

## FLAHERTY & CRUMRINE PREFERRED INCOME FUND

To the Shareholders of Flaherty & Crumrine Preferred Income Fund:

During the first fiscal quarter of 2011, the total return on net asset value<sup>1</sup> of the Fund was +5.1%. Since the depth of the financial crisis, the Fund has delivered eight consecutive quarters of positive returns. We never tire of reporting positive returns, but our focus remains on providing high current income to shareholders.

Present conditions for the Fund's dividend are about as good as we can recall. Low short-term interest rates have continued to amplify the Fund's leverage strategy - we are able to borrow funds at historically attractive levels. At the same time, the investment portfolio is generating relatively high levels of income. We don't see anything on the immediate horizon to change these conditions, but one or both sides of the equation is likely to come under pressure sometime down the road.

As of this writing, the world is still dealing with the devastating events in Japan. Our thoughts go out to the people of Japan in these difficult times. Global financial markets were weaker in the immediate aftermath of the disaster, as investors assessed the impact. The Fund has very little direct exposure to the Japanese economy, and we do not anticipate any material decline in the credit quality of our holdings as a result of these events. Rest assured we are monitoring the impact very closely.

The situation at the Fukushima Dai-Ichi nuclear plant has raised fresh questions about nuclear power safety around the world. Since the Fund must have at least 25% of the portfolio invested in the utility industry, the topic is very relevant. *We do not believe the incident in Japan will negatively impact utility positions owned by the Fund in any material way.* In the U.S., most regulated utility companies have reduced their exposure to nuclear energy, and very few have "bet the farm" on this form of power generation.

The European sovereign debt situation continues to simmer. It may boil over in Portugal and require a bailout similar to those in Greece and Ireland. This may create some turbulence in the preferred market, but the overall impact on the Fund should be modest. The Fund has no direct investments in Portuguese banks or sovereign debt. Although it does own securities issued by companies with exposure to Portugal, we believe those exposures are manageable given the strength and diversification of those companies' activities.

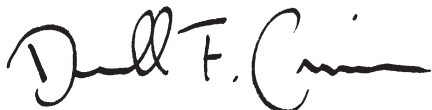
Preferred securities issued by banks comprise the largest portion of the Fund's portfolio and, thus, play a critical role in the Fund's strategy. Bank regulators here and abroad have analyzed bank securities in light of the financial crisis, and some conclusions have begun to trickle out. The Basel Committee on Bank Supervision, the body charged with setting global capital standards, has finalized its recommendations for bank capital, although it will be up to regulators in individual countries to adopt these standards. Bank regulators in the U.S. have until July of this year to propose new capital rules, and we expect final rules will be issued before year-end. Over time, we expect the current crop of preferred securities issued by banks to be replaced with new securities designed to conform to the new standards. As details of the new securities become known, we will study them carefully and determine their appropriateness for the Fund. Based on the information currently available, we are optimistic about the transition.

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<sup>1</sup> Following the methodology required by the SEC, total return includes income, principal change and the impact of the Fund's leverage.

We encourage you to visit the Fund's website [www.preferredincome.com](http://www.preferredincome.com) for a more in-depth discussion of conditions in the preferred markets, as well as the broader economy.

Sincerely,

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

Donald F. Crumrine  
Chairman

April 5, 2011

A handwritten signature in black ink that reads "Robert M. Ettinger". The signature is fluid and cursive, with the last name being the most prominent.

Robert M. Ettinger  
President