looks considerably better, with economists real GDP estimates currently around 2.5% for the rest of 2016. That would leave overall growth of about 2% in 2016, in-line with the average pace since 2010.

Employment growth slowed significantly so far in the second quarter, from an average of 196,000 nonfarm payroll jobs per month in the first quarter to an average of just 76,000 jobs per month in April and May. (June data was not available at the time of writing.) We think this will prove to be a lagged response to Q1 developments, when jobs grew faster than the economy, and we expect employment to pick up again along with better growth. Consistent with gradual labor market tightening, wage growth remained solid, up 2.5% over 12 months ending in May.

Sector performance of the U.S. economy is mixed. On the positive side, consumer spending and housing remain strong, supported by rising income, improved household balance sheets, low interest rates and in the case of housing pent-up demand from years following the housing bust. Government spending is growing slowly. On the negative side, business investment is still feeling the impacts of an energy boom turned bust and shrinking exports. However, cutbacks to energy investment appear mostly done, and oil and gas prices are up from recent lows; those headwinds are diminishing. A wider trade deficit in response to weaker global growth and a sharp rally in the U.S. dollar also slowed U.S. domestic economic growth. While the dollar retreated somewhat prior to Britain s vote to leave the European Union (Brexit), it has rallied again, perhaps setting the stage for greater trade drag ahead. On balance, we expect real GDP growth in the U.S. will continue around its recent 2% average pace.

Core inflation has edged up, but headline inflation remains subdued and well below the Federal Reserve s 2% target. The overall personal consumption expenditure (PCE) deflator was up 0.9% over 12 months ending in May (latest data available); excluding food and energy, the core PCE deflator was up 1.6% over the same period, compared to 1.3% in December 2015. Rising wages and slow productivity growth are encouraging businesses to raise prices, and rising personal income is helping those higher prices stick. If energy prices stabilize or move up further, headline inflation should gradually catch up to core inflation.

Faced with slow first-quarter growth, inflation that remains below target, and uncertainty over employment, the Federal Reserve left monetary policy unchanged in the second quarter. It s likely to do the same at the next Federal Open Market Committee (FOMC) meeting in late July, partly because June s employment data would have to be exceptionally strong to erase doubts raised by weakness in April and May payrolls and partly because Brexit introduces economic uncertainty that might slow U.S. growth for a time. (It s highly likely to slow growth in the UK and Europe.) If global markets are not too unsettled by Brexit, another rate hike is possible at the FOMC s September meeting, by which time it should be clear whether recent weakness in job growth was an outlier or not.

If that outlook is correct, we expect the Fed will hike rates by 0.25% in September. In turn, long-term interest rates should move higher as well, but probably less than short-term rates, since markets already anticipate some Fed tightening. However, uncertainty surrounding the presidential election, Brexit and weaker economic growth abroad, or any number of unforeseen shocks could push the next tightening to December or even into 2017. Forecasting Fed actions is always difficult business, never more so than now.

Fortunately, the credit outlook is a bit less murky, if somewhat mixed. Corporate profits fell in the first quarter (latest data available), and speculative-grade nonfinancial corporate borrowers are experiencing rising rates of default and delinquency. Banks commercial and industrial loan portfolios are feeling some of that strain, and problem loans have risen there. However, most other loan portfolios are seeing stable or improving performance. Moreover, banks are building capital and liquidity, and their credit profiles generally continue to improve. That s good news for the preferred market, and we remain comfortable with the Fund s credit exposures.

This combination of modest economic growth, low interest rates and solid credit conditions provide a good foundation for preferred securities. Although shifting sentiment may make for a bumpy ride occasionally, we think preferred securities should continue to offer good risk-adjusted returns to investors, despite current uncertainties.

Flaherty & Crumrine Total Return Fund Incorporated

PORTFOLIO OVERVIEW

May 31, 2016 (Unaudited)

Fund Statistics	
Net Asset Value	$ 20.33
Market Price	$ 20.95
Premium	3.05%
Yield on Market Price	7.79%
Common Stock Shares Outstanding	9,916,405

Moody s Ratings*	**% of Net Assets**
A	1.1%
BBB	67.8%
BB	21.7%
Below BB	1.0%
Not Rated**	6.7%
Below Investment Grade***	21.2%

* Ratings are from Moody s Investors Service, Inc. Not Rated securities are those with no ratings available from Moody s.
** 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	5.4%
JPMorgan Chase	4.9%
HSBC PLC	4.9%
Wells Fargo & Company	4.2%
MetLife	4.2%
Fifth Third Bancorp	4.0%
PNC Financial Services Group	3.8%
M&T Bank Corporation	3.7%
Citigroup	3.4%
Axis Capital Holdings Ltd	2.9%

% of Net Assets****

Holdings Generating Qualified Dividend Income (QDI) for Individuals	61%
Holdings Generating Income Eligible for the Corporate Dividends Received Deduction (DRD)	47%

**** 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.

Flaherty & Crumrine Total Return Fund Incorporated

PORTFOLIO OF INVESTMENTS

May 31, 2016 (Unaudited)

Shares/$ Par		Value
Preferred Securities 93.1%		
	Banking 50.9%	
6,700	Astoria Financial Corp., 6.50%, Series C	$ 177,031*
$ 5,530,000	Bank of America Corporation, 8.00%, Series K	5,550,738*(1)
	Barclays Bank PLC:	
81,750	7.10%, Series 3	2,110,785**(3)
8,800	7.75%, Series 4	219,912**(3)
121,112	8.125%, Series 5	3,154,968**(1)(3)
	BNP Paribas:	
$ 5,100,000	7.375%, 144A****	5,093,625**(3)
$ 2,000,000	7.625%, 144A****	2,062,500**(3)
	Capital One Financial Corporation:	
15,436	6.20%, Series F	409,054*
31,100	6.70%, Series D	862,481*
	Citigroup, Inc.:	
214,568	6.875%, Series K	5,980,547*(1)
155,338	7.125%, Series J	4,460,142*(1)
	CoBank ACB:	
15,300	6.125%, Series G, 144A****	1,513,744*
10,000	6.20%, Series H, 144A****	1,011,250*
25,000	6.25%, Series F, 144A****	2,586,720*(1)
$ 609,000	6.25%, Series I, 144A****	631,996*
$ 10,000,000	Colonial BancGroup, 7.114%, 144A****	15,000(4)(5)
11,817	Cullen/Frost Bankers, Inc., 5.375%, Series A	303,254*
392,925	Fifth Third Bancorp, 6.625%, Series I	12,177,728*(1)
	First Horizon National Corporation:	
875	First Tennessee Bank, Adj. Rate, 3.75%(6), 144A****	587,535*
3	FT Real Estate Securities Company, 9.50%, 144A****	3,907,500
140,750	First Niagara Financial Group, Inc., 8.625%, Series B	3,716,152*(1)
24,645	First Republic Bank, 6.70%, Series A	646,746*
	Goldman Sachs Group:	
$ 390,000	5.70%, Series L	389,025*
60,000	6.375%, Series K	1,661,400*(1)
	HSBC PLC:	
$ 1,400,000	HSBC Capital Funding LP, 10.176%, 144A****	2,047,500(1)(2)(3)
$ 750,000	HSBC Holdings PLC, 6.875%	757,500**(3)
189,000	HSBC Holdings PLC, 8.00%, Series 2	4,944,713**(1)(3)
154,391	HSBC USA, Inc., 6.50%, Series H	3,923,461*
110,000	Huntington Bancshares, Inc., 6.25%, Series D	2,884,475*(1)

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

Flaherty & Crumrine Total Return Fund Incorporated

PORTFOLIO OF INVESTMENTS (Continued)

May 31, 2016 (Unaudited)

Shares/$ Par		Value
Preferred Securities (Continued)		
	Banking (Continued)	
	ING Groep NV:	
30,000	6.375%	$ 774,300**[3]
50,000	7.05%	1,321,125**[3]
31,425	7.20%	830,641**[3]
	JPMorgan Chase & Company:	
$ 750,000	6.00%, Series R	776,018*[1]
61,469	6.70%, Series T	1,711,297*[1]
$ 4,791,000	6.75%, Series S	5,323,999*[1]
$ 7,000,000	7.90%, Series I	7,166,250*[1]
	M&T Bank Corporation:	
$ 3,500,000	6.450%, Series E	3,797,500*[1]
$ 7,648,000	6.875%, Series D, 144A****	7,676,680*[1]
	Morgan Stanley:	
85,000	6.875%, Series F	2,400,400*[1]
86,900	7.125%, Series E	2,598,527*[1]
	PNC Financial Services Group, Inc.:	
270,195		