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

The following table summarizes the Fund's performance in its most recent fiscal quarter and over longer time periods compared with the average return of investment-grade, fixed-income closed-end funds:

TOTAL RETURN ON NET ASSET VALUE[1]
FOR PERIODS ENDED MAY 31, 2007

	Actual Returns			Average Annualized Returns			
	Three Months	Six Months	One Year	Three Years	Five Years	Ten Years	Life of Fund[2]
Flaherty & Crumrine Preferred Income Fund	-2.3%	-0.7%	7.5%	6.7%	9.5%	7.9%	11.1%
Lipper Domestic Investment Grade Funds[3]	0.3%	1.9%	8.4%	6.0%	6.3%	6.7%	7.5%

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

(2) Since inception on January 31, 1991.

(3) Includes all closed-end funds in Lipper's U.S. Government, U.S. Mortgage and Corporate Debt BBB Rated categories in each month during the period. Although the investment strategies used by the Fund differ significantly from the strategies used by these other fixed-income funds, the Fund seeks to achieve a similar income goal.

While the Fund did not perform as well as the Lipper group of funds during recent periods, it has outperformed this group over all longer time periods. The Fund's performance was impacted by a number of factors, and we've discussed in greater detail the total return for the most recent six-month period in the Questions and Answers section that follows. Stated in short, primarily due to rising long-term interest rates over the six-month period, the Fund's securities portfolio only had a modest positive return, which was reduced by its use of leverage and the overall expenses of operating the Fund. Over longer time periods, the Fund's use of leverage has benefited its common shareholders, not only by offsetting the Fund's expenses, but by increasing the total return.

These days we spend a lot of time assessing the likelihood of a company being purchased in a leveraged buyout (LBO). Billions of dollars are in the hands of LBO firms, fueled by their ability to borrow at historically low rates. As discussed in greater detail in the Questions and Answers section that follows, the economics of these buyouts have changed over the years, and many more companies – including issuers of preferred securities – are now potential targets.

Another type of risk receiving a lot of attention these days is fallout from weakness in the housing sector. We've discussed this in previous letters, but recently the market has refocused on subprime loans. Suffice it to say, the Fund continues to have no direct exposure to subprime lenders. While some of the bank and financial companies we invest in will certainly be impacted by weakness in the housing sector, in each case the impact still appears to be manageable.

Our investment process relies heavily on in-depth credit research – understanding as much as we can about the companies we invest in, from the financial statements to the philosophy of management to more current risks like LBOs and subprime exposure. That being said, we don't mind taking risk in our portfolio as long as we understand it and feel we are being adequately compensated.

The universe of preferred stock eligible for the dividends received deduction (DRD) remains in relatively tight supply. We do see new issues from time to time, but the general trend continues to be shrinkage in this market segment. Of course, this makes the DRD issues owned by the Fund a bit more precious, but it also makes it difficult to find new securities to buy. We don't expect this segment to disappear, but relative to the broader preferred market, it should continue to contract. DRD issues continue to be among the best performers in the fixed-income markets.

In contrast to the DRD market, the market for fully-taxable preferreds is in full bloom. There are often two or three new issues a week, and they tend to be pretty sizable. The lion's share of these new issues has been the "enhanced" variety we've discussed in the past (and described more fully on the Fund's website). In the two years since this structure was developed, close to one hundred new issues, with a market value of roughly $75 billion, have been created. It's harder to generalize about performance of the taxable preferred sector because of the wide variety of issuers and issue types, but it has mostly been a mixed bag. The Fund's portfolio has generally mirrored the overall market, but we think it should outperform over time.

Since preferred securities are connected at the hip to the U.S. Treasury market, a quick recap of that market is useful. Over the three months ended May 31st, the Treasury "curve" (the plot of yields versus maturity) twisted, as shorter-term rates fell modestly and intermediate and long-term rates increased. With intermediate and long-term rates continuing to increase since May 31st, the curve now has a more "normal" shape, with rates on longer maturity issues above those of shorter issues. Since March, intermediate and long-term rates have risen as a result of a combination of factors, including: a resurging domestic economy following a weak first quarter, increasing interest rates internationally and subsequent reduced investment flows from overseas, and the market's declining expectation of the Federal Reserve lowering short-term interest rates.

Sometimes the ride can be a little bumpy when the yield curve goes through a transition like this, but in the long run, the Fund should benefit. In the short run, we anticipate that the Fund's "safety net" hedging strategy should make the Fund's investment portfolio progressively less sensitive to further increases in long-term interest rates. In addition, higher interest rates also reduce the exposure of the Fund's holdings to early redemption, as the issuer's cost of funding these calls increases. In turn, this reduced exposure to early redemption enhances the Fund's ability to pay its current dividend.

The Questions and Answers section that follows and the Fund's website at www.preferredincome.com have more complete discussions of a number of topics that may interest you. The topics on the website include our overall assessment of the state of the economy and interest rates (in our Second Quarter Economic Update) and an archive of frequently-asked questions which remain relevant today – including an in-depth discussion of the risks of subprime mortgages, our interest-rate hedging strategy and our use of leverage. We believe an informed shareholder can be one of the strongest assets of any company, and we encourage you to explore the website for a wide range of additional information about your Fund.

Sincerely,

Donald F. Crumrine
Chairman of the Board

Robert M. Ettinger
President

July 17, 2007