SPECIAL OPPORTUNITIES FUND, INC.
Form N-CSR
March 09, 2012

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 811-07528

Special Opportunities Fund, Inc.
(Exact name of registrant as specified in charter)

615 East Michigan Street
Milwaukee, WI 53202
(Address of principal executive offices) (Zip code)

Andrew Dakos
Brooklyn Capital Management, LLC
Park 80 West
250 Pehle Avenue, Suite 708
Saddle Brook, NJ 10570
(Name and address of agent for service)

Copy to:
Thomas R. Westle, Esp.
Blank Rome LLP
The Chrysler Building
405 Lexington Avenue
New York, NY 10174

1-877-607-0414
Registrant's telephone number, including area code

Date of fiscal year end: 12/31/2011

Date of reporting period: 1/1/2011-12/31/2011

Item 1. Reports to Stockholders.

Special Opportunities Fund, Inc.
Annual Report
For the year ended
December 31, 2011

Special Opportunities Fund, Inc.–

February 11, 2012

Dear Fellow Shareholders:

In 2011 the stock market was about as volatile as in any year we can recall. Big daily moves, both up and down, were frequent. The Fund's net asset value was off 4.99% in the second half of the year vs. -3.69% for the S&P 500 Index. In the end, the market was little changed in 2011. For the year, the Fund posted a modest NAV gain of 0.85% (assuming reinvested dividends), slightly less than the S&P 500 Index which rose 2.11%.

Although Special Opportunities Fund is not intended to be market neutral, we are risk averse. Consequently, in the third quarter when the market hit its lows, the Fund was well ahead of the S&P 500 Index. Given its heavy weighting in special purpose acquisition companies (SPACs), auction rate preferred stock (ARPs) issued by closed-end funds, bankruptcy claims, and other investments that are not highly correlated with the stock market, we think our performance in 2011 was pretty good.

We believe that preserving capital in down markets is more important to generating superior long term results than beating the market when the wind is at our back. Until we find a reliable crystal ball, we will continue to treat the market as an unpredictable beast. As always, our focus is on investing where we think we have an edge and using activism when necessary to try to unlock the value of our investments. The following discussion of a few of our investments should give you some insight into how we try to meet the Fund's objective of generating solid total returns over time without incurring inordinate risk.

Gyrodyne Corporation of America (GYRO)

In June 2010, a trial court awarded GYRO about $70 per share (based upon the current share count) plus 9% statutory interest for property that New York State appropriated in 2005. After the decision was issued, GYRO's stock price quickly moved from the upper $30's to more than $70 per share. Even though most savvy investors fully expected the state to appeal, the euphoria faded after the appeal was actually filed. Despite no change in the status of the case, by mid-summer last year GYRO's stock price had drifted down to the $60's. It then fell into the $50's when a rights offering at $53 per share was announced. The rights offering was designed to raise cash to maintain GYRO's remaining rental properties. We added to our position via the rights offering which concluded on September 22, 2011.

The state's case for overturning the award appeared weak. In the trial, the state argued that GYRO's property could never be used for residential use and that it should be given a much lower valuation based upon light industrial zoning. The trial court disagreed. It ruled that residential use was feasible and yielded the highest valuation. Having failed to present any evidence relating to the property's value for residential use, the state asked the appellate court to order a second trial to allow it to present such evidence.

Oral argument in the appellate court took place on October 24th. The following week the stock price moved from $61 to $79 on heavy volume, indicating optimism that the appeal would fail. That optimism proved to be correct. On November 23rd, the appellate court unanimously upheld the lower court's ruling. Since then, the stock price has been hovering around $100 per share. In late December the state filed a petition for a further appeal to the Court of Appeals, the state's highest court. Nevertheless, we think the risk-reward ratio is attractive at current levels because the appellate court's decision was unanimous although there is a slim possibility that the judges of the Court of Appeals could be influenced by New York's dire fiscal condition.

With most of the uncertainty removed, this investment has little downside risk in our opinion. If, as we expect, the Court of Appeals declines to review the case, we would expect the state to make payment of about $106 per share (including interest) shortly thereafter. Until it does, interest accrues at about 70 cents per share per month. As a REIT, Gyrodyne will have to distribute the accrued interest of about $40 per share to avoid double taxation. Management has also publicly committed to pursue a liquidity event. Therefore, we would expect a merger or sale of the company to yield another $75 to $85 per share in 2012 or 2013.

TS&W/Claymore Tax-Advantage Balanced Fund (TYW)

This hybrid fund's objective was total return and current income through investment in municipal and equity securities. We accumulated a sizeable position at a discount to NAV after another activist investor conducted an aggressive proxy contest in 2010. A majority of the shares were voted for the activist's slate of directors but a quorum was not achieved so the incumbent directors retained control. Nevertheless, the writing was on the wall. On April 15, 2011, TYW announced that it would open-end, which we felt was inevitable. We continued to opportunistically accumulate shares of this low beta fund right up until it ceased trading on December 30, 2011. TYW open-ended on January 17, 2012 and we redeemed all of our shares at NAV. This was a very successful relatively low risk investment.

SunAmerica Asset Management Funds (FGF and FGI)

In 2009 these sister funds traded at discounts in excess of 15%. In order to forestall a proxy contest, management agreed to conduct an in-kind tender offer for 30% and 25% respectively of the outstanding shares at 98.5% of NAV. The tender offers were completed in November 2010. Faced with continuing shareholder unrest over their persistent discounts, the board of each fund announced that it intended to convert it to an open-end fund redeemable at NAV less a 1% charge in late January 2012. We continued to opportunistically add to our positions at discounts slightly wider than 1%. Both funds became eligible for redemption on January 24th and we are now completely out of them. All in all, these were two very successful investments.

Liberty All-Star Growth Fund (ASG) and Liberty All-Star Equity Fund (USA)

These are well diversified multi-manager equity funds. ASG currently trades at about a 10% discount and USA at about a 13% discount. In late July 2011, the funds announced that shareholders would vote on September 30, 2011 to approve a new management agreement due to a change of control of the funds' manager. That vote passed but only because the new manager paid a premium to buy a significant number of shares from a large shareholder. To mollify shareholders that were miffed about what they perceived to be "greenmail," we think there is a good chance that management will initiate a value enhancing liquidity event in 2012. If that does not happen, the Fund may participate in a proxy fight. In any event, these two funds allow us to get broad market exposure at a discount to NAV while we wait.

The New Ireland Fund (IRL)

IRL is a relatively small ($53 million in NAV) closed-end fund whose shares usually trade within a discount range of 9% to 14%. Special Opportunities Fund is part of a group that currently owns almost 13% of IRL's outstanding shares. Last year, we met with IRL's management to discuss measures to enhance shareholder value. Since then, the board hired a consultant "to prepare an analysis of discount-narrowing measures, which may be appropriate for the Fund." We are hopeful for an outcome beneficial to the Fund and all IRL shareholders sometime in 2012.

Auction Rate Preferred Shares

Over the last two years, we purchased a significant amount of ARPs issued by closed-end funds at 80 to 85% of face value. These securities are extremely safe but have become very hard to sell since the auction market collapsed in early 2008. However, because the Investment Company Act of 1940 requires that two directors be elected by the preferred shareholders as a class, we perceived a chance to use our activist approach to investing to unlock their intrinsic value. Due largely to our proactive approach, we have had favorable developments recently with respect to our three largest ARPs positions.

- Blackrock New York Municipal Bond Trust (BQH) – Special Opportunities Fund was a member of a group that purchased 22% of the ARPs at about 85% of face value. Blackrock had previously made some efforts to redeem the ARPs issued by many of its closed-end funds. Progress then slowed. When Blackrock refused to allow us to nominate a director to represent the preferred shareholders, we sued the BQH board in Delaware Chancery Court. Two months later, we reached a settlement in which Blackrock committed to nominate a candidate of our choice to the board in 2012 if the ARPs have not been redeemed. In October 2011, all of our ARPs were redeemed.

Special Opportunities Fund, Inc.

- Federated Premier Intermediate Municipal Income Fund (FPT) – We nominated a director who would commit to explore measures to provide liquidity for the holders of ARPs. In December 2011, FPT conducted a self-tender offer for up to 100% of its ARPs at 96% of their liquidation value. We tendered our shares and booked a nice profit.

- Invesco Quality Municipal Investment Trust (IQT) – As with FPT, we nominated a director and entered into discussions with management about providing liquidity for holders of the ARPs. We then agreed to withdraw our nomination because we felt management was acting in good faith to address the problem. On December 7, 2011, IQT announced that it would redeem a portion of its outstanding ARPs in the first quarter of 2012 at their liquidation value. That redemption recently took place. We are optimistic that all of our ARPs will ultimately be redeemed.

Diamond Hill Financial Trends Fund (DHFT)

This is a good illustration of how we seek to execute our opportunistic activist investment philosophy. DHFT is a small $40 million closed-end fund that invests in the securities of financial services companies. Its top five holdings, Wells Fargo, JP Morgan, Assured Guarantee, U.S. Bancorp and PNC — represent almost 30% of its net asset value.

DHFT began its existence in 1989 as the Southeastern Thrift and Bank Fund. Its name was later changed to John Hancock Financial Trends Fund. In September 2007, Diamond Hill replaced John Hancock as the manager and the name changed again. While the discount for DHFT has often been wide, we avoided making an investment because of a quirk in its corporate governance. Unlike most closed-end funds, DHFT's shares were listed on NASDAQ which did not require closed-end funds to hold an annual meeting. And, to the best of our knowledge, DHFT never held one. Therefore, it would have been very difficult to bring sufficient pressure to bear on management and the board to take measures to address the discount.

Finally, in 2011, NASDAQ changed its rules and now requires all listed companies to hold an annual shareholder meeting. With that impediment removed, we began to rapidly accumulate shares at about a 15% discount late in the third quarter. We became even more aggressive just before we had to make a public filing with the result that our filing group now owns almost 15% of DHFT's shares. The current discount is about 10%. We have contacted management and the board to discuss the discount and we are optimistic that they will be responsive. If that does not happen, we have several options to press our case, given the fund's small size.

SPACs

SPACs or blank check companies make up a large portion of our portfolio. These misunderstood investments are probably the safest equity investments around because the money raised in the IPO is held in a trust account. In addition, there is upside potential via the “free” warrants we receive in the IPO. We think we can earn an average of between 5% and 15% per annum on our entire portfolio of SPACs with virtually no risk to our principal. Thus far, there has been little news from the latest batch of SPACs. However, a number of them are slated to terminate in 2012 unless they consummate a transaction so we expect to see some announcements of proposed transactions in the first half of this year.

New Opportunities

The pipeline for future alpha generating investments is robust. The Fund has been accumulating stock in several closed-end funds that are trading at double-digit discounts and are good targets for activism because their performance has been very poor. It takes time to accumulate a large enough position to begin a campaign to unlock value but we hope to pick up the pace after completion of the planned rights offering. As yet, we have not publicly disclosed any of these potential targets but we are confident that some or all of them will ultimately provide the Fund with true alpha, i.e., unleveraged risk-adjusted outperformance.

In addition, we have been building a position in one operating company that is trading at a significant discount to cash and has recently taken steps to maximize shareholder value. Finally, we, along with our affiliates, have accumulated a meaningful stake in a financial company that is trading for less than half of its intrinsic value due to potential legal problems. We have met with management and feel that the problems can be resolved over time and that the depressed stock price more than compensates for them. We expect to “go public” on both of these investments eventually and will likely have more to say about them in future letters.

In conclusion, we do not believe there is a holy grail of investment success. Nothing works all the time. To us, investing is like running a marathon. In both cases, it is important to have a long term plan that is unlikely to lead to catastrophic losses when things go wrong from time to time, as inevitably happens. Our long term strategy is to stay within striking distance of the market when it moves up and to pass it when it falters. By avoiding market calls and investment fads, and by executing our value activist strategy in a disciplined fashion, we will try hard to provide shareholders of Special Opportunities Fund with superior long term risk-adjusted performance.

Sincerely yours,

Phillip Goldstein
Chairman

Special Opportunities Fund, Inc.

Performance at a glance (unaudited)

Average annual total returns for common stock for the periods ended 12/31/11

Net asset value returns	1 year	Since 1/25/10	5 years*	10 years*
Special Opportunities Fund, Inc.	0.85%	8.19%	4.80%	5.12%
Market price returns				
Special Opportunities Fund, Inc.	1.89%	7.02%	5.60%	5.96%
Index returns				
S&P 500 Index	2.11%	9.59%	-0.25%	2.92%

Share price as of 12/31/11	
Net asset value	$16.01
Market price	$14.50

Past performance does not predict future performance. The return and value of an investment will fluctuate so that an investor's share, when sold, may be worth more or less than their original cost. The Fund's common stock net asset value ("NAV") return assumes, for illustration only, that dividends and other distributions, if any, were reinvested at the NAV on payable dates for dividends and other distributions payable through December 31, 2009 and reinvested at the NAV on the ex-dividend date for dividends and other distributions payable after December 31, 2009. The Fund's common stock market price returns assume that all dividends and other distributions, if any, were reinvested at prices obtained under the Fund's Dividend Reinvestment Plan (which was terminated on January 1, 2010) for dividends and other distributions payable through December 31, 2009 and reinvested at the lower of the NAV or the closing market price on the ex-dividend date for dividends and other distributions payable after December 31, 2009. NAV and market price returns for the period of less than one year have not been annualized. Returns do not reflect the deduction of taxes that a shareholder could pay on Fund dividends and other distributions, if any, or the sale of Fund shares.

* The Fund's investment objective and investment adviser have changed. See Note 1 of the Notes to financial statements for more information about the change in investment objective and see Note 2 of the Notes to financial statements for more information about the change in investment adviser. On January 25, 2010, the Fund began investing using its new investment objective, therefore, performance prior to that date is not relevant.

The S&P 500 Index is a capital weighted, unmanaged index that represents the aggregate market value of the common equity of 500 stocks primarily traded on the New York Stock Exchange.

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Portfolio composition as of 12/31/11(1)

	Value	Percent
Investment Companies	$71,617,683	67.02 %
Common Stocks	29,751,370	27.84
Corporate Bonds	4,507,750	4.22
Money Market Funds	3,852,469	3.60
Structured Life Settlement Notes	876,583	0.82
Warrants	766,409	0.72
Total Investments	$111,372,264	104.22 %
Liabilities in Excess of Other Assets	(4,508,672)	(4.22)
Total Net Assets	$106,863,592	100.00 %

(1) As a percentage of net assets.

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Portfolio of investments—December 31, 2011

	Shares	Value
INVESTMENT COMPANIES—67.02%		
Closed-End Funds—51.66%		
Adams Express Company	276,839	$2,668,728
Alpine Global Premier Properties Fund	785,585	4,163,601
American Strategic Income Portfolio III	159,466	1,039,718
Bancroft Fund, Ltd.	41,401	625,983
BlackRock Credit Allocation Income Trust IV	55,854	678,626
Boulder Growth & Income Fund, Inc.	316,668	1,817,674
Boulder Total Return Fund, Inc.	184,149	2,780,650
Diamond Hill Financial Trends Fund, Inc.	39,736	328,617
Dividend & Income Fund, Inc.	11,112	38,114
DWS RREEF Real Estate Fund, Inc. (a)(c)(f)(g)	126,913	11,803
DWS RREEF Real Estate Fund II, Inc. (a)(c)(f)(g)	201,612	28,830
Eaton Vance Risk Managed Diversified Equity Income Fund	244,645	2,556,540
Federated Enhanced Treasury Income Fund	4,532	65,034
First Opportunity Fund, Inc. (a)	279,106	1,736,039
Firsthand Technology Value Fund, Inc. (a)	2,373	34,527
The GDL Fund	33,327	393,259
The Greater China Fund, Inc.	55,714	561,040
JF China Region Fund, Inc.	1,885	20,754
Liberty All-Star Equity Fund, Inc.	1,437,759	6,067,342
Liberty All-Star Growth Fund, Inc.	349,392	1,331,184
Macquarie Global Infrastructure Total Return Fund, Inc.	80,776	1,372,384
Morgan Stanley Asia Pacific Fund, Inc.	30,101	394,323
Neuberger Berman Real Estate Securities Income Fund, Inc.	5,257	19,714
The New Ireland Fund, Inc.	188,171	1,298,380
Royce Focus Trust, Inc.	17,500	110,250
Royce Micro-Cap Trust, Inc.	440,426	