

FLAHERTY & CRUMRINE PREFERRED INCOME FUND

To the Shareholders of the Flaherty & Crumrine Preferred Income Fund (“PFD”):

During the Fund’s first fiscal quarter ended February 28, 2007, the Fund performed well in choppy, but ultimately little-changed, fixed-income markets by earning a total return of 1.7% on its net asset value (NAV). These three months saw the Fund continue its recent strong performance.

Interest rates were unchanged to slightly higher over the quarter, as the Federal Reserve left the federal funds rate unchanged and long-term Treasury rates rose only slightly. Corporate credit spreads also ended the quarter little changed, while the Fund’s interest-rate hedge had only a minimal impact. Both the recent quarter and trailing twelve-month periods delivered what the Fund is intended to produce – current income and stability of principal.

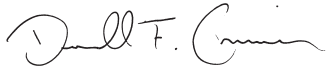
As you can see on the following pages detailing actual holdings in the Fund’s portfolio, the Fund invests in a relatively small number of industries, including utilities and insurers, banks and other finance companies. In fact, the Fund has an investment mandate to concentrate at least 25% of its assets in each of the banking and utilities industries. In terms of the industries the Fund’s assets are in, its portfolio is no different than the overall preferred securities market. Because of the preferred securities market’s overall emphasis in financial services, a portfolio of preferred securities, including the Fund’s, can be at risk if the U.S. economy goes into recession.

One important area of recent concern for the U.S. economy in general, and U.S. credit markets in particular, is subprime mortgage lending, which has experienced increasing default and delinquency rates in recent months. The numbers here are large in an absolute sense, but they are small relative to a \$13 trillion U.S. economy and to the mortgage market as a whole. Because of this, while we cannot entirely rule it out, we currently do not believe that problems in subprime mortgages will push the economy into recession.

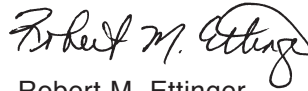
The Fund holds no positions in securities issued by mortgage brokers or subprime specialty lenders. Nonetheless, many of the banks and insurance companies in which we have invested do have some exposure to subprime mortgages in their lending or investment portfolios. While we are examining these companies very closely, the lack of detailed disclosure about subprime mortgages makes it impossible for us to make definitive statements about the Fund’s potential exposure to the problem. However, given what we now know and can infer about the companies in which we invest, we expect that *earnings* (which flow to the companies’ common shareholders) will be reduced at some of the companies we hold as a result of the problems in subprime lending. However, we currently do not expect that they will suffer losses large enough to cut meaningfully into *capital* (which support the debt and preferred securities owned by the Fund). Although we cannot rule out the possibility – despite our best judgment to the contrary – that some of the Fund’s investments could be seriously affected, we do not currently see any serious subprime credit problems in the holdings of the Fund.

The Fund's website at www.preferredincome.com has more information about Fund performance and a more complete discussion of the state of the economy (in our First Quarter Economic Update) and of subprime mortgages and their potential impact on the economy and the Fund's portfolio (in the "Frequently Asked Questions" section). We encourage you to explore the website for a wide range of additional information about your Fund.

Sincerely,

A handwritten signature in black ink, appearing to read "Donald F. Crumrine". The signature is fluid and cursive, with the first name being the most prominent.

Donald F. Crumrine
Chairman of the Board

A handwritten signature in black ink, appearing to read "Robert M. Ettinger". The signature is cursive and includes a large, stylized flourish at the end.

Robert M. Ettinger
President

April 20, 2007