

FLAHERTY & CRUMRINE PREFERRED INCOME FUND

To the Shareholders of Flaherty & Crumrine Preferred Income Fund:

Stating the obvious, we are facing extraordinary and unprecedented times in the financial markets. The events that ultimately culminated in the government's massive financial rescue plan have impacted the market for preferred securities particularly hard. As a result, for the quarter ended August 31, 2008, the Fund's common shareholders experienced a total return on net asset value of -14.2%, subsequent to the quarter-end and through the date of this letter, the net asset value has continued to decline significantly.

Prices on long-term US Treasury bonds rose during the quarter, as investors sought the safety of government bonds despite historically low yields. On the flip side, there were few buyers and abundant sellers of most preferred securities and corporate bonds. A downward cycle for prices ensued, as selling pressure pushed prices lower which in turn led to more selling pressure.

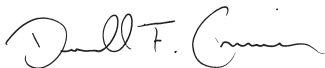
This pattern of selling begetting selling is an effect of severe bear market psychology. In addition, investors and lenders, seeking the safety and security of cash, withhold capital from borrowers. Since the free flow of capital is essential to our economy, and economic growth is a key factor in security valuation, concerns about price declines become self-fulfilling. The bears clearly were in control both during and subsequent to the quarter.

The root cause of the current financial problems remains unresolved—residential real estate markets have yet to stabilize. The speculative component of residential housing has resulted in “bubble and crash” cycles in the past, but the current adjustment is unlike any we can recall. Far too many people wanted to buy homes under the “greater fool” plan and lenders were far too willing to help. The real estate market will eventually return to equilibrium and the dramatic measures taken by the government will help calm the markets. In the meantime we must deal with circumstances at hand.

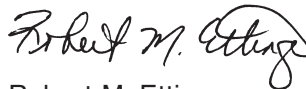
Since the end of our fiscal quarter events have transpired at a breathtaking pace – particularly relating to the Fund's use of leverage and its dividend. Our website allows for much more frequent communication than our quarterly letters. We have posted updates throughout this financial crisis and we encourage you to continue visiting us at www.preferredincome.com.

In addition to managing your Fund, we are also shareholders. We understand your concerns about recent events and we are doing our best to respond to them. Nonetheless, our goals remain constant – conduct exhaustive research and construct an investment portfolio that is designed to deliver high current income consistent with the objectives and guidelines of the Fund.

Sincerely,



Donald F. Crumrine
Chairman of the Board



Robert M. Ettinger
President

October 16, 2008