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

The second fiscal quarter[1] brought with it a few headwinds, but your Fund still earned a respectable 0.7% total return on net asset value[2] ("NAV") during the period. For the first half of the fiscal year, total return on NAV was 3.1%. Total return on market price of Fund shares over the same periods were -0.6% and 6.2%, 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, 2015

	Actual Returns			Average Annualized Returns			
	Three Months	Six Months	One Year	Three Years	Five Years	Ten Years	Life of Fund(1)
Flaherty & Crumrine Preferred Income Fund	0.7%	3.1%	8.1%	12.8%	15.2%	7.3%	10.1%
Barclays U.S. Aggregate Index(2)	-0.1%	1.1%	3.0%	2.2%	3.9%	4.6%	6.3%
S&P 500 Index(3)	0.6%	3.0%	11.8%	19.7%	16.5%	8.1%	10.0%

(1) Since inception on January 31, 1991.
(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 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.

The economy continues to show signs of recovery, even if it has been two-steps-forward, one-step-back over the last year. The slowdown experienced this winter appears to have been temporary, with more recent economic data showing some improvement. With this data comes more speculation about when the Federal Reserve may begin to raise short-term interest rates. Intermediate and long-term interest rates moved higher during the quarter, largely because the time to an initial rate hike is compressing. As we have mentioned before, we currently expect short-term rate increases by the Federal Reserve to be gradual. Increases in intermediate and long-term rates should be on a similar but more muted path, edging up over time on stronger U.S. growth and less accommodative monetary policy, but restrained by low interest rates around the globe.

[1] March 1, 2015—May 31, 2015
[2] Following the methodology required by the Securities Exchange Commission, total return assumes dividend reinvestment and includes income and principal change, plus the impact of the Fund's leverage and expenses.

Higher rates during the quarter were a headwind for most fixed-income markets, with the 30-year Treasury rising from 2.59% to 2.88% during the quarter; it is up another 25 basis points (bp) since quarter-end. Total returns on longer-duration fixed-income benchmarks, such as Barclays Long U.S. Corporate at -4.06%, and intermediate-duration benchmarks, such as Barclays U.S. Corporate at -1.03%, were generally negative during the quarter.

Conditions in the preferred market remain generally positive. Secondary market liquidity has trailed off recently, but patience is often rewarded (we have plenty!). Supply of new preferred securities has continued apace so far this year, with most issuance in the form of traditional preferred securities from U.S. issuers and contingent capital securities (CoCo's) from foreign issuers. Overall, supply was well received and deals performed positively after initial pricing. At the margin, supply has kept spreads on preferred securities a bit wider than they might otherwise have been. Many issuers are reaching capacity in their "buckets" of preferred capital, so supply should remain manageable, if not below average, over the next year.

As we have discussed in previous letters, over 60% of the preferred market now is comprised of fixed-to-float or floating-rate securities. Ten years ago, this type of security made up less than 10% of the market. Without repeating full past discussions, it is notable that these securities have lower interest-rate durations than most fixed-for-life securities. All things being equal, these securities will not fall in price as much as fixed-for-life securities would when interest rates rise. Investors should be aware that fixed-to-float securities are not all fashioned from the same mold, a subject we expand on in the discussion topics that follow. Preferred investors can still find longer-duration securities in the preferred market. However, today's broader range of securities provides a way for us to manage interest-rate exposure in the Fund's portfolio without using more costly (in today's market) hedging strategies.

Preferred securities continue to offer higher yields than most other fixed-income securities, and yield has been very difficult to find in recent years without also adding unwanted risks. This yield cushion is important, as it allows for partial absorption of higher long-term interest rates. This is not to say that preferred-security *price* returns will remain positive despite higher long-term rates, but rather income earned on preferred securities will help to dampen the negative impact of higher long-term rates, and provide positive (or less negative) *total* returns to investors when compared to other fixed-income markets. Long-time shareholders will know the path to higher rates can be bumpy for all markets over short periods of time.

We close this letter by acknowledging the retirement of a long-time portfolio manager of the Fund, Robert Ettinger. Bob retired as a portfolio manager and from Flaherty & Crumrine as of June 30, 2015. You shouldn't expect to notice much change in the way your Fund is managed. Transition planning has always been a top priority of the firm. Moreover, the culture of the firm—which Bob was instrumental in shaping—runs deep. And, given his investment in the Fund, you can bet he won't let us stray from the things which have made the Fund and its sister funds among the top performing preferred funds in the market. We thank Bob for his 30 years of service and lasting contributions, and we wish him all the best in retirement.

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:

R. Eric Chadwick
Donald F. Crumrine
Bradford S. Stone

July 1, 2015