

FLAHERTY & CRUMRINE PREFERRED INCOME FUND

To the Shareholders of Flaherty & Crumrine Preferred Income Fund:

The Fund delivered a second consecutive quarter of double-digit returns as financial markets continued to recover from lows hit earlier this year. During the three-month period ended August 31st, total return on net asset value was +24.4%, and total return on market value of Fund shares was +18.4%.

As the worst of the financial crisis appears to be behind us, prices on most securities in the Fund's portfolio rose during the quarter. Although the credit outlook for some issuers remains speculative and the prices of their securities remain depressed, many securities that suffered the biggest declines earlier in the year staged the most dramatic recoveries. That being said, while prices in general are much higher than just three months ago, they remain well below the highs reached in recent years. There should be further recovery if the markets continue to normalize as we expect.

The strong performance over the past two quarters occurred despite the negative impact of our investments in a few troubled companies. During the past quarter, Colonial Bank was shut down by regulators. At this point, we are assuming there will be no additional income earned and minimal principal recovery on our investment in its parent, Colonial BancGroup, Inc. Two additional credits, FBOP Bancorp and CIT Group, suspended distributions on the securities owned by the Fund. Both companies are currently exploring strategies to improve their financial condition.

One year ago, the world's financial system was on the brink of collapse. In the blink of an eye, we went from a world in which anyone with a pulse could get a loan to a virtual shutdown of the capital markets. Investors, large and small, appeared ready to stuff money in a mattress rather than hand it over to a bank or money market fund. Access to short-term liquidity, the life blood of business, largely disappeared, and long-term financing was virtually unobtainable. Banks simply stopped lending (not only to long-time customers, but even more troublesome, to other banks), and capital market investors were in no mood to provide new financing.

When compared to broader credit markets, the preferred market has a much greater concentration in financial companies. In addition, the majority of preferred issues are long-term and consequently tend to have more volatile prices than other fixed-income instruments. As a result, the performance of the preferred market (and the Fund) was dismal throughout the early part of the financial crisis.

After one year, and massive amounts of government intervention, we see signs of recovery and perhaps a greater sense of rationality in the markets. On more than one occasion we've expressed our opinion that market volatility was exacerbated by excessive amounts of leverage. We underestimated the extent to which price declines could trigger selling by over-leveraged investors, producing an accelerating downward price spiral. We learned some valuable lessons during this financial chaos. We improved our analytic tools (and hopefully developed a more refined sense of smell) to help us discern changes in fundamental value from a leverage-fed frenzy. We further refined our credit criteria to help us identify riskier issuers earlier in the credit cycle. And, as leveraged investors ourselves, we have a keener appreciation for liquidity in the Fund's portfolio.

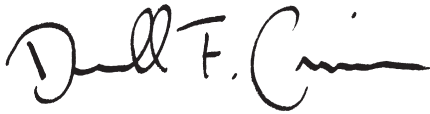
We believe these lessons will improve ongoing management of the Fund. Don't expect wholesale changes, but we would not be doing our job if we did not adapt to this new, more turbulent environment. For instance, the Fund suspended its hedging strategy last year, not because we no longer believe in hedging but because we did not think it would work in a crisis environment. At some point in the future, we anticipate reinstating the Fund's hedging strategy. Similarly, we have increased the portfolio's emphasis on liquid issues and issuers. By doing so, the Fund may give up some current income, but we believe this provides greater flexibility in managing the portfolio and its leverage for the benefit of shareholders.

In our last letter we indicated that the Fund was in the process of replacing all remaining shares of Auction Preferred Stock with bank debt. The switch is complete and the Fund's leverage is now comprised entirely of debt. While the breakdown in the auction preferred stock market made the change necessary, the Fund already is realizing some benefits from the new leverage. Foremost among these benefits are lower borrowing expense and greater flexibility in managing the portfolio.

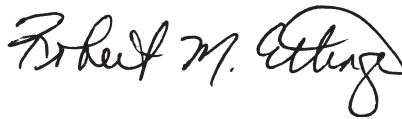
All markets have endured tremendous upheaval over the past year. More change is on the horizon, as the financial system moves from crisis to recovery. The Fund will continue to assess and adapt to this new market environment. We take that responsibility seriously, and we appreciate the support that shareholders have given us.

More information is always available on the Fund's website, including discussion of many of the topics in this letter. In addition, our thoughts on the economic outlook are published quarterly and posted to the site. We encourage you to visit the website at www.preferredincome.com.

Sincerely,



Donald F. Crumrine
Chairman of the Board



Robert M. Ettinger
President

October 15, 2009

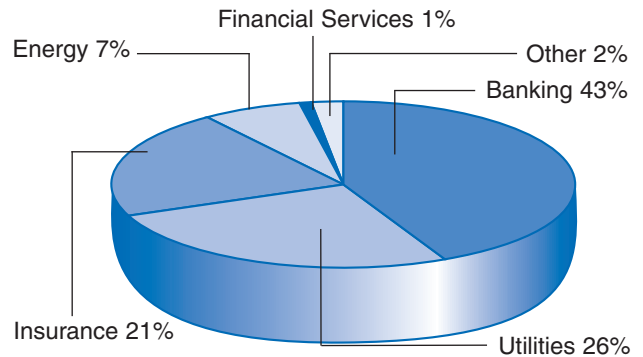
PORTFOLIO OVERVIEW
August 31, 2009 (Unaudited)

Fund Statistics on 8/31/09

Net Asset Value	\$	8.73
Market Price	\$	8.50
Discount		2.63%
Yield on Market Price		8.89%
Common Stock Shares Outstanding		10,664,392

Industry Categories

% of Net Assets†



Moody's Ratings **% of Net Assets†**

AA	0.3%
A	19.4%
BBB	55.9%
BB	18.9%
Below "BB"	1.6%
Not Rated	3.1%

Below Investment Grade* 17.3%

* Below investment grade by both Moody's and S&P.

Top 10 Holdings by Issuer

% of Net Assets†

PNC Financial Services	6.9%
Banco Santander	6.5%
Sovereign Bancorp	4.5%
Metlife	4.3%
Liberty Mutual Group	4.1%
Comerica	3.6%
Dominion Resources	3.5%
Interstate Power & Light	3.5%
Goldman Sachs	3.2%
Capital One Financial	3.2%

% of Net Assets†**

Holdings Generating Qualified Dividend Income (QDI) for Individuals	49%
Holdings Generating Income Eligible for the Corporate Dividends Received Deduction (DRD)	36%

** This does not reflect year-end results or actual tax categorization of Fund distributions. These percentages can, and do, change, perhaps significantly, depending on market conditions. Investors should consult their tax advisor regarding their personal situation.

† Net Assets includes assets attributable to the use of leverage.

PORTFOLIO OF INVESTMENTS**August 31, 2009 (Unaudited)**

<u>Shares/\$ Par</u>		<u>Value</u>
Preferred Securities — 97.2%		
Banking — 42.7%		
\$ 3,000,000	Astoria Capital Trust I, 9.75% 11/01/29, Series B	\$ 3,012,129 ⁽¹⁾
	Banco Santander:	
47,248	Adj. Rate Pfd.	745,692 ^{** (1) (2)}
273,950	6.50% Pfd.	6,342,627 ^{** (1) (2)}
79,400	6.80% Pfd.	1,913,739 ^{** (1) (2)}
48,700	Bank of America Corporation, 6.70% Pfd.	971,565 ^{* (1)}
\$ 2,400,000	Barclays Bank PLC, 6.278%	1,707,000 ^{** (1) (2)}
45,000	BB&T Capital Trust VI, 9.60% Pfd.	1,178,100 ⁽¹⁾
\$ 5,500,000	Capital One Capital III, 7.686% 08/15/36	4,345,000 ⁽¹⁾
	CIT Group, Inc.:	
32,500	5.189% Pfd., Series B	141,173 [†]
\$ 905,000	6.10% 03/15/67	99,550 [†]
154,500	6.35% Pfd., Series A	426,806 [†]
50,000	Cobank, ACB, 7.00% Pfd., 144A****	1,745,315 ^{* (1)}
\$ 5,210,000	Colonial BancGroup, 7.114%, 144A****	91,175 [†]
\$ 7,100,000	Comerica Capital Trust II, 6.576% 02/20/37	4,899,000 ⁽¹⁾
9,000	FBOP Corporation, Adj. Rate Pfd., 144A****	385,313 [†]
1,250	First Republic Preferred Capital Corporation, 10.50% Pfd., 144A****	1,131,250 ⁽¹⁾
22,500	First Republic Preferred Capital Corporation II, 8.75% Pfd., Series B, 144A****	492,892 ⁽¹⁾
2,500	First Tennessee Bank, Adj. Rate Pfd., 144A****	1,013,281 ^{* (1)}
\$ 500,000	First Tennessee Capital II, 6.30% 04/15/34, Series B	282,724
\$ 1,500,000	First Union Capital II, 7.95% 11/15/29	1,346,721 ⁽¹⁾
	Goldman Sachs:	
\$ 5,001,000	Capital II, 5.793%	3,675,735 ⁽¹⁾
11	Pass-Through Certificates, Class B, 144A****	182,600 [†]
2,500	STRIPES Custodial Receipts, Pvt.	515,000 [*]
	HSBC USA, Inc.:	
43,900	Adj. Rate Pfd., Series D	914,108 ^{* (1)}
176,000	Adj. Rate Pfd., Series G	3,284,600 ^{* (1)}
2,500	\$2.8575 Pfd.	96,750 ^{* (1)}
11,300	Keycorp Capital VIII, 7.00% Pfd. 06/15/66	217,101
10,000	Keycorp Capital X, 8.00% Pfd.	213,650
\$ 550,000	Lloyds Banking Group PLC, 6.657%, 144A****	236,893 ^{** (2)}
31,500	PFGI Capital Corporation, 7.75% Pfd.	738,281 ⁽¹⁾
274,200	PNC Financial Services, 9.875% Pfd., Series F	7,299,890 ^{* (1)}
\$ 1,600,000	PNC Preferred Funding Trust III, 8.70%, 144A****	1,411,699 ⁽¹⁾
171,480	Sovereign Bancorp, 7.30% Pfd., Series C	4,100,516 ^{* (1)}

PORTFOLIO OF INVESTMENTS (Continued)

August 31, 2009 (Unaudited)

<u>Shares/\$ Par</u>		<u>Value</u>
Preferred Securities — (continued)		
Banking — (continued)		
20,100	Sovereign Capital Trust V, 7.75% Pfd. 05/22/36	\$ 460,943 ⁽¹⁾
1,750	Sovereign REIT, 12.00% Pfd., Series A, 144A****	1,579,375
	U.S. Bancorp, Auction Pass-Through Trust, Cl. B:	
11	Series 2006-5, Variable Rate Pfd., 144A****	275*†
11	Series 2006-6, Variable Rate Pfd., 144A****	275*†
\$ 1,000,000	Washington Mutual, 9.75%, 144A****	15,000††
\$ 1,600,000	Webster Capital Trust IV, 7.65% 06/15/37	944,000 ⁽¹⁾
27,500	Wells Fargo & Company, 8.00% Pfd., Series J	675,125 ⁽¹⁾
		<u>58,832,868</u>
Financial Services — 0.3%		
\$ 500,000	General Electric Capital Corporation, 6.375% 11/15/67	404,356
	Lehman Brothers Holdings, Inc.:	
15,000	5.67% Pfd., Series D	5,550*††
19,500	5.94% Pfd., Series C	6,435*††
25,000	6.50% Pfd., Series F	2,813*††
27,500	7.95% Pfd.	2,613*††
		<u>421,767</u>
Insurance — 19.7%		
\$ 1,000,000	Ace Capital Trust II, 9.70% 04/01/30	1,003,484 ⁽¹⁾⁽²⁾
	Arch Capital Group Ltd.:	
2,600	7.875% Pfd., Series B	59,598 ^{** (2)}
24,900	8.00% Pfd., Series A	605,879 ^{** (1)(2)}
	AXA SA:	
\$ 1,500,000	6.379%, 144A****	1,117,500 ^{** (1)(2)}
\$ 4,000,000	6.463%, 144A****	2,980,000 ^{** (1)(2)}
35,900	Axis Capital Holdings, 7.50% Pfd., Series B	2,340,231 ⁽¹⁾⁽²⁾
90,600	Delphi Financial Group, 7.376% Pfd. 05/15/37	1,562,850 ⁽¹⁾
\$ 3,000,000	Everest Re Holdings, 6.60% 05/15/37	2,115,000 ⁽¹⁾
	Liberty Mutual Group:	
\$ 2,000,000	7.80% 03/15/37, 144A****	1,430,000 ⁽¹⁾
\$ 3,900,000	10.75% 06/15/58, 144A****	3,490,500 ⁽¹⁾
\$ 500,000	MetLife Capital Trust IV, 7.875% 12/15/37, 144A****	447,500 ⁽¹⁾
\$ 4,200,000	MetLife Capital Trust X, 9.25% 04/08/38, 144A****	4,094,530 ⁽¹⁾
\$ 1,250,000	MetLife, Inc., 10.75% 08/01/39	1,409,896 ⁽¹⁾

PORTFOLIO OF INVESTMENTS (Continued)

August 31, 2009 (Unaudited)

<u>Shares/\$ Par</u>		<u>Value</u>
Preferred Securities — (continued)		
Insurance — (continued)		
	Principal Financial Group:	
5,000	5.563% Pfd., Series A	\$ 317,500*
80,000	6.518% Pfd., Series B	1,452,200*(1)
	Renaissancere Holdings Ltd.:	
82,050	6.08% Pfd., Series C	1,524,489***(1)(2)
10,700	7.30% Pfd., Series B	234,785***(2)
119,500	Scottish Re Group Ltd., 7.25% Pfd.	294,269***(2)†
\$ 750,000	USF&G Capital, 8.312% 07/01/46, 144A****	721,121(1)
		<u>27,201,332</u>
Utilities — 25.7%		
300	Alabama Power Company, 4.52% Pfd.	22,209*(1)
10,000	Baltimore Gas & Electric Company, 6.70% Pfd., Series 1993	890,000*(1)
2,780	Central Vermont Public Service Corporation, 8.30% Sinking Fund Pfd., Pvt.	281,141*
\$ 2,491,000	COMED Financing III, 6.35% 03/15/33	1,937,442(1)
	Dominion Resources, Inc.:	
\$ 3,500,000	7.50%	2,873,605(1)
76,000	8.375% Pfd., Series A	2,014,000(1)
	Duquesne Light Company:	
9,190	4.15% Pfd.	264,212*(1)
910	4.20% Pfd.	28,551*(1)
25,000	Entergy Arkansas, Inc., 6.45% Pfd.	518,750*(1)
	Georgia Power Company:	
12,600	6.125% Pfd.	305,708*(1)
12,500	6.50% Pfd., Series 2007A	1,201,173*(1)
3,000	Gulf Power Company, 6.45% Pfd., Series 2007A	281,336*(1)
32,650	Indianapolis Power & Light Company, 5.65% Pfd.	2,619,144*
170,900	Interstate Power & Light Company, 8.375% Pfd., Series B	4,795,881*(1)
	Pacific Enterprises:	
22,430	\$4.50 Pfd.	1,717,297*(1)
10,000	\$4.75 Pfd., Series 53	794,688*(1)
\$ 500,000	PECO Energy Capital Trust III, 7.38% 04/06/28, Series D	425,115(1)
\$ 3,475,000	Puget Sound Energy, Inc., 6.974% 06/01/67	2,790,057(1)
	Southern California Edison:	
35,000	6.00% Pfd., Series C	2,757,346*(1)
11,500	6.125% Pfd.	928,985*(1)
\$ 2,350,000	Southern Union Company, 7.20% 11/01/66	1,768,375(1)

PORTFOLIO OF INVESTMENTS (Continued)

August 31, 2009 (Unaudited)

<u>Shares/\$ Par</u>		<u>Value</u>
Preferred Securities — (continued)		
Utilities — (continued)		
\$ 750,000	TXU Electric Capital V, 8.175% 01/30/37	\$ 341,250
	Union Electric Company:	
14,150	4.56% Pfd.	944,513 ⁽¹⁾
18,800	\$7.64 Pfd.	1,828,888 ⁽¹⁾
\$ 3,900,000	Wisconsin Energy Corporation, 6.25% 05/15/67	3,085,411 ⁽¹⁾
		<u>35,415,077</u>
Energy — 6.9%		
\$ 4,500,000	Enbridge Energy Partners LP, 8.05% 10/01/37	3,802,405 ⁽¹⁾
	Enterprise Products Partners:	
\$ 1,000,000	7.034% 01/15/68	821,217 ⁽¹⁾
\$ 1,500,000	8.375% 08/01/66, Series A	1,302,871 ⁽¹⁾
3,500	Kinder Morgan GP, Inc., 8.33% Pfd., 144A****	3,195,063*
\$ 500,000	Teppco Partners LP, 7.00% 06/01/67	397,212
		<u>9,518,768</u>
Miscellaneous Industries — 1.9%		
40,000	Ocean Spray Cranberries, Inc., 6.25% Pfd., 144A****	2,672,500 ⁽¹⁾
		<u>2,672,500</u>
	Total Preferred Securities	
	(Cost \$156,297,857)	<u>134,062,312</u>
Corporate Debt Securities — 1.8%		
Financial Services — 0.2%		
10,000	Ameriprise Financial, Inc., 7.75% 06/15/39	240,025 ⁽¹⁾
		<u>240,025</u>
Insurance — 1.6%		
\$ 1,200,000	Liberty Mutual Insurance, 7.697% 10/15/97, 144A****	799,129 ⁽¹⁾
\$ 2,000,000	UnumProvident Corporation, 7.25% 03/15/28, Senior Notes	1,485,472 ⁽¹⁾
		<u>2,284,601</u>
	Total Corporate Debt Securities	
	(Cost \$2,610,616)	<u>2,524,626</u>

PORTFOLIO OF INVESTMENTS (Continued)

August 31, 2009 (Unaudited)

	<u>Value</u>
Money Market Fund — 0.1%	
89,679 BlackRock Provident Institutional, T-Fund	\$ 89,679
Total Money Market Fund (Cost \$89,679)	<u>89,679</u>
Total Investments (Cost \$158,998,152 ^{***})	99.1% 136,676,617
Other Assets And Liabilities (Net)	<u>0.9%</u> 1,175,261
Net Assets before loan	<u>100.0%†</u> \$ 137,851,878
Loan Principal Balance	<u>(44,800,000)</u>
Total Net Assets Available To Common Stock	<u>\$ 93,051,878</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. At August 31, 2009, these securities amounted to \$29,233,186 or 21.2% of net assets. These securities have been determined to be liquid under the guidelines established by the Board of Directors.
- (1) All or a portion of this security has been pledged as collateral for the Fund's loan. The total value of such securities was \$118,303,745 at August 31, 2009.
- (2) Foreign Issuer.
- † Non-income producing.
- †† The issuer has filed for bankruptcy protection. As a result, the Fund may not be able to recover the principal invested and also does not expect to receive income on this security going forward.
- ‡ The percentage shown for each investment category is the total value of that category as a percentage of net assets before the loan.

ABBREVIATIONS:

- Pfd.** — Preferred Securities
- Pvt.** — Private Placement Securities
- REIT** — Real Estate Investment Trust
- STRIPES** — Structured Residual Interest Preferred Enhanced Securities

STATEMENT OF CHANGES IN NET ASSETS AVAILABLE TO COMMON STOCK⁽¹⁾
For the period from December 1, 2008 through August 31, 2009 (Unaudited)

	<u>Value</u>
OPERATIONS:	
Net investment income	\$ 7,258,434
Net realized gain/(loss) on investments sold during the period	(14,684,815)
Change in net unrealized appreciation/depreciation of investments	43,764,833
Distributions to APS* Shareholders from net investment income, including changes in accumulated undeclared distributions	<u>(1,041,660)</u>
Net increase in net assets resulting from operations	35,296,792
DISTRIBUTIONS:	
Dividends paid from net investment income to Common Stock Shareholders ⁽²⁾	<u>(6,024,386)</u>
Total Distributions to Common Stock Shareholders	(6,024,386)
FUND SHARE TRANSACTIONS:	
Increase from shares issued under the Dividend Reinvestment and Cash Purchase Plan	<u>502,097</u>
Net increase in net assets available to Common Stock resulting from Fund share transactions	502,097
NET INCREASE IN NET ASSETS AVAILABLE TO COMMON STOCK FOR THE PERIOD	<u>\$ 29,774,503</u>

NET ASSETS AVAILABLE TO COMMON STOCK:

Beginning of period	\$ 63,277,375
Net increase in net assets during the period	<u>29,774,503</u>
End of period	<u><u>\$ 93,051,878</u></u>

* Auction Preferred Stock.

⁽¹⁾ These tables summarize the nine months ended August 31, 2009 and should be read in conjunction with the Fund's audited financial statements, including footnotes, in its Annual Report dated November 30, 2008.

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

FINANCIAL HIGHLIGHTS⁽¹⁾

For the period from December 1, 2008 through August 31, 2009 (Unaudited)

For a Common Stock share outstanding throughout the period.

PER SHARE OPERATING PERFORMANCE:

Net asset value, beginning of period \$ 5.98

INVESTMENT OPERATIONS:

Net investment income 0.69

Net realized and unrealized gain/(loss) on investments 2.73

DISTRIBUTIONS TO APS* SHAREHOLDERS:

From net investment income (0.10)

Total from investment operations 3.32

DISTRIBUTIONS TO COMMON STOCK SHAREHOLDERS:

From net investment income (0.57)

Total distributions to Common Stock Shareholders (0.57)

Net asset value, end of period \$ 8.73

Market value, end of period \$ 8.50

Common Stock shares outstanding, end of period 10,664,392

RATIOS TO AVERAGE NET ASSETS AVAILABLE TO COMMON STOCK SHAREHOLDERS:

Net investment income† 13.86%**

Net investment income, including payments to APS Shareholders† 11.87%**

Operating expenses including interest expense 2.54%**

Operating expenses excluding interest expense 2.31%**

SUPPLEMENTAL DATA:††

Portfolio turnover rate 42%***

Net assets before loan, end of period (in 000's) \$ 137,852

Ratio of operating expenses including interest expense⁽²⁾ to net assets before loan and APS 1.51%**

Ratio of operating expenses excluding interest expense⁽²⁾ to net assets before loan and APS 1.37%**

⁽¹⁾ These tables summarize the nine months ended August 31, 2009 and should be read in conjunction with the Fund's audited financial statements, including footnotes, in its Annual Report dated November 30, 2008.

⁽²⁾ Does not include distributions to APS Shareholders.

* Auction Preferred Stock.

** Annualized.

*** Not Annualized.

† The net investment income ratios reflect income net of operating expenses, including interest expense.

†† Information presented under heading Supplemental Data includes APS and loan principal balance.

FINANCIAL HIGHLIGHTS (Continued)
Per Share of Common Stock (Unaudited)

	Total Dividends Paid	Net Asset Value	NYSE Closing Price	Dividend Reinvestment Price⁽¹⁾
December 31, 2008	\$0.0630	\$6.50	\$5.90	\$6.56
January 30, 2009	0.0630	6.08	7.05	6.70
February 27, 2009	0.0630	5.11	5.43	5.16
March 31, 2009	0.0630	5.30	5.50	5.30
April 30, 2009	0.0630	5.81	6.02	5.81
May 29, 2009	0.0630	7.18	7.35	7.18
June 30, 2009	0.0630	7.64	8.00	7.64
July 31, 2009	0.0630	8.18	8.11	8.20
August 31, 2009	0.0630	8.73	8.50	8.60

⁽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 reinvestment 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.

NOTES TO FINANCIAL STATEMENTS (Unaudited)

1. Aggregate Information for Federal Income Tax Purposes

At August 31, 2009 the aggregate cost of securities for federal income tax purposes was \$159,206,570, the aggregate gross unrealized appreciation for all securities in which there is an excess of value over tax cost was \$12,741,106 and the aggregate gross unrealized depreciation for all securities in which there is an excess of tax cost over value was \$35,271,059.

2. Additional Accounting Standards

Statement of Financial Accounting Standards No. 157 “Fair Value Measurements” (“SFAS 157”)

In September 2006, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards No. 157 “Fair Value Measurements” (“SFAS 157”) effective for fiscal years beginning after November 15, 2007. This standard clarifies the definition of fair value for financial reporting, establishes a framework for measuring fair value and requires additional disclosures about the use of fair value measurements. The Fund has adopted SFAS 157 as of December 1, 2007. The three levels of the fair value hierarchy under SFAS 157 are described below:

- Level 1 – quoted prices in active markets for identical securities
- Level 2 – other significant observable inputs (including quoted prices for similar securities, interest rates, prepayment speeds, credit risk, etc.)
- Level 3 – significant unobservable inputs (including the Fund’s own assumptions in determining the fair value of investments)

In April 2009, FASB issued FASB Staff Position No. 157-4, “Determining Fair Value when the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly”, (“FSP 157-4”). FSP 157-4 is effective for fiscal years and interim periods ending after June 15, 2009. FSP 157-4 provides additional guidance for estimating fair value in accordance with SFAS 157, when the volume and level of activity for the asset or liability have significantly decreased. FSP 157-4 also includes guidance on identifying circumstances that indicate a transaction is not orderly. FSP 157-4 requires entities to describe the inputs and valuation techniques used to measure fair value and changes in those techniques and related inputs during the period. FSP 157-4 expands the three-level hierarchy disclosure and the level three-roll forward disclosure for each major security type as described in paragraph 19 of SFAS 115, “Accounting for Certain Investments in Debt and Equity Securities.”

NOTES TO FINANCIAL STATEMENTS (Unaudited) (Continued)

The inputs or methodology used for valuing securities are not necessarily an indication of the risk associated with investing in those securities. A summary of the inputs used to value the Fund's net assets as of August 31, 2009 is as follows:

	<u>Total Value at August 31, 2009</u>	<u>Level 1 Quoted Price</u>	<u>Level 2 Significant Observable Inputs</u>	<u>Level 3 Significant Unobservable Inputs</u>
Preferred Securities				
Banking	\$58,832,868	\$29,539,362	\$28,908,193	\$385,313
Financial Services	421,767	17,411	404,356	—
Insurance	27,201,332	5,734,070	21,467,262	—
Utilities	35,415,077	7,115,589	28,299,488	—
Energy	9,518,768	—	9,518,768	—
Miscellaneous Industries	2,672,500	—	2,672,500	—
Corporate Debt Securities	2,524,626	240,025	2,284,601	—
Money Market Fund	89,679	89,679	—	—
Total Investments	<u>\$136,676,617</u>	<u>\$42,736,136</u>	<u>\$93,555,168</u>	<u>\$385,313</u>

Following is a reconciliation of Level 3 investments for which significant unobservable inputs were used to determine fair value:

	<u>Preferred Securities</u>	
	<u>Total Investments</u>	<u>Banking</u>
Balance as of 11/30/08	\$ —	\$ —
Accrued discounts/premiums	—	—
Realized gain/(loss)	—	—
Change in unrealized appreciation/(depreciation)	(4,339,687)	(4,339,687)
Net purchases/(sales)	—	—
Transfers in and/or out of Level 3	4,725,000	4,725,000
Balance as of 8/31/09	\$ 385,313	\$ 385,313

NOTES TO FINANCIAL STATEMENTS (Unaudited) (Continued)

3. Section 19 Notices

Section 19 of the Investment Company Act of 1940 requires registered investment companies to include a notice with the payment of a dividend if a portion of that dividend may come from sources other than undistributed net income (other sources could include realized gains from the sale of securities and non-taxable return of capital). Copies of the Section 19 notices for the Fund are available on the website at www.preferredincome.com.

The amounts and sources of distributions reported below are only estimates and are not being provided for tax reporting purposes. Form 1099-DIV will be sent to shareholders in January 2010 reporting the amount and tax characterization of distributions for the 2009 calendar year.

	Source of Distributions as of 8/31/09		
	Net Investment Income	Net Realized Capital Gains	Return of Capital
Calendar 2009 Percentage of Total Distributions . . .	95.0%	0.0%	5.0%

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Directors

Donald F. Crumrine, CFA
Chairman of the Board
David Gale
Morgan Gust
Karen H. Hogan
Robert F. Wulf, CFA

Officers

Donald F. Crumrine, CFA
Chief Executive Officer
Robert M. Ettinger, CFA
President
R. Eric Chadwick, CFA
Chief Financial Officer,
Vice President and Treasurer
Chad C. Conwell
Chief Compliance Officer,
Vice President and Secretary
Bradford S. Stone
Vice President and
Assistant Treasurer
Laurie C. Lodolo
Assistant Compliance Officer,
Assistant Treasurer and
Assistant Secretary

Investment Adviser

Flaherty & Crumrine Incorporated
e-mail: flaherty@pfdincome.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 —
PNC Global Investment Servicing
(U.S.) 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

August 31, 2009

www.preferredincome.com