

FLAHERTY & CRUMRINE PREFERRED INCOME FUND

Dear Shareholder:

The Flaherty & Crumrine Preferred Income Fund ("PFD") got off to a very good start in fiscal 2004. The total return on net asset value ("NAV") for fiscal first quarter ending February 29th was +5.4%¹. For the trailing twelve month period, the total return was +21.1%¹.

Once again, strength in the preferred securities market was the major factor in the Fund's performance. With interest rates hovering near all-time lows, individual investors have increasingly turned to preferred securities as they try to increase the income from their portfolios. At the same time, the size of the market has remained fairly stable. There has been a steady stream of new issues brought to market, but older issues are being redeemed at about the same pace. As expected, issuers are replacing older high coupon preferred issues with similar but less expensive ones.

These refinancing transactions are very important to the Fund—if the trend persists for a long period of time, there may be downward pressure on the income generated by the portfolio. On the other hand, low interest rates keep the cost of the Fund's leverage extremely low. So far these two effects have roughly offset each other.

The Fund's hedging strategy also performed as expected. To refresh your memory, PFD normally hedges by purchasing put options on U.S. Treasury bond futures. As interest rates go up or down, the prices of these put options typically move in the opposite direction of the preferred securities. There is, however, an important and valuable feature to a put option hedge—in a period of falling interest rates (as in recent months), the value of the preferred portfolio usually goes up by more than the drop in the value of the put options. Although the value of the hedge positions declined during the period, when compared to appreciation in the preferred positions this loss was small. Of course, if we knew interest rates were going to fall, the best hedge would have been no hedge at all, but our crystal ball is a bit too cloudy for that! We prefer to hedge consistently, knowing that the portfolio should participate in a rally but be protected if interest rates rise significantly.

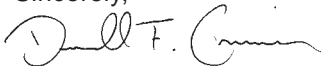
The Fund's combination of preferred securities and the put option hedge creates an unusual investment product and we have yet to find a perfect benchmark for comparison. When measured against *long-term* fixed income investments, we expect the returns on NAV to lag (but generally only a little!) during periods of falling interest rates (because the hedge will hurt returns), and to perform much better if rates rise substantially. In most interest rate scenarios, the Fund's returns on NAV should out-perform *short-term* investments, although the Fund's returns on NAV may lag briefly during periods of rising short-term rates. In any event, investors should always bear in mind that changes in the Fund's premium or discount to NAV can significantly affect the performance and volatility of the Fund's common share price.

To provide some comparison of the Fund's performance, the total return on the Lehman Brothers index of long-term investment grade corporate bonds (a good proxy for long-term fixed-income investments) was +4.9% during the fiscal quarter and +10.8% during the twelve months ending February 29th. The Lehman Brothers index of 3 – 6 month U.S. Treasury Bills (a short-term proxy) earned 0.3% during the quarter and 1.2% for the year. Keep in mind that these indices do not utilize leverage.

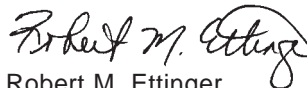
Economic conditions in the United States continue to show signs of improvement. This rising economic tide has benefited corporate profitability and enabled companies to improve the quality of their balance sheets. At the same time, sluggish job formation and subdued inflation have persuaded the Federal Reserve to keep monetary policy accommodative, which has held down the cost of the Fund's leverage.

In the coming weeks, the Fund's adviser, Flaherty & Crumrine, will launch a new web site, www.preferredstockguide.com. The site will contain useful information about most of the issues that make up the preferred securities universe. We've tried to make the site informative and easy to use. We hope you will also continue to visit the Fund's web site at www.preferredincome.com.

Sincerely,



Donald F. Crumrine
Chairman of the Board



Robert M. Ettinger
President

April 12, 2004

(1) Based on monthly data provided by Lipper Inc. Distributions are assumed to be reinvested at NAV in accordance with Lipper's practice.

SUMMARY OF INVESTMENTS

February 29, 2004 (Unaudited)

	<u>Value (000's)</u>	<u>Percent of Total Net Assets</u>
Adjustable Rate Preferred Securities		
Utilities	\$ 382	0.1%
Banking	<u>20,990</u>	<u>8.5</u>
Total Adjustable Rate	<u>21,372</u>	<u>8.6</u>
Fixed Rate Preferred Securities		
Utilities	92,393	37.4
Banking	52,182	21.2
Financial Services	24,637	10.0
Insurance	22,281	9.0
Oil and Gas	9,111	3.7
Miscellaneous Industries	<u>4,217</u>	<u>1.7</u>
Total Fixed Rate	<u>204,821</u>	<u>83.0</u>
Inverse Floating Rate Preferred Securities	2,133	0.9
Total Preferred Stocks and Securities	228,326	92.5
Corporate Debt Securities	3,224	1.3
Common Stocks and Convertible Securities	9,310	3.8
Purchased Put Options	786	0.3
Money Market Funds	<u>3,612</u>	<u>1.4</u>
Total Investments	245,258	99.3
Other Assets and Liabilities (net)	<u>1,624</u>	<u>0.7</u>
Total Net Assets Available to Common and Preferred Stock	<u>\$246,882</u>	<u>100.0%</u>

FINANCIAL DATA

Per Share of Common Stock (Unaudited)

	<u>Dividend Paid</u>	<u>Net Asset Value</u>	<u>NYSE Closing Price</u>	<u>Dividend Reinvestment Price (1)</u>
December 31, 2003 - Extra	\$0.0400	\$15.90	\$18.40	\$17.48
December 31, 2003	0.0950	15.90	18.40	17.48
January 31, 2004	0.0950	16.23	18.35	17.43
February 29, 2004	0.0950	16.37	18.97	18.02

(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.

STATEMENT OF CHANGES IN NET ASSETS AVAILABLE TO COMMON STOCK⁽¹⁾
Three Months Ended February 29, 2004 (Unaudited)

	<u>Value (000's)</u>
OPERATIONS:	
Net investment income	\$ 3,218
Net realized gain on investments sold during the period	265
Change in net unrealized appreciation of investments held during the period	5,331
Distributions to Money Market Cumulative Preferred™ Stock Shareholders from net investment income, including changes in accumulated undeclared distributions	<u>(250)</u>
Net increase in net assets from operations	8,564
DISTRIBUTIONS:	
Distributions paid from net investment income to Common Stock Shareholders (2)	(3,306)
Distributions paid from net realized capital gains to Common Stock Shareholders	<u>0</u>
Total Distributions	(3,306)
FUND SHARES TRANSACTIONS:	
Increase from Common Stock Transactions	<u>574</u>
NET INCREASE IN NET ASSETS AVAILABLE TO COMMON STOCK FOR THE PERIOD	5,832
NET ASSETS AVAILABLE TO COMMON STOCK:	
Beginning of period	160,924
End of period	<u>\$ 166,756</u>

FINANCIAL HIGHLIGHTS⁽¹⁾
Three Months Ended February 29, 2004 (Unaudited)
For a Common share outstanding throughout the period.

PER SHARE OPERATING PERFORMANCE:	
Net asset value, beginning of period	<u>\$ 15.85</u>
INVESTMENT OPERATIONS:	
Net investment income	0.32
Net realized gain and unrealized appreciation on investments	0.55
DISTRIBUTIONS TO MMP®* SHAREHOLDERS:	
From net investment income (including change in accumulated undeclared dividends on MMP®*)	(0.03)
From net realized capital gains	<u>0.00</u>
Total from investment operations	0.84
DISTRIBUTIONS TO COMMON STOCK SHAREHOLDERS:	
From net investment income	(0.32)
From net realized capital gains	<u>0.00</u>
Total distributions to Common Shareholders	(0.32)
Net asset value, end of period	<u>\$ 16.37</u>
Market value, end of period	<u>\$ 18.97</u>
Common shares outstanding, end of period	<u>10,186,011</u>
RATIOS TO AVERAGE NET ASSETS AVAILABLE TO COMMON STOCK SHAREHOLDERS:	
Net investment income †	7.37%**
Operating expenses	1.49%**

SUPPLEMENTAL DATA:††

Portfolio turnover rate fiscal year to date	8%***
Total net assets available to Common and Preferred Stock, end of period (in 000's)	\$ 246,882
Ratio of operating expenses to total average net assets available to Common and Preferred Stock*	1.00%**

(1) These tables summarize the three months ended February 29, 2004 and should be read in conjunction with the Fund's audited financial statements, including footnotes, in its Annual Report dated November 30, 2003.

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

* Money Market Cumulative Preferred™ Stock.

** Annualized.

*** Not Annualized.

† The net investment income ratios reflect income net of operating expenses and payments to MMP®* Shareholders.

†† Information presented under heading Supplemental Data includes MMP®*.

Directors

Martin Brody
Donald F. Crumrine, CFA
Robert M. Ettinger, CFA
David Gale
Morgan Gust
Robert F. Wulf, CFA

Officers

Donald F. Crumrine, CFA
Chairman of the Board
and Chief Executive Officer
Robert M. Ettinger, CFA
President
Peter C. Stimes, CFA
Chief Financial and Accounting
Officer, Vice President
and Treasurer
R. Eric Chadwick, CFA
Vice President and Secretary
Bradford S. Stone
Vice President

Investment Adviser

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

Questions concerning your shares of Flaherty & Crumrine 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 43027
Providence, RI 02940-3027
1-800-331-1710

This report is sent to shareholders of Flaherty & Crumrine 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.



Flaherty & Crumrine
PREFERRED INCOME FUND

Quarterly Report

February 29, 2004

web site: www.preferredincome.com