

FLAHERTY & CRUMRINE PREFERRED INCOME FUND

Dear Shareholder:

During Flaherty & Crumrine Preferred Income Fund's ("PFD") recently concluded 2nd fiscal quarter, the biggest challenge we faced was holding on to the impressive returns of the 1st quarter. In this regard, we can report success. Although the Fund's total return on Net Asset Value ("NAV") **declined 3.9%**⁽¹⁾ during the three month period ending May 31st, results over the first six months of fiscal 2004 **increased 1.2%**⁽¹⁾.

As can be seen from the table below, over longer time periods, the Fund has produced consistently strong results. For comparison purposes, we have included the average return on all funds in the Lipper Domestic Investment Grade Bond Fund category. Although the investment strategies that we use in the Fund typically differ significantly from those of the bond funds, we believe that PFD provides a superior way of accomplishing a similar investment objective.

AVERAGE TOTAL RETURN PER YEAR FOR PERIODS ENDING MAY 31, 2004⁽¹⁾

	<u>One Year</u>	<u>Five Years</u>	<u>Ten Years</u>	<u>Life of Fund⁽²⁾</u>
Flaherty & Crumrine Preferred Income Fund's Return on Net Asset Value	6.9%	8.5%	9.4%	12.1%
Lipper Domestic Investment Grade Bond Funds ⁽³⁾	2.1%	7.0%	7.6%	7.8%

(1) Based on monthly data provided by Lipper Inc. Distributions are assumed to be reinvested at NAV in accordance with Lipper's practice, which differs from the procedures used elsewhere in this report.

(2) Since inception on January 31, 1991.

(3) Includes all U.S. Government bond, mortgage bond and term trust and investment grade bond funds in Lipper's closed-end fund database at each point in time.

The NAV performance during the second fiscal quarter was mainly the result of rising interest rates (the Fund incurs the cost of falling into the "safety net" of the hedge), as well as relatively weak performance of preferred securities.

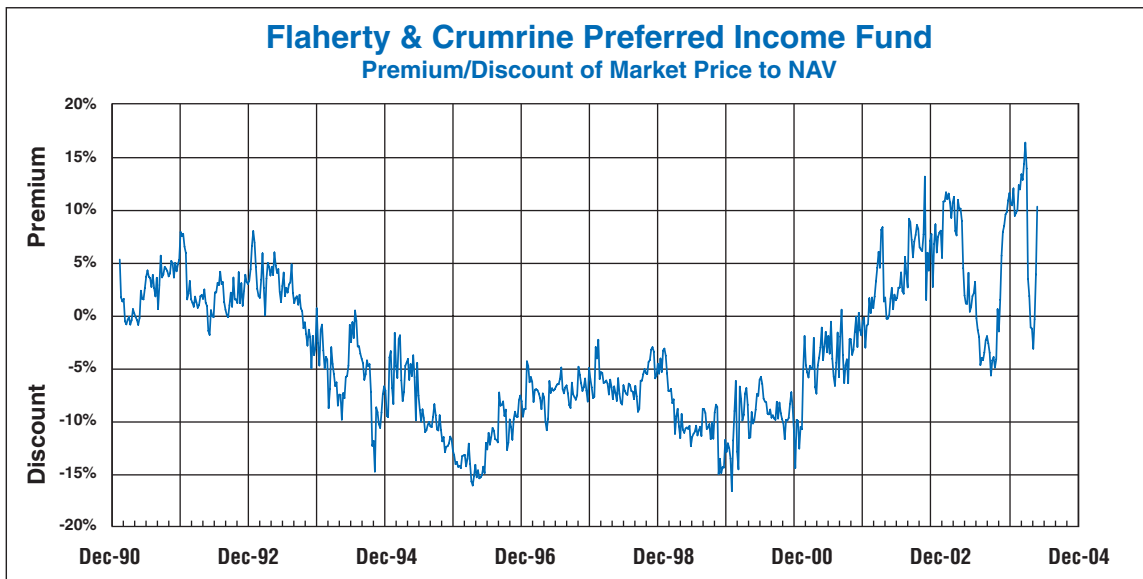
In early April, we learned that the economy had finally begun to experience job growth consistent with an expanding economy. As a result, investors stopped wondering *if* the Federal Reserve would raise interest rates, and instead simply asked *when*. From a low of 3.7% in mid-March, the yield on the benchmark ten-year U.S. Treasury had risen a full percentage point by the end of May.

Of course, the Fund's hedging strategy is intended to protect the NAV against substantial increases in interest rates. So, how did it work? As expected, the hedge significantly cushioned the decline (without the hedge, the total return for the quarter would have been -5.3% instead of -3.9%).

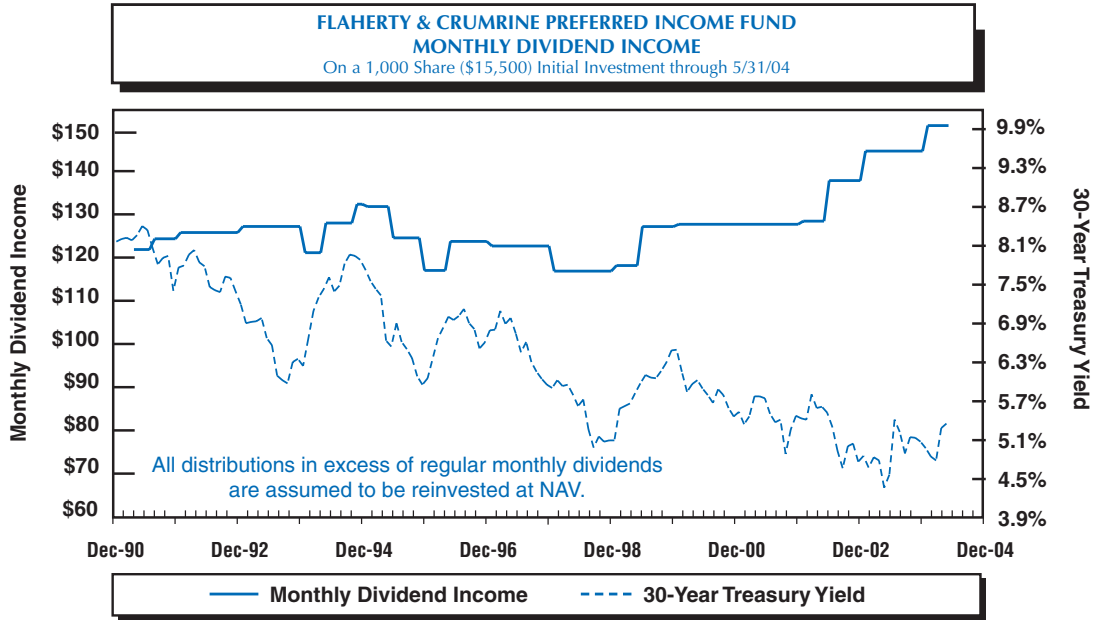
Recall that our hedge positions are analogous to an insurance policy. We make regular “premium” payments to buy protection against rising interest rates. In order to keep the cost of these payments down, we typically structure the hedge with a “deductible,” meaning some portion of the loss must be absorbed by the Fund before we can collect on the policy. (For those familiar with options, we are purchasing *out-of-the-money put options* on the U.S. Treasury Bond future contract.) During the most recent quarter, the Fund absorbed the entire amount of the deductible. If long-term interest rates continue to climb, the current hedge position should neutralize more of the decline in the value of preferred positions.

Also working against the Fund’s NAV was a modest, adverse move in the relationship between the preferred securities market and U.S. Treasuries. Simply stated, the price of a typical preferred security fell by more than the price of a corresponding Treasury bond during the quarter. Since our hedge positions are tied to Treasuries, this meant the appreciation in the Fund’s hedge position didn’t quite keep up with the decline in the value of the preferred securities.

In early April, the *market price* of PFD fell almost 15% in just two days. Needless to say, this had a lot of people scratching their heads, including us. We address this more completely in the Question and Answer section, but the drop can be attributed primarily to two factors—a concern about rising interest rates and technical factors in the market. For some owners of PFD as well as other closed-end income funds, the attitude appeared to be “sell now, ask questions later.” Such across-the-board selling ignores the fundamental differences between PFD and most other funds, especially its hedging strategy. As the chart below demonstrates, the relationship of the market price of the Fund’s shares to the NAV has been a bit erratic over time. We’d like to see the price track the NAV more closely, but obviously that has not been the case.



PFD is all about income, and as the chart below shows, the Fund's income (represented by the solid line) has performed remarkably well. Income has held up pretty well when the interest rate on long-term Treasury bonds (the broken line) has gone down. In contrast, when the Treasury interest rate has increased, the Fund has typically reflected a large part of the increase. This is the objective of the Fund, and for over thirteen years, the strategy has been successful.



In recent weeks, a number of investors have visited the new web site created by the Fund's adviser, Flaherty & Crumrine. We think you'll find www.preferredstockguide.com contains useful information about most of the issues that make up the preferred securities universe. 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

July 23, 2004

QUESTIONS & ANSWERS

What caused the Fund's market price to drop in April?

It appears as though the drop can be attributed mainly to two things — concerns about rising interest rates and a large number of stop-loss sell orders for the Fund's shares.

In early April, the Department of Labor announced the economy had added over 300,000 new non-farm jobs during March. In the preceding months, job creation had been persistently below expectations despite other indications that economic activity was picking up. The widespread belief was the Federal Reserve would keep short-term interest rates low until there was sufficient evidence employment conditions were improving. With the job growth in March, policymakers began talking about the need to remove current policy accommodation and move rates gradually back to "normal". A sharp market selloff ensued.

With concerns about rising interest rates, shareholders of income oriented closed-end funds apparently began selling indiscriminately. Of course, selling PFD simply due to concerns about rising interest rates seems to ignore the Fund's hedging strategy. Nonetheless, for the sellers, the decision was sell first, ask questions later.

Stop-loss orders apparently also contributed to the price decline. It is impossible to get information on stop-loss orders since the NYSE keeps the data private. But anecdotal evidence indicates that small bits of selling pressure triggered stop-loss orders, which in turn led to more selling and more stop-losses being triggered.

How did preferred securities perform during the quarter?

A large portion of the portfolio is comprised of traditional preferred stock (issues that pay dividends as opposed to interest) and this market sector underperformed other segments of the fixed-income market during the quarter. This sector has been one of the strongest performers over the past year, so in the long-run, a small correction is probably a good thing. By the end of the quarter, preferred prices had stabilized, but relative to other market sectors were still somewhat below where they started. We still think the positions we hold in the Fund represent good long-term value, and we'll continue to hold them until better opportunities come along.

What is the impact of rising interest rates on the Fund's income?

Rising rates can affect the income earned in the Fund in different ways.

On the plus side, if we make money on the hedge, we can purchase more securities and produce more income. This should occur if long-term interest rates rise. Increases in short-term rates, however, generally result in higher costs, as the Fund will have to pay higher rates on its shares of Money Market Cumulative Preferred™ Stock (MMP®).

Over time, changes in the slope of the yield curve (the difference between long-term and short-term interest rates) will also impact the Fund's income. When the differential is small (the yield curve is "flat"), the cost of leverage is relatively high, but the Fund's hedging strategy should be less expensive. In a steep yield curve environment (as we've seen over recent quarters), the opposite occurs — the cost of leverage is low but the cost of the hedge goes up.

Over the long-run, changes in the cost of leverage and changes in the cost of hedging should substantially offset one another. This is not by accident; the Fund's leverage and hedging strategy have been carefully structured to maintain this balance. In the near term, however, sharp increases in short-term interest rates may adversely impact the Fund's dividend rate.

What is the breakdown between dividends and interest this year?

The composition of distributions made by the Fund cannot be determined until the end of the fiscal year on November 30th. Once the books are closed, we add up dividends and interest earned, short- and long-term realized gains (or losses), and expenses incurred by the Fund. Only then are we able to compute the breakdown between qualified dividend income (eligible for lower tax treatment) and other income.

A review of the portfolio holdings in this report shows that as of May 31st, 73.3% of the portfolio's value was in issues that pay qualified dividends. *This is not the percentage of income that is dividends.* The amount of dividend paying securities held in the portfolio correlates well with the composition of the portfolio's income, but there are a number of additional things (such as realized gains and losses) that factor into the breakdown. Of course, the composition of the portfolio's holdings may change over the balance of the year.

Have there been recent changes in the way the Fund is regulated?

In a word, yes. Over the past several quarters a number of meaningful new regulations have been imposed on the mutual fund industry. As we have discussed in the past, while every fiduciary breach has occurred in open-end funds, most of the new rules also apply to closed-end funds, such as PFD. Shareholders should be aware that, as a result, the Fund's regulatory expenses continue to increase.

The deadline for implementation of the most recently adopted rules is October, 2004. The Fund will have a Chief Compliance Officer ("CCO") reporting directly to the Board of Directors. The CCO will oversee development and implementation of all aspects of regulatory compliance.

One significant change you will notice will be in the August quarterly report. Beginning with this report, all of the Fund's quarterly reports will contain a complete listing of the portfolio's investments. Other changes may not be as apparent, but we'll do our best to keep you informed about the most significant ones.

What was the recent change regarding investments in foreign securities?

The Board of Directors has recently amended the investment policies to raise the authorized maximum percentage investment in *dollar-denominated securities of foreign issuers* in the Fund to 30% of total assets. The change was approved at the regular Board meeting held on April 23, 2004.

The percentage limitation does not include the portion of the Fund's assets that can be invested in high quality money market obligations of foreign banks or foreign branches of U.S. banks, which remains at 25% of total assets.

The change was undertaken in consideration of the significant cumulative growth in the amount of U.S. dollar-denominated foreign preferred securities outstanding. A significant portion of these securities pay income that is characterized as Qualified Dividend Income pursuant to the Federal Jobs and Growth Tax Act of 2003. In the opinion of the Fund's Adviser, the income and return available from foreign securities often exceeds that of comparably situated U.S. issuers.

Investments by the Fund in these securities are subject to the same restrictions on credit quality and diversification that apply to U.S. domestic debt and preferred securities. The Fund's Adviser has stated that investing a greater portion of the Fund's assets in non-U.S. securities is not expected to adversely impact the effectiveness of the Fund's hedging strategies.

Investors are cautioned that, although U.S. dollar-denominated foreign securities are not subject to currency risk, they may be subject to risks different from U.S. investments. In particular, the prices of foreign securities may be affected by political and economic conditions, less stringent regulation, and higher volatility. In addition, many foreign securities may be less liquid and more volatile than U.S. securities.

Does the Fund use Credit Derivatives?

Not at this time, but the Fund is currently considering the ability to purchase protection against both an issuer's deteriorating credit quality and adverse interest rate spread changes through the use of credit derivatives.

While we attempt to manage credit risk primarily through diversification and the sale of securities holdings before an issuer's credit quality deteriorates significantly, the Fund is considering from time to time managing the credit risk of its securities holdings by entering into credit derivative contracts, such as credit default swaps. At the risk of oversimplification, as a buyer of such credit protection the Fund would be entitled to receive the par value of a preferred or debt security from a counterparty in the event of a default by the issuer, offsetting some or all of the corresponding loss on the underlying security. In return, the Fund would pay to the counterparty a periodic stream of payments over the term of the contract, provided that no event of default has occurred. Of course, if no default occurs, the Fund would have spent the stream of payments and received no benefit from entering into the contract.

To protect against an adverse interest rate spread change (such as an adverse change in the yield spread between preferred securities and a benchmark Treasury security), the Fund is also considering from time to time purchasing options on market spread swaps. In the typical market spread swap, two counterparties agree to exchange payments at future dates based on the yield spread between a reference rate and a benchmark rate. Options on such swaps, which are analogous to interest rate swaptions, would give the Fund as the buyer the right, but not the obligation, to buy or sell the market spread between the reference and benchmark rate at a fixed price from the seller. At each future payment date, if the spread between the reference and benchmark rates were above (or below depending on the contract) the contract spread, the Fund would receive from the seller the difference between the current spread and the contracted spread. Of course, if the current spread were below (or above) the contract spread, the Fund would receive no benefit from entering into the contract for that payment date.

Because the Fund has paid the option premium for both credit derivative transactions being considered, the financial risk of the transactions is initially limited to the amount of the premium paid and to the marked-to-market value of the option at a future. In addition to the option expiring worthless, there are various other ways for financial risk to occur in such derivatives. Even though major financial and broker/dealer organizations are the usual counterparties, anyone entering into such agreements must carefully consider the other party's credit worthiness and its ability to perform its obligations. In addition, because credit derivatives are highly specialized investments and are not traded on any securities exchange, market liquidity may also be a risk at certain times. Further, such derivatives are not regulated by either the Commodities Futures Trading Commission or the Securities and Exchange Commission. Nonetheless, the liquidity and transparency of credit derivatives has increased significantly over the past several years, and we believe that having the ability to use them is in the best interest of shareholders.

FINANCIAL DATA

Per Share of Common Stock

	<u>Total Dividends 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
March 31, 2004.	0.0950	16.36	19.62	18.64
April 30, 2004	0.0950	15.94	16.11	15.94
May 31, 2004	0.0950	15.45	17.62	16.74

(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.

The accompanying notes are an integral part of the financial statements.

PORTFOLIO OF INVESTMENTS**May 31, 2004 (Unaudited)**

<u>Shares/\$ Par</u>	<u>Value (Note 1)</u>	<u>Shares/\$ Par</u>	<u>Value (Note 1)</u>
PREFERRED SECURITIES — 91.1%		\$500,000	Comerica (Imperial) Capital Trust I, 9.98% 12/31/26 Capital Security, Series B
			\$ 601,123
ADJUSTABLE RATE PREFERRED SECURITIES — 8.5%			
BANKING — 8.4%			
75,000	Cobank, ACB, Adj. Rate Pfd., 144A****	\$ 4,144,125*	\$1,500,000 Deutsche Bank, BT Preferred Capital Trust II, 7.875% 02/25/27 Capital Security
62,900	J.P. Morgan Chase & Co.: Adj. Rate Pfd.	3,178,023*	1,607,790
136,675	Series A, Adj. Rate Pfd.	<u>12,608,269*</u>	\$7,820,000 GreenPoint Financial Corporation, GreenPoint Capital Trust I, 9.10% 06/01/27 Capital Security
	TOTAL BANKING ADJUSTABLE RATE PREFERRED SECURITIES	<u>19,930,417</u>	8,921,877
			34,200 HSBC USA, Inc.: \$2.8575 Pfd.
			1,698,714*
7,465	Northern Indiana Public Service Company, Series A, Adj. Rate Pfd.	<u>390,046*</u>	\$2,635,000 Republic New York Capital II, 7.53% 12/04/26 Capital Security, STOPS
	TOTAL ADJUSTABLE RATE PREFERRED SECURITIES	<u>20,320,463</u>	2,799,819
			37,500 J.P. Morgan Chase & Co., 6.625% Pfd., Series H
			2,004,188*
			\$270,000 Keycorp Institutional Capital B, 8.25% 12/15/26 Capital Security
			297,342
			16,500 Regions Financial Trust I, 8.00% Pfd.
			438,818
			Wachovia Corporation: First Union Capital II, 7.95% 11/15/29 Capital Security
3,625	ABN AMRO North America, Inc.: 6.46% Pfd., 144A****	3,759,487*	1,742,790
4,000	6.59% Pfd., 144A****	4,222,500*	\$906,000 First Union Institutional Capital I, 8.04% 12/01/26 Capital Security
	BNP Paribas:		987,481
400	BancWest Capital I, 9.50% 12/01/30 QUIPS	10,888	\$1,820,000 First Union Institutional Capital II, 7.85% 01/01/27 Capital Security
\$2,250,000	First Hawaiian Capital I, 8.343% 07/01/27 Capital Security, Series B	2,503,012	\$1,500,000 Wachovia Capital Trust V, 7.965% 06/01/27 Capital Security, 144A****
	Bank of America Corporation:		1,623,570
\$750,000	Barnett Capital II, 7.95% 12/01/26 Capital Security	811,327	7,500 Wachovia Preferred Funding, 7.25% Pfd., REIT, Series A
\$674,000	NB Capital Trust II, 7.83% 12/15/26 Capital Security	732,092	<u>200,700</u>
	Citigroup, Inc.:		TOTAL BANKING FIXED RATE PREFERRED SECURITIES
128,927	5.864% Pfd., Series M	6,316,778*	50,102,084
12,676	6.213% Pfd., Series G	639,441*	
48,500	6.231% Pfd., Series H	2,465,983*	FINANCIAL SERVICES — 9.7%
21,350	6.365% Pfd., Series F	1,094,508*	Bear Stearns Companies, Inc.: 5.49% Pfd., Series G
50,000	Cobank, ACB, 7.00% Pfd., 144A****	2,659,250*	53,700 2,499,466*
			62,540 5.72% Pfd., Series F
			2,973,464*
			Lehman Brothers Holdings, Inc.: 5.67% Pfd., Series D
			65,400 3,098,652*
			151,275 5.94% Pfd., Series C
			7,385,246*
			20,000 6.50% Pfd., Series F
			516,900*

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PORTFOLIO OF INVESTMENTS (Continued)

May 31, 2004 (Unaudited)

<u>Shares/\$ Par</u>	<u>Value (Note 1)</u>	<u>Shares/\$ Par</u>	<u>Value (Note 1)</u>
PREFERRED SECURITIES — (Continued)		29,050	REI Trust I, 7.20% TOPrS, Series C \$ 686,451
FIXED RATE PREFERRED SECURITIES — (Continued)			Central Hudson Gas & Electric Corporation: 4.35% Pfd., Series D, Pvt. 375,025*
FINANCIAL SERVICES (Continued)		900	4.96% Pfd., Series E, Pvt. 76,333*
123,805	SLM Corporation, 6.97% Pfd., Series A \$ 6,587,664*		Central Illinois Light Company: 4.64% Pfd. 832,250*
TOTAL FINANCIAL SERVICES FIXED RATE PREFERRED SECURITIES		10,000	5.85% Sinking Fund Pfd. 707,175*
	<u>23,061,392</u>	7,000	Central Illinois Public Service Corporation, 4.90% Pfd. 966,020*
INSURANCE — 7.0%		11,000	Central Vermont Public Service Corporation, 8.30% Pvt. Sinking Fund Pfd. 2,315,302*
11,000	Everest Re Capital Trust II, 6.20% Pfd. Series B 244,530	22,239	Connecticut Light & Power Company: 4.50% Pfd., 144A**** 17,510*
\$5,800,000	The St. Paul Companies, Inc.: MMI Capital Trust I, 7.625% 12/15/27 Capital Security, Series B 6,036,930	500	5.28% Pfd. 414,687*
		9,300	6.56% Pfd., Series 1968 98,717*
12,000	St. Paul Capital Trust I, 7.60% Pfd. 306,660	1,905	\$3.24 Pfd. 774,384*
\$4,000,000	UnumProvident Corporation, Provident Financing Trust I, 7.405% 03/15/38 Capital Security 3,256,840	15,778	Consolidated Edison Company of New York, 4.65% Pfd., Series C 174,363*
		2,100	Constellation Energy Group, Baltimore Gas & Electric Company, 6.70% Pfd., Series 1993 1,047,900*
4,250	Zurich RegCaPS Fund Trust I: 6.01% Pfd., 144A**** 4,342,480*	10,000	Duke Energy Corporation: 4.50% Pfd., Series C, Pvt. 359,036*
2,450	6.58% Pfd., Pvt., 144A**** 2,478,530*	31,965	6.75%, Series X, Sinking Fund Pfd. 3,306,779*
TOTAL INSURANCE FIXED RATE PREFERRED SECURITIES		519	7.04% Pfd., Series Y 53,662*
	<u>16,665,970</u>	30,762	7.85% Pfd., Series S 3,194,172*
UTILITIES — 38.8%			Duquesne Light Company: 4.10% Pfd. 249,284*
	Alabama Power Company: 4.52% Pfd. 24,931*	7,675	4.15% Pfd. 208,130*
300	4.72% Pfd. 497,597*	6,330	4.20% Pfd. 30,280*
5,734	5.20% Pfd. 973,659*	910	6.50% Pfd. 1,568,257*
41,100	5.30% Pfd. 6,528,500*	31,650	\$2.10 Pfd., Series A 182,680*
275,000	Appalachian Power Company, 5.92% Sinking Fund Pfd. 206,109*	5,490	Energy East Capital Trust I, 8.25% TOPrS 129,750
2,049	Avista Corporation, \$6.95 Sinking Fund Pfd., Series K 2,596,041*	5,000	Entergy Arkansas, Inc.: 7.32% Pfd. 565,059*
26,125	Boston Edison Company, 4.78% Pfd. 872,993*	5,407	7.40% Pfd. 1,182,159*
10,100	CenterPoint Energy, Inc.: Houston Light & Power, Capital Trust II, 8.257%, 02/01/37 Capital Security, Series B 3,482,500	11,350	7.88% Pfd. 399,265*
\$3,500,000		3,822	\$1.96 Pfd. 768,756*
		30,266	

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PORTFOLIO OF INVESTMENTS (Continued)**May 31, 2004 (Unaudited)**

<u>Shares/\$ Par</u>		<u>Value (Note 1)</u>	<u>Shares/\$ Par</u>		<u>Value (Note 1)</u>
PREFERRED SECURITIES — (Continued)			5,000	PPL Electric Utilities Corporation, 6.75% Pfd.	\$ 523,275*
FIXED RATE PREFERRED SECURITIES — (Continued)				PacifiCorp:	
UTILITIES — (Continued)			200	5.40% Sinking Fund Pfd.	18,748*
4,440	Entergy Gulf States, Inc., 7.56% Pfd.	\$ 452,414*	1,225	\$4.56 Pfd.	96,971*
	Entergy Louisiana, Inc.:		14,542	\$4.72 Pfd.	1,191,499*
260	7.84% Pfd.	27,213*	16,444	\$7.48 Sinking Fund Pfd.	1,707,216*
106,138	8.00% Pfd., Series 92	2,679,454*		Pacific Enterprises:	
8,600	Entergy Mississippi, Inc., 7.44% Pfd.	891,949*	27,430	\$4.50 Pfd.	2,116,224*
	Florida Power Company:		10,000	\$4.75 Pfd., Series 53	814,350*
17,769	4.58% Pfd.	1,428,272*	790	Pennsylvania Power Company, 7.75% Pfd.	80,260*
5,157	4.60% Pfd.	414,494*	12,722	Portland General Electric, 7.75% Sinking Fund Pfd.	1,310,366*
18,535	4.75% Pfd., Pvt.	1,538,405*		Potomac Electric Power Company:	
170	Florida Power & Light Company, 4.50% Pfd., Series A, Pvt.	14,084*	5,000	\$2.44 Pfd., Series 1957	214,875*
50,000	Georgia Power Capital Trust V, 7.125% Pfd.	1,295,000	19,209	\$3.40 Sinking Fund Pfd.	962,179*
2,010	Great Plains Energy, Inc., 4.50% Pfd.	146,449*	10,000	Public Service Company of New Mexico, 4.58% Pfd., Series 1965	691,000*
	Hawaiian Electric Company, Inc., HECO Capital Trust III, 6.50% Pfd.	2,740,650	10,800	Public Service Enterprise Group, Inc., Enterprise Capital Trust I, 7.44% TOPrS, Series A	267,084
2,717	Idaho Power Company, 7.68% Pfd., Series 1	281,006*	1,200	San Diego Gas & Electric Company: 4.40% Pfd.	18,984*
8,000	Indiana Michigan Power Company, 6.875% Sinking Fund Pfd.	811,160*	700	4.50% Pfd.	11,323*
32,650	Indianapolis Power & Light Company, 5.65% Pfd.	2,810,512*	21,250	\$1.7625 Sinking Fund Pfd.	543,575*
384,000	Interstate Power & Light Company, 8.375% Pfd., Series B	11,784,960*	40,000	\$1.70 Pfd.	1,045,800*
14,250	Narragansett Electric Company, 4.64% Pfd.	584,179*	25,373	South Carolina Electric & Gas Company: 5.125% Purchase Fund Pfd., Pvt. ...	1,241,755*
3,905	Northern Indiana Public Service Company, 7.44% Pfd.	399,521*	6,703	6.00% Purchase Fund Pfd., Pvt.	342,054*
6,170	Ohio Edison Company, 4.44% Pfd.	447,726*	60,000	Southern Union Company, 7.55% Pfd.	1,582,800*
1,724	Ohio Power Company, 5.90% Sinking Fund Pfd.	172,512*		TXU US Holdings Company:	
5,000	PECO Energy Company, \$4.40 Pfd., Series C	383,125*	10,000	\$4.00 Pfd., Series TES	666,950*
			5,700	\$4.00 Pfd., Series TPL	380,162*
			1,000	\$4.84 Pfd.	80,700*
			\$ 750,000	TXU Electric Capital V, 8.175% 01/30/37 Capital Security ...	816,188
			14,150	Union Electric Company, 4.56% Pfd.	1,180,747*
			12,500	Virginia Electric & Power, \$7.05 Pfd.	1,291,625*

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PORTFOLIO OF INVESTMENTS (Continued)

May 31, 2004 (Unaudited)

Shares/\$ Par	Value (Note 1)	Shares/\$ Par	Value (Note 1)
PREFERRED SECURITIES — (Continued)		INVERSE FLOATING RATE PREFERRED — 0.9%	
FIXED RATE PREFERRED SECURITIES — (Continued)		18	Premium Assets, Series A, Zurich Financial Reg. Capital \$ 2,077,915*
UTILITIES — (Continued)		TOTAL PREFERRED SECURITIES	
Wisconsin Power & Light:		(Cost \$202,820,037) 216,787,140	
1,220	4.50% Pfd. \$ 100,772*	CORPORATE DEBT SECURITY — 0.5% (Cost \$1,107,375)	
333	4.80% Pfd. 29,073*	45,000	Northern States Power Company, 8.00% PINES 1,197,225
13,000	6.20% Pfd. 1,335,490*	COMMON STOCK AND CONVERTIBLE SECURITIES — 4.6%	
Xcel Energy, Inc.:		107,500	Duke Energy Corporation 2,150,537*
16,030	\$4.08 Pfd., Series B 1,096,212*	109,500	FPL Group, Inc., 8.50% Pfd., Mandatory Convertible 02/16/05 5,990,198
26,200	\$4.10 Pfd., Series C 1,800,464*	30,000	TXU Corporation, 8.75% Pfd., Mandatory Convertible 11/16/05 1,333,500
22,000	\$4.11 Pfd., Series D 1,515,580*	50,000	UnumProvident Corporation, 8.25% Pfd., Mandatory Convertible 05/16/06 1,536,500
17,750	\$4.16 Pfd., Series E 1,237,708*	TOTAL COMMON STOCK AND CONVERTIBLE SECURITIES	
10,000	\$4.56 Pfd., Series G 764,300*	(Cost \$11,120,313) 11,010,735	
TOTAL UTILITIES FIXED RATE PREFERRED SECURITIES 92,245,110		OPTION CONTRACTS — 2.1% (Cost \$6,483,264)	
OIL AND GAS — 3.4%		1,499	Put Option on U.S. Treasury Bond, September Futures, Expiring 08/27/04 4,894,453†
17,200	Anadarko Petroleum Corporation, 5.46% Pfd. 1,719,914*		
10,000	ENI, S.p.A., Lasmo America Limited, 8.15% Pfd., 144A**** 1,129,500*		
4,985	EOG Resources, Inc., 7.195% Pfd., Series B 5,364,757*		
TOTAL OIL AND GAS FIXED RATE PREFERRED SECURITIES 8,214,171			
MISCELLANEOUS INDUSTRIES — 1.7%			
13,600	E.I. Du Pont de Nemours and Company, \$4.50 Pfd., Series B 1,140,156*		
36,200	Farmland Industries, Inc., 8.00% Pfd., 144A**** 27,150*†		
33,250	Ocean Spray Cranberries, Inc., 6.25% Pfd., 144A**** 2,568,729*		
26,000	Touch America Holdings, \$6.875 Pfd. 364,000*†		
TOTAL MISCELLANEOUS INDUSTRIES FIXED RATE PREFERRED SECURITIES 4,100,035			
TOTAL FIXED RATE PREFERRED SECURITIES 194,388,762			

The accompanying notes are an integral part of the financial statements.

PORTFOLIO OF INVESTMENTS (Continued)

May 31, 2004 (Unaudited)

<u>Shares/\$ Par</u>	<u>Value (Note 1)</u>
MONEY MARKET FUND — 0.9% (Cost \$2,049,332)	
2,049,332 BlackRock Provident Institutional TempFund, 0.91%	<u>\$ 2,049,332</u>
TOTAL INVESTMENTS (Cost \$223,580,321***) 99.2%	235,938,885
OTHER ASSETS AND LIABILITIES (Net) 0.8%	<u>1,949,580</u>
TOTAL NET ASSETS AVAILABLE TO COMMON AND PREFERRED STOCK	<u>100.0%† \$237,888,465</u>
MONEY MARKET CUMULATIVE PREFERRED™ STOCK (MMP®) REDEMPTION VALUE	(80,000,000)
ACCUMULATED UNDECLARED DISTRIBUTIONS TO MMP®	<u>(118,366)</u>
TOTAL NET ASSETS AVAILABLE TO COMMON STOCK	<u>\$157,770,099</u>

* Securities eligible for the Dividends Received Deduction and distributing Qualified Dividend Income.

** Securities distributing Qualified Dividend Income only.

*** Aggregate cost of securities held.

**** Securities exempt from registration under Rule 144A of the Securities Act of 1933. These securities may be resold in transactions exempt from registration to qualified institutional buyers.

† Non-income producing.

‡ The percentage shown for each investment category is the total value of that category as a percentage of net assets available to Common and Preferred Stock.

ABBREVIATIONS (Note 7):

PINES — Public Income Notes

QUIPS — Quarterly Income Preferred Securities

REIT — Real Estate Investment Trust

STOPS — Semi-Annual Trust Originated Pass Through Securities

TOPrS — Trust Originated Preferred Securities

Pfd. — Preferred Securities

Pvt. — Private Placement Securities

Capital Securities are treated as debt instruments for financial statement purposes and the amounts shown in the Shares/\$ Par column are dollar amounts of par value.

The accompanying notes are an integral part of the financial statements.

STATEMENT OF ASSETS AND LIABILITIES

May 31, 2004 (Unaudited)

ASSETS:

Investments, at value (Cost \$223,580,321) (See accompanying Portfolio of Investments)	\$ 235,938,885
Receivable for Investments sold	95,551
Dividends and interest receivable	2,168,328
Prepaid expenses.	<u>181,813</u>
Total Assets.	238,384,577

LIABILITIES:

Payable for Investments purchased.	\$ 99,425
Dividends payable to Common Shareholders	158,472
Investment advisory fee payable	111,597
Administration, Transfer Agent and Custodian fees and expenses payable	57,095
Professional fees payable	33,274
Directors' fees payable	858
Accrued expenses and other payables	35,391
Accumulated undeclared distributions to Money Market Cumulative Preferred™ Stock	<u>118,366</u>
Total Liabilities.	<u>614,478</u>

Money Market Cumulative Preferred™ Stock (800 shares outstanding) redemption value	<u>80,000,000</u>
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NET ASSETS AVAILABLE TO COMMON STOCK.	<u><u>\$ 157,770,099</u></u>
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NET ASSETS AVAILABLE TO COMMON STOCK consist of:

Undistributed net investment income.	\$ 301,490
Accumulated net realized loss on investments sold.	(1,894,181)
Unrealized appreciation of investments	12,358,564
Par value of Common Stock	102,141
Paid-in capital in excess of par value of Common Stock	<u>146,902,085</u>
Total Net Assets Available to Common Stock	<u><u>\$157,770,099</u></u>

NET ASSET VALUE PER SHARE OF COMMON STOCK:

Common Stock (10,214,082 shares outstanding)	<u><u>\$ 15.45</u></u>
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The accompanying notes are an integral part of the financial statements.

STATEMENT OF OPERATIONS
For the Six Months Ended May 31, 2004 (Unaudited)

INVESTMENT INCOME:

Dividends††	\$ 5,931,702
Interest	<u>1,601,966</u>
Total Investment Income	7,533,668

EXPENSES:

Investment advisory fee	\$672,478
Administrator's fee	108,824
Money Market Cumulative Preferred™ Stock broker commissions and auction agent fees	107,430
Professional fees	57,850
Insurance expense	120,385
Shareholder servicing agent fees and expenses	40,189
Directors' fees and expenses	37,450
Custodian fees and expenses	13,470
Other	<u>46,706</u>
Total Expenses	<u>1,204,782</u>

NET INVESTMENT INCOME	<u>6,328,886</u>
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REALIZED AND UNREALIZED GAIN/(LOSS) ON INVESTMENTS

Net realized gain on investments sold during the period	4,790,523
Change in unrealized depreciation of investments during the period	<u>(8,650,145)</u>

NET REALIZED AND UNREALIZED LOSS ON INVESTMENTS	<u>(3,859,622)</u>
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DISTRIBUTIONS TO MONEY MARKET CUMULATIVE PREFERRED™ STOCK SHAREHOLDERS:

From net investment income (including changes in accumulated undeclared distributions)	<u>(473,369)</u>
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**NET INCREASE IN NET ASSETS TO COMMON STOCK
 RESULTING FROM OPERATIONS**

\$ 1,995,895

†† For Federal income tax purposes, a significant portion of this amount does not qualify for the Inter-corporate dividends received deduction ("DRD") or as Qualified Dividend Income ("QDI") for individuals.

The accompanying notes are an integral part of the financial statements.

STATEMENTS OF CHANGES IN NET ASSETS

	<u>Six Months Ended May 31, 2004 (Unaudited)</u>	<u>Period Ended November 30, 2003</u>
OPERATIONS:		
Net investment income	\$ 6,328,886	\$ 13,047,887
Net realized gain on investments sold during the period	4,790,523	3,098,132
Change in net unrealized appreciation/(depreciation) of investments sold during the period	(8,650,145)	19,645,164
Distributions to Money Market Cumulative Preferred™ Stock Shareholders from net investment income, including changes in accumulated undeclared distributions	<u>(473,369)</u>	<u>(1,055,700)</u>
Net increase in net assets resulting from operations	1,995,895	34,735,483
DISTRIBUTIONS:		
Dividends paid from net investment income to Common Stock Shareholders	(6,214,679)	(12,392,105)
Distributions paid from net realized capital gains to Common Stock Shareholders	<u>—</u>	<u>—</u>
Total Distributions to Common Stock Shareholders	(6,214,679)	(12,392,105)
FUND SHARE TRANSACTIONS:		
Increase from Common Stock transactions	1,064,712	1,830,875
Decrease due to Money Market Cumulative Preferred™ Stock transactions (see Note 6)	<u>—</u>	<u>(6,318)</u>
Net increase in net assets available to Common Stock resulting from Fund share transactions	1,064,712	1,824,557
NET INCREASE/(DECREASE) IN NET ASSETS AVAILABLE TO COMMON STOCK FOR THE PERIOD	(3,154,072)	24,167,935
NET ASSETS AVAILABLE TO COMMON STOCK:		
Beginning of period	<u>160,924,171</u>	<u>136,756,236</u>
End of period (including undistributed net investment income of \$301,490 and \$660,652, respectively)	<u>\$157,770,099</u>	<u>\$160,924,171</u>

The accompanying notes are an integral part of the financial statements.

FINANCIAL HIGHLIGHTS**For a Common share outstanding throughout each period.**

Contained below is per share operating performance data, total investment returns, ratios to average net assets and other supplemental data. This information has been derived from information provided in the financial statements and market price data for the Fund's shares.

	Six Months Ended May 31, 2004 (Unaudited)	Year Ended November 30,				
		2003	2002	2001	2000	1999
PER SHARE OPERATING PERFORMANCE:						
Net asset value, beginning of period	\$ 15.85	\$ 13.63	\$ 14.62	\$ 13.41	\$ 14.41	\$ 16.43
INVESTMENT OPERATIONS:						
Net investment income	0.62	1.28	1.29	1.23	1.32	1.29
Net realized and unrealized gain/(loss) on investments	(0.37)	2.27	(1.01)	1.19	(0.56)	(1.35)
DISTRIBUTIONS TO MMP^{®*} SHAREHOLDERS:						
From net investment income	(0.04)	(0.10)	(0.12)	(0.23)	(0.29)	(0.23)
From net realized capital gains	—	—	—	—	(0.01)	(0.08)
Total from investment operations	0.21	3.45	0.16	2.19	0.46	(0.37)
Cost of Issuance of Additional MMP ^{®*} (Note 6)	—	—	(0.05)	—	—	—
DISTRIBUTIONS TO COMMON SHAREHOLDERS:						
From net investment income	(0.61)	(1.23)	(1.10)	(0.98)	(1.04)	(1.12)
From net realized capital gains	—	—	—	—	(0.42)	(0.53)
Total distributions to Common Shareholders	(0.61)	(1.23)	(1.10)	(0.98)	(1.46)	(1.65)
Net asset value, end of period	\$ 15.45	\$ 15.85	\$ 13.63	\$ 14.62	\$ 13.41	\$ 14.41
Market value, end of period	\$ 17.62	\$ 17.65	\$ 15.00	\$ 14.47	\$ 12.13	\$ 12.75
Total investment return based on net asset value****	0.96%***	25.87%	0.58%	17.01%	4.55%	(1.81)%
Total investment return based on market value****	3.39%***	27.35%	11.84%	28.02%	6.88%	(10.43)%
RATIOS TO AVERAGE NET ASSETS AVAILABLE TO COMMON STOCK SHAREHOLDERS:						
Total net assets, end of period (in 000's)	\$157,770	\$160,924	\$136,756	\$144,650	\$131,892	\$141,802
Operating expenses	1.47%**	1.51%	1.48%	1.42%	1.41%	1.37%
Net investment income†	7.09%**	7.84%	8.32%	7.21%	7.58%	6.66%
SUPPLEMENTAL DATA:††						
Portfolio turnover rate	18%***	28%	30%	39%	66%	65%
Total net assets available to Common and Preferred Stock, end of period (in 000's)	\$237,770	\$240,992	\$216,974	\$202,412	\$189,983	\$199,863
Ratio of operating expenses to total average net assets available to Common and Preferred Stock	0.99%**	0.99%	0.99%	1.00%	0.98%	0.99%
* Money Market Cumulative Preferred™ Stock.						
** Annualized.						
*** Not annualized.						
**** Assumes reinvestment of distributions at the price obtained by the Fund's Dividend Reinvestment Plan.						
† The net investment income ratios reflect income net of operating expenses and payments to MMP ^{®*} Shareholders.						
†† Information presented under heading Supplemental Data includes MMP ^{®*} .						

The accompanying notes are an integral part of the financial statements.

FINANCIAL HIGHLIGHTS (Continued)

The table below sets out information with respect to Money Market Cumulative Preferred™ Stock currently outstanding.

<u>Date</u>	<u>Total Shares Outstanding (1)</u>	<u>Asset Coverage Per Share (3)</u>	<u>Involuntary Liquidating Preference Per Share (2)</u>	<u>Average Market Value Per Share (1) & (2)</u>
05/31/04*	800	\$297,361	\$100,000	\$100,000
11/30/03	800	301,240	100,000	100,000
11/30/02	800	271,218	100,000	100,000
11/30/01	575	352,021	100,000	100,000
11/30/00	575	330,404	100,000	100,000
11/30/99	575	347,588	100,000	100,000
11/30/98	575	381,562	100,000	100,000

(1) See Note 6.

(2) Excludes accumulated undeclared dividends.

(3) Calculated by subtracting the Fund's total liabilities (excluding the MMP®) from the Fund's total assets and dividing that amount by the number of MMP® shares outstanding.

* Unaudited.

The accompanying notes are an integral part of the financial statements.

NOTES TO FINANCIAL STATEMENTS (Unaudited)

1. Organization

Flaherty & Crumrine Preferred Income Fund Incorporated (the “Fund”, formerly known as Preferred Income Fund Incorporated) was incorporated as a Maryland corporation on September 28, 1990, and commenced operations on January 31, 1991 as a diversified, closed-end management investment company under the Investment Company Act of 1940, as amended. The Fund’s investment objective is to provide its common shareholders with high current income consistent with the preservation of capital.

2. Significant Accounting Policies

The following is a summary of significant accounting policies consistently followed by the Fund in the preparation of its financial statements. The preparation of financial statements is in conformity with accounting principles generally accepted in the United States of America and requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities in the financial statements and the reported amounts of increases and decreases in net assets from operations during the reporting period. Actual results could differ from those estimates.

Portfolio valuation: The net asset value of the Fund’s Common Stock is determined by the Fund’s Administrator no less frequently than on the last business day of each week and month. It is determined by dividing the value of the Fund’s net assets attributable to Common Stock by the number of shares of Common Stock outstanding. The value of the Fund’s net assets available to Common Stock is deemed to equal the value of the Fund’s total assets less (i) the Fund’s liabilities, (ii) the aggregate liquidation value of the outstanding Money Market Cumulative Preferred™ Stock (“MMP®”) and (iii) accumulated and unpaid dividends on the outstanding MMP®.

Securities listed on a national securities exchange are valued on the basis of the last sale on such exchange on the day of valuation, except as described hereafter. In the absence of sales of listed securities and with respect to (a) securities for which the most recent sale prices are not deemed to represent fair market value and (b) unlisted securities (other than money market instruments), securities are valued at the mean between the closing bid and asked prices when quoted prices for investments are readily available. Investments in over-the-counter derivative instruments, such as interest rate swaps and options thereon (“swaptions”), are valued at the prices obtained from the broker/dealer or bank that is the counterparty to such instrument, subject to comparison of such valuation with a valuation obtained from a broker/dealer or bank that is not a counterparty to the particular derivative instrument. Investments for which market quotations are not readily available or for which management determines that the prices are not reflective of current market conditions are valued at fair value as determined in good faith by or under the direction of the Board of Directors of the Fund, including reference to valuations of other securities which are comparable in quality, maturity and type. Investments in money market instruments, which mature in 60 days or less, are valued at amortized cost. Investments in money market funds are valued at the net asset value of such funds.

NOTES TO FINANCIAL STATEMENTS (Unaudited) (Continued)

Securities transactions and investment income: Securities transactions are recorded as of the trade date. Realized gains and losses from securities sold are recorded on the identified cost basis. Dividend income is recorded on ex-dividend dates. Interest income is recorded on an accrual basis. The Fund also amortizes premiums and accretes discounts on those fixed income securities, including capital securities and bonds, which trade and are quoted on an “accrued income” basis.

Options: Upon the purchase of an option by the Fund, the total purchase price paid is recorded as an investment. The market valuation is determined as set forth in the preceding portfolio valuation paragraph. When the Fund enters into a closing sale transaction, the Fund will record a gain or loss depending on the difference between the purchase and sale price. The risks associated with purchasing options and the maximum loss the Fund would incur are limited to the purchase price originally paid.

Repurchase agreements: The Fund may engage in repurchase agreement transactions. The Fund’s investment adviser reviews and approves the eligibility of the banks and dealers with which the Fund may enter into repurchase agreement transactions. The value of the collateral underlying such transactions is at least equal at all times to the total amount of the repurchase obligations, including interest. The Fund maintains possession of the collateral through its custodian and, in the event of counterparty default, the Fund has the right to use the collateral to offset losses incurred. There is the possibility of loss to the Fund in the event the Fund is delayed or prevented from exercising its rights to dispose of the collateral securities.

Dividends and distributions to shareholders: The Fund expects to declare dividends on a monthly basis to Shareholders of Common Stock (“Shareholders”). The Shareholders of MMP® are entitled to receive cumulative cash dividends as declared by the Fund’s Board of Directors. Distributions to Shareholders are recorded on the ex-dividend date. Any net realized short-term capital gains will be distributed to Shareholders at least annually. Any net realized long-term capital gains may be distributed to Shareholders at least annually or may be retained by the Fund as determined by the Fund’s Board of Directors. Capital gains retained by the Fund are subject to tax at the capital gains corporate tax rate. Subject to the Fund’s qualifying as a regulated investment company, any taxes paid by the Fund on such net realized long-term gains may be used by the Fund’s Shareholders as a credit against their own tax liabilities.

Federal income taxes: The Fund intends to continue to qualify as a regulated investment company by complying with the requirements under subchapter M of the Internal Revenue Code of 1986, as amended, applicable to regulated investment companies and intends to distribute substantially all of its taxable net investment income to its shareholders. Therefore, no Federal income tax provision is required.

Income and capital gain distributions are determined and characterized in accordance with income tax regulations which may differ from generally accepted accounting principles. These differences are primarily due to (1) differing treatments of income and gains on various investment securities held by the Fund, including timing differences, (2) the attribution of expenses against certain components of taxable investment income, and (3) federal regulations requiring proportionate allocation of income and gains to all classes of shareholders.

NOTES TO FINANCIAL STATEMENTS (Unaudited) (Continued)

Distributions from net realized gains for book purposes may include short-term capital gains, which are included as ordinary income for tax purposes, and may exclude amortization of premium on “accrued income” securities, which are not reflected in ordinary income for tax purposes. The tax character of distributions paid, including changes in accumulated undeclared distributions to MMP® Shareholders, during 2003 and year-to date was as follows:

	<u>Distributions paid in fiscal year 2004</u>		<u>Distributions paid in fiscal year 2003</u>	
	<u>Ordinary Income</u>	<u>Long-Term Capital Gains</u>	<u>Ordinary Income</u>	<u>Long-Term Capital Gains</u>
Common	N/A	N/A	\$12,392,105	—
Preferred	N/A	N/A	\$ 1,055,700	—

As of November 30, 2003, the components of distributable earnings (i.e., ordinary income and capital gain/loss) available to Common and Preferred Stock Shareholders, on a tax basis were as follows:

<u>Capital (Loss) Carryforward</u>	<u>Undistributed Ordinary Income</u>	<u>Undistributed Long-Term Gain</u>	<u>Unrealized Appreciation/(Depreciation)</u>
\$(5,713,607)	\$1,035,610	—	\$20,037,612

At November 30, 2003, the composition of the Fund's \$5,713,607 accumulated realized capital losses was \$4,444,626, \$513,821 and \$755,160 in 2000, 2001 and 2002, respectively. These losses may be carried forward and offset against any future capital gains through 2008, 2009 and 2010, respectively.

Excise tax: The Internal Revenue Code of 1986, as amended, imposes a 4% nondeductible excise tax on the Fund to the extent the Fund does not distribute by the end of any calendar year at least (1) 98% of the sum of its net investment income for that year and its capital gains (both long term and short term) for its fiscal year and (2) certain undistributed amounts from previous years. The Fund paid \$21,162 of Federal excise taxes attributable to calendar year 2003 in March of 2004.

3. Investment Advisory Fee, Directors’ Fees, Administration Fee, Transfer Agent Fee and Custodian Fee

Flaherty & Crumrine Incorporated (the “Adviser”) serves as the Fund’s investment adviser. The Fund pays the Adviser a monthly fee at an annual rate of 0.625% of the value of the Fund’s average monthly total net assets available to Common and Preferred Stock up to \$100 million and 0.50% of the value of the Fund’s average monthly total net assets available to Common and Preferred Stock in excess of \$100 million.

The Fund currently pays each Director who is not a director, officer or employee of the Adviser a fee of \$9,000 per annum, plus \$500 for each in-person meeting of the Board of Directors or any committee and \$150 for each telephone meeting. The Audit Committee Chairman receives an additional annual fee of \$2,500. In addition, the Fund reimburses all Directors for travel and out-of-pocket expenses incurred in connection with such meetings.

NOTES TO FINANCIAL STATEMENTS (Unaudited) (Continued)

PFPC Inc., a member of the PNC Financial Services Group, Inc. ("PNC Financial Services"), serves as the Fund's Administrator and Transfer Agent. As Administrator, PFPC Inc. calculates the net asset value of the Fund's shares attributable to Common and Preferred Stock and generally assists in all aspects of the Fund's administration and operation. As compensation for PFPC Inc.'s services as Administrator, the Fund pays PFPC Inc. a monthly fee at an annual rate of 0.10% of the first \$200 million of the Fund's average weekly total managed assets, 0.04% of the next \$300 million of the Fund's average weekly total managed assets, 0.03% of the next \$500 million of the Fund's average weekly total managed assets and 0.02% of the Fund's average weekly total managed assets above \$1 billion.

PFPC Inc. also serves as the Fund's Common Stock Servicing Agent (Transfer Agent), dividend-paying agent and registrar and, as compensation for PFPC Inc.'s services as such, the Fund pays PFPC Inc. a fee at an annual rate of 0.02% of the first \$150 million of the Fund's average weekly net assets attributable to Common Stock, 0.01% of the next \$350 million of the Fund's average weekly net assets attributable to Common Stock, 0.005% of the next \$500 million of the Fund's average weekly net assets attributable to Common Stock and 0.0025% of the Fund's average weekly net assets attributable to Common Stock above \$1 billion, plus certain out-of-pocket expenses. For the purpose of calculating such fee, the Fund's average weekly net assets attributable to Common Stock will be deemed to be the average weekly value of the Fund's total assets minus the sum of the Fund's liabilities and accumulated dividends, if any, on Preferred Stock. For this calculation, the Fund's liabilities are deemed to include the aggregate liquidation preference of any outstanding Fund preferred shares.

PFPC Trust Company ("PFPC Trust") serves as the Fund's custodian. PFPC Trust is an indirect subsidiary of PNC Financial Services. As compensation for PFPC Trust's services as custodian, the Fund pays PFPC Trust a monthly fee at the annual rate of 0.010% of the first \$200 million of the Fund's average weekly total managed assets, 0.008% of the next \$300 million of the Fund's average weekly total managed assets, 0.006% of the next \$500 million of the Fund's average weekly total managed assets, and 0.005% of the Fund's average weekly total managed assets above \$1 billion.

4. Purchases and Sales of Securities

Cost of purchases and proceeds from sales of securities for the six months ended May 31, 2004, excluding short-term investments, aggregated \$43,918,322 and \$46,392,160 respectively.

At May 31, 2004, aggregate gross unrealized appreciation for all securities in which there is an excess of value over tax cost was \$19,579,076 and aggregate gross unrealized depreciation for all securities in which there is an excess of tax cost over value was \$7,220,512.

NOTES TO FINANCIAL STATEMENTS (Unaudited) (Continued)**5. Common Stock**

At May 31, 2004, 240,000,000 shares of \$0.01 par value Common Stock were authorized.

Common Stock Transactions were as follows:

	<u>Six Months Ended</u> 5/31/04		<u>Year Ended</u> 11/30/03	
	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>
Issued as reinvestment of dividends under the Dividend Reinvestment and Cash Purchase Plan	61,366	\$1,064,712	120,171	\$1,830,875

6. Money Market Cumulative Preferred™ Stock (MMP®)

The Fund's Articles of Incorporation authorize the issuance of up to 10,000,000 shares of \$0.01 par value preferred stock. The MMP® is senior to the Common Stock and results in the financial leveraging of the Common Stock. Such leveraging tends to magnify both the risks and opportunities to Common Stock Shareholders. Dividends on shares of MMP® are cumulative.

The Fund is required to meet certain asset coverage tests with respect to the MMP®. If the Fund fails to meet these requirements and does not correct such failure, the Fund may be required to redeem, in part or in full, MMP® at a redemption price of \$100,000 per share plus an amount equal to the accumulated and unpaid dividends on such shares in order to meet these requirements. Additionally, failure to meet the foregoing asset requirements could restrict the Fund's ability to pay dividends to Common Stock Shareholders and could lead to sales of portfolio securities at inopportune times.

If the Fund allocates any net gains or income ineligible for the Dividends Received Deduction to shares of the MMP®, the Fund is required to make additional distributions to MMP® Shareholders or to pay a higher dividend rate in amounts needed to provide a return, net of tax, equal to the return had such originally paid distributions been eligible for the Dividends Received Deduction.

An auction of the MMP® is generally held every 49 days. Existing shareholders may submit an order to hold, bid or sell such shares at par value on each auction date. MMP® Shareholders may also trade shares in the secondary market between auction dates.

On June 4, 2002, the Fund issued 225 shares of additional MMP® with an initial dividend rate equal to 2.04%. These newly issued shares are identical to the previously outstanding 575 shares in all respects on and after their first auction date, which was June 5, 2002. Consequently, the Fund now has 800 shares of MMP® outstanding in one series, which represents a par value of \$80 million.

The newly issued shares were underwritten by Lehman Brothers. The underwriter's discount of 1.25% of the \$22.5 million face value totaled \$281,250 and was immediately charged to common equity capital upon completion of the offering.

NOTES TO FINANCIAL STATEMENTS (Unaudited) (Continued)

Costs of the issue, including legal, printing, registration, rating agency fees, etc. of \$219,027 were charged against common equity capital. The sum of underwriters discount and cost of the issue totaled \$500,277.

At May 31, 2004, 800 shares of MMP® were outstanding at the annual rate of 1.10%. Additionally, on June 9, 2004 the auction rate was 1.42%. The dividend rate, as set by the auction process, is generally expected to vary with short-term interest rates. These rates may vary in a manner unrelated to the income received on the Fund's assets, which could have either a beneficial or detrimental impact on net investment income and gains available to Common Stock Shareholders. While the Fund expects to structure its portfolio holdings and hedging transactions to lessen such risks to Common Stock Shareholders, there can be no assurance that such results will be attained.

7. Portfolio Investments, Concentration and Investment Quality

The Fund invests primarily in traditional DRD-eligible preferred securities (i.e., adjustable and fixed rate preferred and preference stocks) and similar hybrid, i.e., fully taxable, preferred securities. Under normal market conditions, at least 80% of the value of the Fund's net assets will be invested in preferred securities. Also, under normal market conditions, the Fund invests at least 25% of its assets in securities issued by utilities and at least 25% of its assets in securities issued by companies in the banking industry. The Fund's portfolio may therefore be subject to greater risk and market fluctuation than a portfolio of securities representing a broader range of investment alternatives. The risks could adversely affect the ability and inclination of companies in these industries to declare and pay dividends or interest and the ability of holders of securities of such companies to realize any value from the assets of the issuer upon liquidation or bankruptcy.

The Fund may invest up to 25% of its assets at the time of purchase in securities rated below investment grade. These securities must be rated at least either "Ba3" by Moody's Investors Service, Inc. or "BB-" by Standard & Poor's or judged to be comparable in quality, in either case, at the time of purchase; however, these securities must be issued by an issuer having a class of senior debt rated investment grade outstanding.

The Fund may invest up to 15% of its assets in common stocks and, under normal market conditions, up to 20% of its assets in debt securities. Certain of its investments in hybrid, i.e., fully taxable, preferred securities, such as TOPrS, TIPS, QUIPS, MIPS, QUIDS, QUICS, QIB's, STOPS, CorTS, REIT, Capital Securities, and other similar or related investments, will be subject to the foregoing 20% limitation to the extent that, in the opinion of the Adviser, such investments are deemed to be debt-like in key characteristics. Typically, a security will not be considered debt-like if (a) an issuer can defer

NOTES TO FINANCIAL STATEMENTS (Unaudited) (Continued)

payment of income for eighteen months or more without triggering an event of default and (b) such issue is a junior and fully subordinated liability of an issuer or its ultimate guarantor.

The Fund may invest up to 30% of its total assets in the securities, other than money market securities, of companies organized or having their principal place of business outside the United States. All foreign securities held by the Fund will be denominated in U.S. dollars. The percentage limitation was instituted by the Fund's Board of Directors at its regular board meeting on April 23, 2004.

8. Special Investment Techniques

The Fund may employ certain investment techniques in accordance with its fundamental investment policies. These may include the use of when-issued and delayed delivery transactions. Securities purchased or sold on a when-issued or delayed delivery basis may be settled within 45 days after the date of the transaction. Such transactions may expose the Fund to credit and market valuation risk greater than that associated with regular trade settlement procedures. The Fund may also enter into transactions, in accordance with its fundamental investment policies, involving any or all of the following: lending of portfolio securities, short sales of securities, futures contracts, interest rate swaps, options on futures contracts, options on securities and swaptions. As in the case of when-issued securities, the use of over-the-counter derivatives, such as interest rate swaps and swaptions, may expose the Fund to greater credit, operations, and market value risk than is the case with regulated, exchange traded futures and options. With the exception of purchasing securities on a when-issued or delayed delivery basis or lending portfolio securities, these transactions are used for hedging or other appropriate risk-management purposes or, under certain other circumstances, to increase income. As of May 31, 2004, the Fund owned put options on U.S. Treasury bond futures contracts. No assurance can be given that such transactions will achieve their desired purposes or will result in an overall reduction of risk to the Fund.

ADDITIONAL INFORMATION (Unaudited)

Dividend Reinvestment and Cash Purchase Plan

Under the Fund's Dividend Reinvestment and Cash Purchase Plan (the "Plan"), a shareholder whose Common Stock is registered in his or her own name will have all distributions reinvested automatically by PFPC Inc. as agent under the Plan, unless the shareholder elects to receive cash. Distributions with respect to shares registered in the name of a broker-dealer or other nominee (that is, in "street name") may be reinvested by the broker or nominee in additional shares under the Plan, but only if the service is provided by the broker or nominee, unless the shareholder elects to receive distributions in cash. A shareholder who holds Common Stock registered in the name of a broker or other nominee may not be able to transfer the Common Stock to another broker or nominee and continue to participate in the Plan. Investors who own Common Stock registered in street name should consult their broker or nominee for details regarding reinvestment.

The number of shares of Common Stock distributed to participants in the Plan in lieu of a cash dividend is determined in the following manner. Whenever the market price per share of the Fund's Common Stock is equal to or exceeds the net asset value per share on the valuation date, participants in the Plan will be issued new shares valued at the higher of net asset value or 95% of the then current market value. Otherwise, PFPC Inc. will buy shares of the Fund's Common Stock in the open market, on the New York Stock Exchange or elsewhere, on or shortly after the payment date of the dividend or distribution and continuing until the ex-dividend date of the Fund's next distribution to holders of the Common Stock or until it has expended for such purchases all of the cash that would otherwise be payable to the participants. The number of purchased shares that will then be credited to the participants' accounts will be based on the average per share purchase price of the shares so purchased, including brokerage commissions. If PFPC Inc. commences purchases in the open market and the then current market price of the shares (plus any estimated brokerage commissions) subsequently exceeds their net asset value most recently determined before the completion of the purchases, PFPC Inc. will attempt to terminate purchases in the open market and cause the Fund to issue the remaining dividend or distribution in shares. In this case, the number of shares received by the participant will be based on the weighted average of prices paid for shares purchased in the open market and the price at which the Fund issues the remaining shares. These remaining shares will be issued by the Fund at the higher of net asset value or 95% of the then current market value.

Plan participants are not subject to any charge for reinvesting dividends or capital gains distributions. Each Plan participant will, however, bear a proportionate share of brokerage commissions incurred with respect to PFPC Inc.'s open market purchases in connection with the reinvestment of dividends or capital gains distributions. For the period ended May 31, 2004, \$190 in brokerage commissions were incurred.

ADDITIONAL INFORMATION (Unaudited) (Continued)

The automatic reinvestment of dividends and capital gains distributions will not relieve Plan participants of any income tax that may be payable on the dividends or capital gains distributions. A participant in the Plan will be treated for Federal income tax purposes as having received, on the dividend payment date, a dividend or distribution in an amount equal to the cash that the participant could have received instead of shares.

In addition to acquiring shares of Common Stock through the reinvestment of cash dividends and distributions, a shareholder may invest any further amounts from \$100 to \$3,000 semi-annually at the then current market price in shares purchased through the Plan. Such semi-annual investments are subject to any brokerage commission charges incurred by PFPC Inc. under the Plan.

A shareholder whose Common Stock is registered in his or her own name may terminate participation in the Plan at any time by notifying PFPC Inc. in writing, by completing the form on the back of the Plan account statement and forwarding it to PFPC Inc. or by calling PFPC Inc. directly. A termination will be effective immediately if notice is received by PFPC Inc. not less than 10 days before any dividend or distribution record date. Otherwise, the termination will be effective, and only with respect to any subsequent dividends or distributions, on the first day after the dividend or distribution has been credited to the participant's account in additional shares of the Fund. Upon termination and according to a participant's instructions, PFPC Inc. will either (a) issue certificates for the whole shares credited to the shareholder's Plan account and a check representing any fractional shares or (b) sell the shares in the market. Shareholders who hold common stock registered in the name of a broker or other nominee should consult their broker or nominee to terminate participation.

The Plan is described in more detail in the Fund's Plan brochure. Information concerning the Plan may be obtained from PFPC Inc. at 1-800-331-1710.

Proxy Voting Policies

The Fund's proxy voting policies and procedures are available (i) without charge, upon request, by calling the Fund's transfer agent at 1-800-331-1710, (ii) on the Fund's website at www.preferredincome.com and (iii) on the Securities and Exchange Commission's website at www.sec.gov.

Portfolio Management Team

In managing the day-to-day operations of the Fund, the Adviser relies on the expertise of its team of money management professionals, consisting of Messrs. Crumrine, Ettinger, Stimes, Stone and Chadwick. The professional backgrounds of each member of the management team are included in the "Information about Fund Directors and Officers" section of this report beginning on page 29.

ADDITIONAL INFORMATION (Unaudited) (Continued)

Meeting of Shareholders

On April 23, 2004, the Fund held its Annual Meeting of Shareholders (the "Meeting") to elect two Directors of the Fund ("Proposal 1"). The results of the proposal are as follows:

Proposal 1: Election of Directors.

<u>Name</u>	<u>For</u>	<u>Withheld</u>
Common Stock		
Robert M. Ettinger	9,381,782	77,383
	<u>For</u>	<u>Withheld</u>
Preferred Stock		
Morgan Gust	580	—

Martin Brody, Donald F. Crumrine, David Gale and Robert F. Wulf continue to serve in their capacities as Directors of the Fund.

ADDITIONAL INFORMATION (Unaudited) (Continued)**Information about Fund Directors and Officers**

The business and affairs of the Fund are managed under the direction of the Fund's Board of Directors. Information pertaining to the Directors and officers of the Fund is set forth below.

<u>Name, Address, and Age</u>	<u>Position(s) Held with Fund</u>	<u>Term of Office and Length of Time Served*</u>	<u>Principal Occupation(s) During Past Five Years</u>	<u>Number of Funds in Fund Complex Overseen by Director</u>	<u>Other Directorships Held by Director</u>
NON-INTERESTED DIRECTORS:					
Martin Brody c/o HMK Associates 30 Columbia Turnpike Florham Park, NJ 07932 Age: 82	Director	Class I Director since 1991	Retired	4	Director, Jaclyn, Inc. (luggage and accessories). Director Emeritus, Smith Barney Mutual Funds (18 Funds). Director, Flaherty & Crumrine Preferred Income Opportunity Fund, Flaherty & Crumrine/Claymore Preferred Securities Income Fund and Flaherty & Crumrine/Claymore Total Return Fund.
David Gale Delta Dividend Group, Inc. 220 Montgomery Street Suite 426 San Francisco, CA 94104 Age: 55	Director	Class I Director since 1997	President & CEO of Delta Dividend Group, Inc. (investments).	4	Director, Golden State Vintners, Inc. (wine pressing). Director, Flaherty & Crumrine Preferred Income Opportunity Fund, Flaherty & Crumrine/Claymore Preferred Securities Income Fund and Flaherty & Crumrine/Claymore Total Return Fund.

* The Fund's Board of Directors is divided into three classes, each class having a term of three years. Each year the term of office of one class expires and the successor or successors elected to such class serve for a three year term. The three year term for each class expires as follows:

Class I Directors – three year term expires at the Fund's 2005 Annual Meeting of Shareholders; directors may continue in office until their successors are duly elected and qualified.

Class II Directors – three year term expires at the Fund's 2006 Annual Meeting of Shareholders; directors may continue in office until their successors are duly elected and qualified.

Class III Directors – three year term expires at the Fund's 2007 Annual Meeting of Shareholders; directors may continue in office until their successors are duly elected and qualified.

ADDITIONAL INFORMATION (Unaudited) (Continued)

<u>Name, Address, and Age</u>	<u>Position(s) Held with Fund</u>	<u>Term of Office and Length of Time Served*</u>	<u>Principal Occupation(s) During Past Five Years</u>	<u>Number of Funds in Fund Complex Overseen by Director</u>	<u>Other Directorships Held by Director</u>
NON-INTERESTED DIRECTORS:					
Morgan Gust† Giant Industries, Inc. 23733 N. Scottsdale Road Scottsdale, AZ 85255 Age: 57	Director	Class III Director since 1991	From March 2002, President of Giant Industries, Inc. (petroleum refining and marketing) and, for more than five years prior thereto, Executive Vice President, and various other Vice President positions at Giant Industries, Inc.	4	Director, Flaherty & Crumrine Preferred Income Opportunity Fund, Flaherty & Crumrine/Claymore Preferred Securities Income Fund and Flaherty & Crumrine/Claymore Total Return Fund.
Robert F. Wulf 3560 Deerfield Drive South Salem, OR 97302 Age: 67	Director	Class II Director since 1991	Financial Consultant; Trustee, University of Oregon Foundation; Trustee, San Francisco Theological Seminary.	4	Director, Flaherty & Crumrine Preferred Income Opportunity Fund, Flaherty & Crumrine/Claymore Preferred Securities Income Fund and Flaherty & Crumrine/Claymore Total Return Fund.

* The Fund's Board of Directors is divided into three classes, each class having a term of three years. Each year the term of office of one class expires and the successor or successors elected to such class serve for a three year term. The three year term for each class expires as follows:

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Class II Directors – three year term expires at the Fund's 2006 Annual Meeting of Shareholders; directors may continue in office until their successors are duly elected and qualified.

Class III Directors – three year term expires at the Fund's 2007 Annual Meeting of Shareholders; directors may continue in office until their successors are duly elected and qualified.

† As a Director, represents holders of shares of the Fund's Money Market Cumulative Preferred™ Stock.

ADDITIONAL INFORMATION (Unaudited) (Continued)

<u>Name, Address, and Age</u>	<u>Position(s) Held with Fund</u>	<u>Term of Office and Length of Time Served*</u>	<u>Principal Occupation(s) During Past Five Years</u>	<u>Number of Funds in Fund Complex Overseen by Director</u>	<u>Other Directorships Held by Director</u>
INTERESTED DIRECTORS:					
Donald F. Crumrine†, †† 301 E. Colorado Boulevard Suite 720 Pasadena, CA 91101 Age: 56	Director, Chairman of the Board and Chief Executive Officer	Class II Director since 1991	Chairman of the Board and Director of Flaherty & Crumrine Incorporated.	4	Director, Flaherty & Crumrine Preferred Income Opportunity Fund, Flaherty & Crumrine/ Claymore Preferred Securities Income Fund and Flaherty & Crumrine/Claymore Total Return Fund.
Robert M. Ettinger†† 301 E. Colorado Boulevard Suite 720 Pasadena, CA 91101 Age: 45	Director, President	Class III Director since 2002	President and Director of Flaherty & Crumrine Incorporated.	2	Director, Flaherty & Crumrine Preferred Income Opportunity Fund.

* The Fund's Board of Directors is divided into three classes, each class having a term of three years. Each year the term of office of one class expires and the successor or successors elected to such class serve for a three year term. The three year term for each class expires as follows:

Class I Directors – three year term expires at the Fund's 2005 Annual Meeting of Shareholders; directors may continue in office until their successors are duly elected and qualified.

Class II Directors – three year term expires at the Fund's 2006 Annual Meeting of Shareholders; directors may continue in office until their successors are duly elected and qualified.

Class III Directors – three year term expires at the Fund's 2007 Annual Meeting of Shareholders; directors may continue in office until their successors are duly elected and qualified.

† As a Director, represents holders of shares of the Fund's Money Market Cumulative Preferred™ Stock.

†† "Interested person" of the Fund as defined in the Investment Company Act of 1940. Messrs. Crumrine and Ettinger are each considered an "interested person" because of their affiliation with Flaherty & Crumrine Incorporated which acts as the Fund's investment adviser.

ADDITIONAL INFORMATION (Unaudited) (Continued)

<u>Name, Address, and Age</u>	<u>Position(s) Held with Fund</u>	<u>Term of Office and Length of Time Served*</u>	<u>Principal Occupation(s) During Past Five Years</u>	<u>Number of Funds in Fund Complex Overseen by Director</u>	<u>Other Directorships Held by Director</u>
OFFICERS:					
Peter C. Stimes 301 E. Colorado Boulevard Suite 720 Pasadena, CA 91101 Age: 48	Chief Financial Officer, Chief Accounting Officer, Vice President, Treasurer, and Assistant Secretary	Since 1991	Vice President of Flaherty & Crumrine Incorporated.	—	—
Bradford S. Stone 392 Springfield Avenue Mezzanine Suite Summit, NJ 07901 Age: 44	Vice President and Assistant Treasurer	Since July 2003	Since May 2003, Vice President of Flaherty & Crumrine Incorporated; from June 2001 to April 2003, Director of US Market Strategy at Barclays Capital; from February 1987 to June 2001, Vice President of Goldman, Sachs & Company as Director of U.S. Interest Rate Strategy and, previously, Vice President of Interest Rate Product Sales.	—	—
R. Eric Chadwick 301 E. Colorado Boulevard Suite 720 Pasadena, CA 91101 Age: 29	Vice President, Secretary and Assistant Treasurer	Since October 2002	Vice President of Flaherty & Crumrine Incorporated since August 2001, and previously (since January 1999) portfolio manager of Flaherty & Crumrine Incorporated.	—	—

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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 Officer,
Chief Accounting Officer,
Vice President, Treasurer,
and Assistant Secretary
Bradford S. Stone
Vice President and
Assistant Treasurer
R. Eric Chadwick, CFA
Vice President, Secretary and
Assistant Treasurer

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 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

Semi-Annual Report

May 31, 2004

web site: www.preferredincome.com