

## PREFERRED INCOME FUND INCORPORATED

Dear Shareholder:

The Preferred Income Fund is off to a good start in Fiscal 2001. The total return on net asset value in the fiscal first quarter ended February 28th was 5.37%. These strong results helped the Fund achieve a return of 11.55% for the trailing twelve months through February.

It is nice to see this progress also reflected in the market price of the Fund's shares. The discount of the market price from the net asset value has typically been rather erratic. However, the discount has generally narrowed recently, and it has virtually disappeared on several occasions. As a result, total returns on market value have exceeded the returns on net asset value stated above.

The Fund has done well in a market environment that most investors would like to forget. The common stock market has taken it on the chin, and the overall economy appears to be feeling some sympathetic pains. As Washington has debated the merits of tax cuts, the Federal Reserve Bank has moved to stimulate the economy by lowering interest rates. Lower interest rates are generally helpful to investors in bonds and preferreds, and that includes us.

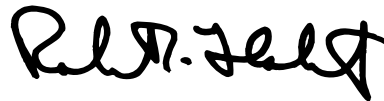
Falling interest rates helped the Fund in a couple of ways. The Fed's actions most directly affected short-term interest rates. That brought down the cost of the Fund's leverage, which is determined every 49 days. As the decline spilled over to long-term interest rates, the market value of the Fund's portfolio of preferreds appreciated. So far, that's two for two.

As we should expect, falling interest rates also produced losses on the Fund's hedges. As usual, we hedged the portfolio in an effort to limit the Fund's exposure to the risk of interest rates going up and the value of the portfolio declining. We did this by purchasing put options on Treasury bond futures contracts, which created something of a "safety net" below the level of the market. When interest rates went down and preferred prices increased, the hedges were simply unneeded "insurance". However, the cost of acquiring them was easily absorbed in a strong market.

Within the portfolio, hybrid preferreds led the performance parade in the last quarter, while traditional preferreds lagged behind. Hybrids appeared to benefit, both directly and indirectly, from increased interest by individual investors abandoning the common stock market in search of income and safety. In contrast, corporate investors, who typically buy traditional preferreds because of their tax advantages, generally overlooked exceptionally attractive values (in our opinion) in that sector. In the absence of a crystal ball, diversifying the Fund's portfolio over various types of preferreds has definite advantages.

Don't forget the Fund's web site at [www.preferredincome.com](http://www.preferredincome.com). It is an easy way to keep up to date on the recent progress of the Fund. We invite your comment and suggestions for improving the web site.

Sincerely,



Robert T. Flaherty  
*Chairman of the Board*

March 19, 2001

Preferred Income Fund Incorporated  
**SUMMARY OF INVESTMENTS**  
**February 28, 2001 (Unaudited)**

	<u>Value (000's)</u>	<u>Percent of Total Net Assets</u>
<b>Adjustable Rate Preferred Stocks</b>		
Utilities .....	\$ 9,863	5.1%
Banking .....	<u>22,570</u>	<u>11.6</u>
Total Adjustable Rate .....	<u>32,433</u>	<u>16.7</u>
<b>Fixed Rate Preferred Stocks and Securities</b>		
Utilities .....	51,843	26.7
Banking .....	43,912	22.6
Financial Services .....	27,943	14.4
Insurance .....	19,755	10.2
Oil and Gas .....	7,919	4.1
Miscellaneous Industries .....	<u>4,539</u>	<u>2.3</u>
Total Fixed Rate .....	<u>155,911</u>	<u>80.3</u>
<b>TOTAL PREFERRED STOCKS AND SECURITIES</b> .....	188,344	97.0
<b>COMMON STOCKS</b>		
Utilities .....	604	0.3
<b>REPURCHASE AGREEMENT</b> .....	4,096	2.1
<b>PURCHASED PUT OPTIONS</b> .....	<u>389</u>	<u>0.2</u>
<b>TOTAL INVESTMENTS</b> .....	193,433	99.6
<b>OTHER ASSETS AND LIABILITIES (Net)</b> .....	<u>820</u>	<u>0.4</u>
<b>TOTAL NET ASSETS</b> .....	<u>\$194,253</u>	<u>100.0%</u>

**FINANCIAL DATA**

**Per Share of Common Stock (Unaudited)**

	<u>Distribution Paid</u>	<u>Net Asset Value</u>	<u>NYSE Closing Price</u>	<u>Dividend Reinvestment Price (1)</u>
December 31, 2000 .....	\$0.0820	\$13.42	\$12.13	\$12.78
January 31, 2001 .....	0.0820	13.68	13.00	13.29
February 28, 2001 .....	0.0820	13.87	13.50	13.66

(1) Whenever the net asset value per share of the Fund's common stock is less than or equal to the market price per share on the payment date, new shares issued will be valued at the higher of net asset value or 95% of the then current market price. Otherwise, the reinvestment shares of common stock will be purchased in the open market.

Preferred Income Fund Incorporated

**STATEMENT OF CHANGES IN NET ASSETS<sup>(1)</sup>**  
**Three Months Ended February 28, 2001 (Unaudited)**

<b>OPERATIONS:</b>	
Net investment income . . . . .	\$ 3,035,802
Net realized loss on investments sold . . . . .	(1,151,819)
Net unrealized appreciation of investments during the period . . . . .	5,894,030
Net increase in net assets from operations . . . . .	7,778,013
<b>DISTRIBUTIONS:</b>	
Dividends paid from net investment income to MMP* Shareholders . . . . .	(1,087,716)
Distributions paid from net realized capital gains to MMP* Shareholders . . . . .	—
Dividends paid from net investment income to Common Stock Shareholders (2) . . . . .	(2,420,288)
Distributions paid from net realized capital gains to Common Stock Shareholders . . . . .	—
Total Distributions . . . . .	(3,508,004)
<b>NET INCREASE IN NET ASSETS:</b> . . . . .	4,270,009
<b>NET ASSETS:</b>	
Beginning of period . . . . .	189,982,533
End of period . . . . .	<u>\$ 194,252,542</u>

**FINANCIAL HIGHLIGHTS<sup>(1)</sup>**  
**Three Months Ended February 28, 2001 (Unaudited)**  
**For a Common share outstanding throughout the period.**

<b>OPERATING PERFORMANCE:</b>	
Net asset value, beginning of period . . . . .	\$ 13.41
Net investment income . . . . .	0.31
Net realized loss and unrealized appreciation on investments . . . . .	0.48
Net increase in net asset value resulting from investment operations . . . . .	0.79
<b>DISTRIBUTIONS:</b>	
Dividends paid from net investment income to MMP* Shareholders . . . . .	(0.11)
Distributions paid from net realized capital gains to MMP* Shareholders . . . . .	—
Dividends paid from net investment income to Common Stock Shareholders (2) . . . . .	(0.25)
Distributions paid from net realized capital gains to Common Stock Shareholders . . . . .	—
Change in accumulated undeclared dividends on MMP* . . . . .	0.03
Total distributions . . . . .	(0.33)
Net asset value, end of period . . . . .	<u>\$ 13.87</u>
Market value, end of period . . . . .	<u>\$ 13.50</u>
Common shares outstanding, end of period . . . . .	<u>9,838,571</u>
<b>RATIOS TO AVERAGE NET ASSETS AVAILABLE TO COMMON STOCK SHAREHOLDERS:</b>	
Net investment income . . . . .	6.72%**
Operating expenses . . . . .	1.44%**
<b>SUPPLEMENTAL DATA:††</b>	
Portfolio turnover rate fiscal year to date . . . . .	5%
Net assets, end of period (in 000's) . . . . .	\$ 193,253
Ratio of operating expenses to total average net assets including MMP* . . . . .	1.00%**

(1) These tables summarize the three months ended February 28, 2001 and should be read in conjunction with the Fund's audited financial statements, including footnotes, in its Annual Report dated November 30, 2000.

(2) Includes income earned, but not paid out, in prior fiscal year.

\* Money Market Cumulative Preferred™ Stock.

\*\* Annualized.

†† Information presented under Supplemental Data includes MMP\*.

**Directors**

Martin Brody  
Donald F. Crumrine, CFA  
Robert T. Flaherty, CFA  
David Gale  
Morgan Gust  
Robert F. Wulf, CFA

**Officers**

Robert T. Flaherty, CFA  
Chairman of the Board  
and President  
Donald F. Crumrine, CFA  
Vice President  
and Secretary  
Robert M. Ettinger, CFA  
Vice President  
Peter C. Stimes, CFA  
Vice President  
and Treasurer

**Investment Adviser**

Flaherty & Crumrine Incorporated  
e-mail: flaherty@fin-mail.com

**Questions concerning your shares of Preferred  
Income Fund?**

- If your shares are held in a Brokerage Account, contact your Broker.
- If you have physical possession of your shares in certificate form, contact the Fund's Transfer Agent & Shareholder Servicing Agent —  
PFPC Inc.  
P.O. Box 1376  
Boston, MA 02104  
1-800-331-1710

**This report is sent to shareholders of Preferred Income Fund Incorporated for their information. It is not a Prospectus, circular or representation intended for use in the purchase or sale of shares of the Fund or of any securities mentioned in this report.**



## Quarterly Report

February 28, 2001

web site: [www.preferredincome.com](http://www.preferredincome.com)