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

Your Fund performed well during its third fiscal quarter[1], delivering +3.1% total return on net asset value[2]. For the first nine months of fiscal 2014, the Fund's return on NAV was an impressive +15.1%. While third quarter *market* performance was -3.3%, year-to-date market performance was +19.2% at August 31st.

U.S. economic growth appears to be running around 3% currently, after averaging just 1.3% in 2014's first half. Job growth is up, unemployment is down and inflation remains low. The Fed is not filling its monetary punch bowl as quickly as before, but, while it's always hard to predict what the Fed will do, it probably won't start to raise short-term interest rates until mid-2015 or later. In contrast, economic growth abroad has slowed, with most developed countries trailing the U.S. recovery and monetary policy in many of those countries is easing further.

Although long-term interest rates in the U.S. will probably rise modestly over coming quarters, we think any upward movement will be limited by moderate GDP growth and strong investor demand for yield. Credit conditions continue to improve for most issuers of preferred securities, as earnings remain healthy and companies continue to build capital. With this backdrop, we believe prospective returns remain attractive for long-term investors.

The Fund's portfolio benefited from small declines in intermediate and long-term interest rates during the quarter, as well as on-going demand for higher yields of preferred securities. Supply of new issues remains steady—a key measure of market health. From December 2013 through September 2014, U.S. and foreign companies issued 103 new securities in the United States, raising just under $64 billion. Over the same period, issuers redeemed 67 preferred securities totaling $25 billion.

New issue supply was dominated by banks tailoring their capital to meet new regulatory requirements. Large U.S. banks (those deemed to be a systemically important financial institution, or "SIFI") have issued traditional non-cumulative perpetual preferred stock. Non-U.S. SIFI banks are utilizing a preferred stock variation termed Contingent Convertible Securities, or CoCos. As you know from prior letters, the Fund has not yet purchased any CoCos, but we continue to evaluate them as potential investments.

With foreign economies lagging recovery in the U.S. and foreign banks issuing securities we have not yet been inclined to buy, the portion of the portfolio invested in foreign securities has drifted lower this fiscal year. Through September 30th, this portion declined from 26.8% of the portfolio to 18%. We anticipate this rate could fall further through more issuer redemptions.

As we discussed last quarter, another portfolio trend is a continued shift to "fixed-to-float" securities. These have coupons that are *fixed* for an initial period, typically five or ten years. Afterwards, coupons *float* based on a formula set at issuance. Prices on floating rate issues typically are less sensitive to changes in benchmark interest rates; this effect has spilled over to fixed-to-float preferred securities as well. If long-term interest rates begin to rise, as we expect they will eventually, these securities should tend to outperform issues with fixed-for-life coupons, all other things being equal. This fiscal year through September 30th, the portion of the portfolio in this structure increased from 44.7% to 51%. We continue to look for opportunities to add fixed-to-float holdings. Although these issues yield a bit less than many fixed-for-life securities, and thus

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[1] June 1, 2014 – August 31, 2014

[2] Following methodology required by the SEC, total return assumes dividend reinvestment and includes income and principal change, plus the impact of the Fund's leverage and expenses.

may reduce portfolio income at the margin, we believe owning fixed-to-float securities is prudent and consistent with our interest-rate outlook.

As always, we encourage you to visit the Fund's website, www.preferredincome.com, for current information on preferred-securities markets, the Fund and the broader economy.

Sincerely,

The Flaherty & Crumrine Portfolio Management Team:

R. Eric Chadwick
Donald F. Crumrine
Robert M. Ettinger
Bradford S. Stone

October 1, 2014