

FLAHERTY & CRUMRINE PREFERRED INCOME FUND

Dear Shareholder:

The Flaherty & Crumrine Preferred Income Fund (“PFD”) wrapped up a very successful fiscal year on November 30, 2003. The Fund produced +3.1%⁽¹⁾ total return on net asset value (“NAV”) during the fourth fiscal quarter, and +26.2%⁽¹⁾ for the full year. The market price of Fund shares also produced very strong returns. For the full fiscal year, the combination of income and share price appreciation totaled +27.4%. By any practical measure, those returns were very, very good.

There is also good news on the dividend. Beginning in December, the regular monthly dividend has increased to \$0.095 per share from \$0.0915, an increase of 3.8%. In addition, the Fund made a one-time extra distribution of \$0.04 per share, payable December 31 to holders of record on December 24, 2003. We have more to say about this in the Question and Answer section.

The table below compares the return on your Fund with a broad composite of fixed-income, closed-end funds. Although the investment strategies used by the Fund differ significantly from those of the typical bond fund, we believe that the Flaherty & Crumrine Preferred Income Fund provides a better way of accomplishing a similar objective.

AVERAGE TOTAL RETURN PER YEAR ON NET ASSET VALUE⁽¹⁾ FOR PERIODS ENDING NOVEMBER 30, 2003

	<u>ONE YEAR</u>	<u>FIVE YEARS</u>	<u>TEN YEARS</u>	<u>LIFE OF FUND⁽²⁾</u>
Flaherty & Crumrine Preferred Income Fund	26.2%	8.6%	9.2%	12.5%
Lipper Composite of Investment Grade Bond Funds ⁽³⁾	9.5%	6.6%	6.8%	8.0%

(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.

A number of factors contributed to the outstanding performance of the Fund over the past fiscal year, but three in particular stand out:

- A very favorable market for preferred securities;
- Successful execution of the Fund’s hedging strategy; and
- Attractive financing rates on the Fund’s Money Market Preferred (“MMPTM”) shares.

The demand for preferred securities increased steadily over the past year. This was especially true for preferred securities that pay dividends subject to new, lower tax rates. As we have discussed in the past, preferred securities can be divided into two broad categories—"hybrid preferreds" which pay *interest* and "traditional preferreds" which pay *dividends*. Prior to 2003, the distinction was most critical for corporations because they received favorable tax treatment on dividends. Starting in 2003, however, individuals will also be taxed at lower rates on dividends, and, as a result, have increasingly become buyers of traditional preferreds.

For several years the Fund has been steadily increasing its holdings of dividend-paying preferreds and thus has been well positioned to capitalize on the greater demand. These portfolio moves have been an important key to the Fund's superior performance. 79.82% of the distributions made by PFD in 2003 to Common Shareholders is considered qualified dividend income for individual taxpayers. A more detailed discussion is included in the Q&A section.

The Fund's hedging strategy played a very important role in fiscal 2003. Long-term U.S. Treasury interest rates ended the year at about the same level as where they began, slightly above 5%. Over the course of the year, however, interest rates were anything but stable. The Fund's hedges performed according to design, and actually benefited from the volatility. The hedging strategy enabled the Fund to make a lot of money when interest rates declined during the spring, while protecting much of those gains as rates spiked back up during the summer.

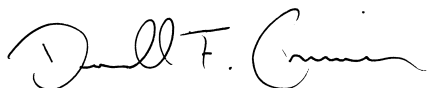
The Fund also benefited from low short-term interest rates, which kept the average rate the Fund paid on its shares of MMP™ below 1¹/₄%. Keep in mind that low short-term rates can be a double-edged sword—while reducing the cost of leverage, low rates typically make the Fund's hedging strategy more expensive. In the case of PFD, the cost of the leverage and the cost of the hedge should move as if they are on opposite ends of a teeter-totter—when one is going up, the other should be falling (though not necessarily by the same amount). Over the past year, however, we managed to "bend the board"—leverage cost was low *and* active management of the hedge positions kept the hedge costs down.

During the past few months it seems as if each passing day has brought new revelations of misdeeds by open-end mutual funds. The abuses have been almost entirely the result of certain fund complexes permitting two different types of trading strategies in funds they manage—after-hour trades and rapid or excessive trading. **Not one of these alleged abuses has involved a closed-end fund.** Shares of closed-end funds, such as PFD, trade at prices determined in the market place rather than at the net asset value computed at the market's close. As a result, these abusive trading techniques simply can't work in closed-end funds. We address this topic in greater detail in the Q&A section, but we want our shareholders to know that in addition to the structural protection offered by the Fund, we are committed to following both the letter and spirit of the law, and to making certain that every investor is treated exactly the same.

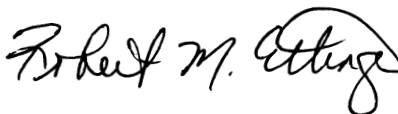
Our approach to managing your Fund is straightforward. We intensively study and monitor the fundamental credit quality of each potential investment, and carefully evaluate the specific terms of each individual issue. If all this research produces a suitable level of comfort, we then begin the process of assessing the appropriate price for the security. Since our investment philosophy is to own the issues that offer the best *overall* value within the universe of eligible securities, it often means that we pass up the temptation of issues offering higher absolute yields. If we make intelligent investments and continue to successfully implement the hedging strategy, then the Fund will have more money to invest and thus be able to generate more income over time. The process is arduous and ongoing, but rarely do good things come without substantial effort.

We encourage you to read the Questions and Answers section beginning on the next page, which contains additional information on the Fund's strategy and operation.

Sincerely,



Donald F. Crumrine
Chairman of the Board



Robert M. Ettinger
President

January 21, 2004

QUESTIONS & ANSWERS

WHY WAS THE FUND ABLE TO RAISE ITS DIVIDEND RATE?

A number of things contributed to the dividend increase, but the key factors were the management of the investment portfolio, the success of the hedging strategy and continued low short-term interest rates.

One proven strategy to increase income from an investment portfolio is to have a larger portfolio. Over the years, consistent, active management of the portfolio has been the surest way to make it grow. Sometimes our focus may be on specific securities and other times on broader sectors of the market, but the simple goal is to “buy ’em cheap and sell ’em dear”.

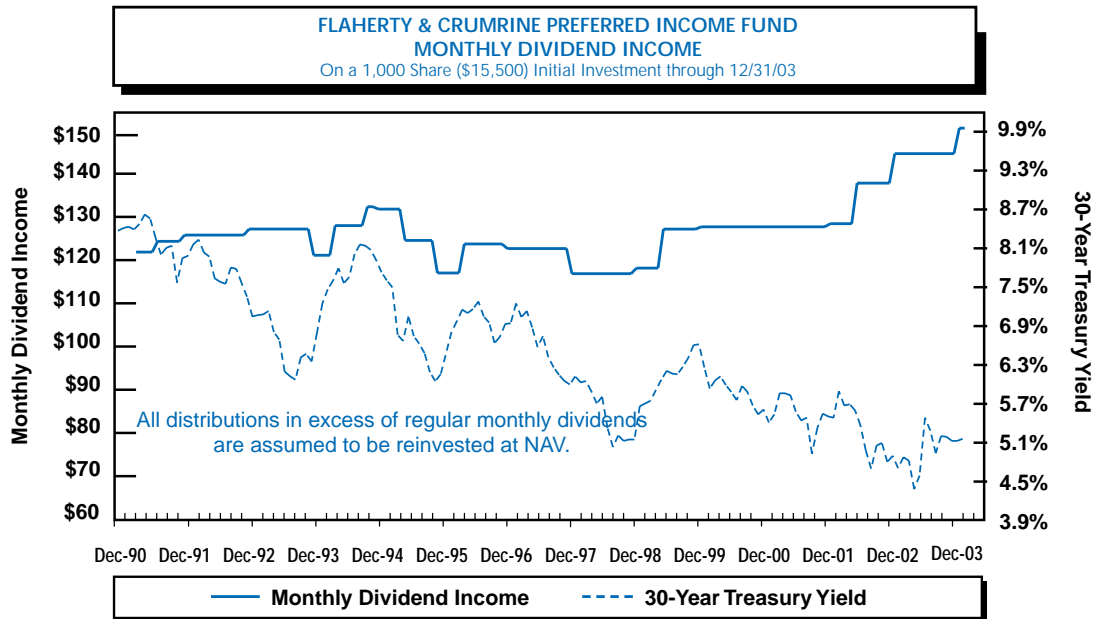
During the past year, almost anyone who purchased a preferred security probably made money. Producing returns like PFD, however, required owning the “right” preferreds. For example, the decision to increase the portfolio’s allocation to traditional preferreds was a major factor in this year’s performance.

We also actively manage the Fund’s hedge. This past spring, when yields on intermediate and long-term U.S. Treasury bonds were falling to historical lows, the Fund’s put option hedges quickly became worthless, but the prices on the Fund’s preferred securities kept going up! When yields reversed course and rose rapidly in mid-summer, gains on the hedge offset much of the decline in the value of the securities, and a portion of the hedge gains were used to purchase additional income producing securities.

Finally, Federal Reserve monetary policy has kept short-term yields very low. Since the rates paid by the Fund on its shares of Money Market Cumulative Preferred™ Stock (MMP™) are closely correlated to these yields, the Fund has more income available for shareholders.

WHAT HAS HAPPENED TO THE FUND’S INCOME OVER TIME?

The following chart provides the clearest answer. The chart may look familiar—it has appeared several times in the past (it is one of our favorites because it clearly demonstrates the success of the Fund’s investment strategy). The solid line (measured on the left-hand scale) represents the monthly dollar income received from an original investment in 1,000 shares of the Fund. It is based on the assumption that the shareholder spent his or her regular monthly dividend income from the Fund and reinvested at net asset value only the portion of each special year-end distribution that was “above and beyond” the monthly dividends.



The chart's message is that the *monthly dividend income has increased since the inception of the Fund for shareholders that reinvested the "extra" distributions*. That increase is rather remarkable in view of the substantial decline in the interest rate on long-term U.S. Treasury bonds (the dashed line measured on the right-hand scale) over the life of the Fund from roughly 8% to slightly more than 5%.

ARE DIVIDENDS PAID BY THE FUND ELIGIBLE FOR THIS YEAR'S LOWER TAX RATES?

For individual investors in PFD, 79.82% of the distributions made by the Fund in *calendar year 2003* was *qualified dividend income*. For corporate investors, 79.45% was eligible for the inter-corporate dividend received deduction.

WHAT PORTION OF 2004 DISTRIBUTIONS WILL BE QUALIFIED DIVIDEND INCOME?

The short answer is "we don't know". The breakdown between dividends, interest and capital gains can only be determined once we close the books on the Fund's fiscal year-end, so the 2004 numbers can't be computed until a year from now.

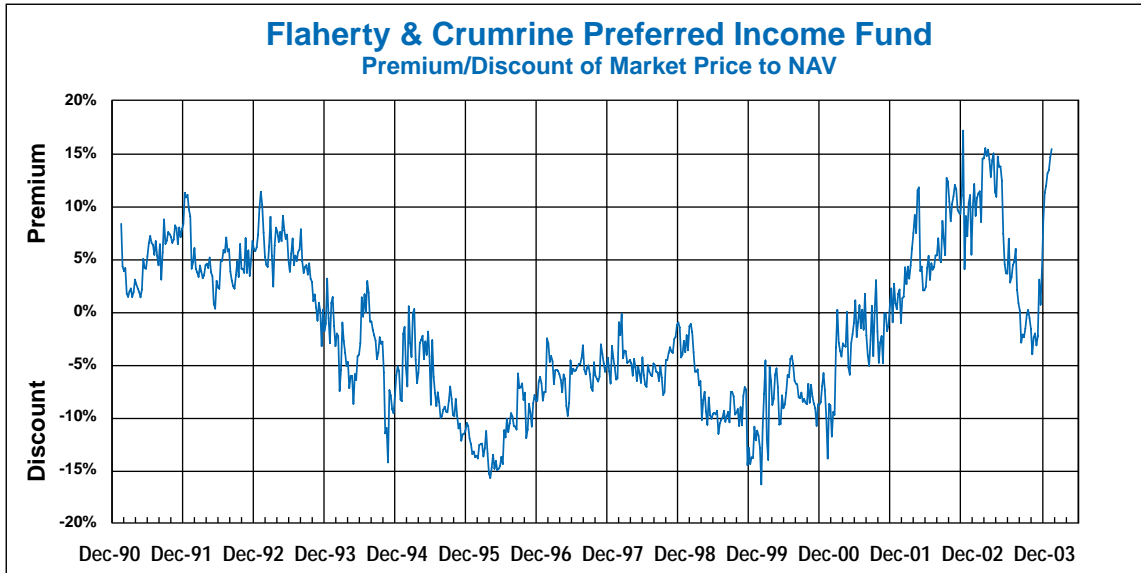
As can be seen in the attached portfolio listing, more than two thirds of the portfolio was invested in traditional preferred stocks at our fiscal year end. This percentage has increased since then simply because we believed these securities were undervalued. If the "pendulum of value" swings too far the other way and taxable (or "hybrid") preferreds look relatively more attractive, the portfolio composition may move more toward hybrids. In that scenario, the Fund's qualified dividend percentage would likely decline, but the dividend rate could possibly increase.

HOW WILL THE FUND NOTIFY SHAREHOLDERS ABOUT HOW MUCH INCOME IS ELIGIBLE FOR THE LOWER TAX RATE?

If you are an individual investor and have possession of your Fund share certificate, you will receive Form 1099 from PFPC. If your shares are registered in the name of your brokerage firm, it will issue Form 1099 directly to you. In either case, Box 1b of Form 1099 includes “Qualified dividends” eligible for the lower tax rate.

WHY HAS THE MARKET PRICE INCREASED RELATIVE TO THE NAV?

The following chart plots the relationship of market price to net asset value over the life of the Fund.



We can only speculate on what factors are driving the market price, but increased interest in qualified dividend income appears to be the primary reason.

IS THE FUND SUSCEPTIBLE TO TRADING ABUSES LIKE THE ONES IN THE NEWS RECENTLY?

In a word, the answer is NO!

A critical difference between closed-end funds such as PFD and open-end mutual funds, which have been grabbing all the headlines, is the way in which they are purchased and sold.

Orders to buy or sell shares of PFD on the NYSE can be placed throughout the trading day, and limit prices can be specified. The investor has control over the transaction price, and the trade takes place only if there is a willing seller and buyer. This degree of control is not possible in an open-end mutual fund because orders placed throughout the day are completed *after* the close of business, based upon the closing net asset value.

Transactions in open-end mutual funds take place between the investor and the mutual fund company. At the close of business (typically 4:00 PM Eastern Time), the fund company computes the mutual fund's net asset value. This price is used to redeem shares from sellers or issue new shares to buyers who placed orders earlier that day. The rules prohibit fund companies from accepting orders after the close of business, but some fund companies have permitted favored clients to place orders *after* the close, but at that day's NAV. All gains from "late trading" are at the expense of the other investors in the fund.

The other frequently mentioned abuse in open-end mutual funds is fund companies permitting "frequent trading" practices by favored clients. Although not illegal, this practice may harm investors because these favored clients' gains are again at the expense of the other investors in the fund and usually force the fund to maintain larger cash positions than would otherwise be appropriate. Managers of closed-end funds don't face this problem either. If a holder of a closed-end fund wishes to sell shares, the market must facilitate the trade, not the fund. Therefore a closed-end fund can remain fully invested without regard to possible redemptions.

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, 2002 Extra	\$0.1285	\$13.65	\$15.10	\$14.35
December 31, 2002.	0.0915	13.65	15.10	14.35
January 31, 2003	0.0915	14.45	16.70	15.87
February 28, 2003.	0.0915	14.55	16.42	15.60
March 31, 2003.	0.0915	14.64	16.10	15.30
April 30, 2003	0.0915	14.83	16.20	15.39
May 31, 2003	0.0915	15.54	16.63	15.80
June 30, 2003.	0.0915	15.84	16.35	15.84
July 31, 2003	0.0915	15.58	15.34	15.27
August 31, 2003	0.0915	15.64	15.61	15.64
September 30, 2003	0.0915	16.04	15.62	15.45
October 31, 2003	0.0915	15.94	16.44	15.94
November 30, 2003.	0.0915	15.85	17.65	16.77
December 31, 2003 Extra	0.0400	15.90	18.40	17.48
December 31, 2003.	0.0950	15.90	18.40	17.48

(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**November 30, 2003**

<u>Shares/\$ Par</u>	<u>Value (Note 2)</u>	<u>Shares/\$ Par</u>	<u>Value (Note 2)</u>
PREFERRED SECURITIES — 91.7%		30,000	Cobank, ABC, 7.00% Pfd., 144A****
ADJUSTABLE RATE PREFERRED SECURITIES — 9.7%			\$ 1,543,650*
BANKING — 9.3%			Comerica, Inc.:
75,000	Cobank, Adj. Rate Pfd., 144A****	\$500,000	Comerica (Imperial) Capital Trust I, Series B, 9.98%
	J.P. Morgan Chase & Co.:		12/31/26 Capital Security
136,675	Series A, Adj. Rate Pfd.		622,727
19,000	Series L, Adj. Rate Pfd.	\$1,500,000	Deutsche Bank:
125,700	Series N, Adj. Rate Pfd.		BT Preferred Capital Trust II, 7.875% 02/25/27 Capital Security
	TOTAL BANKING ADJUSTABLE RATE		1,679,122
	PREFERRED SECURITIES	\$12,820,000	GreenPoint Financial Corporation: GreenPoint Capital Trust I, 9.10% 06/01/27 Capital Security
			14,903,378
	FINANCIAL SERVICES — 0.2%		HSBC USA, Inc.:
10,500	Bear Stearns Companies, Inc., Series A, Adj. Rate Pfd.	34,200	\$2.8575 Pfd.
		\$2,635,000	1,749,159*
			Republic New York Capital II, 7.53% 12/04/26 Capital Security, STOPS
	UTILITIES — 0.2%	\$ 270,000	2,844,206
7,465	Northern Indiana Public Service Company, Series A, Adj. Rate Pfd.		Keycorp Institutional Capital B, 8.25% 12/15/26 Capital Security
			308,657
		16,500	Regions Financial Trust I, 8.00% 02/28/31 Pfd.
	TOTAL ADJUSTABLE RATE PREFERRED		450,120
	SECURITIES		23,317,670
		\$1,500,000	Wachovia Corporation: First Union Capital II, 7.95% 11/15/29 Capital Security
	FIXED RATE PREFERRED SECURITIES — 81.2%		1,816,403
	BANKING — 21.7%		First Union Institutional Capital I, 8.04% 12/01/26 Capital Security
	ABN AMRO North America, Inc.:	\$1,906,000	2,193,520
2,625	6.46% Pfd., 144A****		First Union Institutional Capital II, 7.85% 01/01/27 Capital Security
4,000	6.59% Pfd., 144A****	\$1,820,000	2,066,301
	BancWest Corporation:		Wachovia Capital Trust V, 7.965% 06/01/27 Capital Security, 144A****
400	BancWest Capital I, 9.50% 12/01/30 QUIPS	\$1,500,000	1,715,153
\$2,250,000	First Hawaiian Capital I, 8.343% 07/01/27 Capital Security, Series B	7,500	207,675
	2,570,490		TOTAL BANKING FIXED RATE
	Bank of America Corporation:		PREFERRED SECURITIES
\$ 750,000	Barnett Capital II, 7.95% 12/01/26 Capital Security		52,377,728
\$ 674,000	NB Capital Trust II, 7.83% 12/15/26 Capital Security		
	759,295		FINANCIAL SERVICES — 10.0%
	Citigroup, Inc.:	96,000	Bear Stearns Companies, Inc.:
151,177	5.864% Pfd., Series M	12,540	5.49% Pfd., Series G
12,676	6.213% Pfd., Series G		4,789,440*
11,000	6.231% Pfd., Series H	65,400	5.72% Pfd., Series F
	589,875*	151,275	634,775*
			Lehman Brothers Holdings, Inc.:
			5.67% Pfd., Series D
			3,331,149*
			5.94% Pfd., Series C
			7,766,458*

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PORTFOLIO OF INVESTMENTS (Continued)**November 30, 2003**

Shares/\$ Par		Value (Note 2)	Shares/\$ Par		Value (Note 2)
PREFERRED SECURITIES — (Continued)			26,125	Avista Corporation,	
FIXED RATE PREFERRED SECURITIES — (Continued)				\$6.95 Sinking Fund Pfd., Series K . . .	\$ 2,534,125*
FINANCIAL SERVICES — (Continued)			10,000	Boston Edison Company,	
20,000	6.50% Pfd. Series F	\$ 529,500*		4.78% Pfd.	874,950*
123,805	SLM Corporation,		10,457	Carolina Power & Light Company,	
	6.97% Pfd., Series A	<u>7,059,361*</u>		\$5.44 Pfd.	1,017,518*
TOTAL FINANCIAL SERVICES FIXED RATE				CenterPoint Energy, Inc.:	
PREFERRED SECURITIES			45,000	Houston Light & Power, Capital Trust I,	
		<u>24,110,683</u>		8.125% QUIPS	1,128,375
INSURANCE — 9.5%			\$3,500,000	Houston Light & Power, Capital Trust II,	
47,000	ACE Ltd.,			8.257%, 02/01/37 Capital Security,	
	7.80% Pfd., Series C	1,253,255**		Series B	3,510,062
	AON Corporation:		60,150	REI Trust I,	
\$1,645,000	AON Capital Trust A,			7.20% TOPrS, Series C	1,408,713
	8.205% 01/01/27 Capital Security . . .	1,827,579		Central Hudson Gas & Electric Corporation:	
1,250	Fortis Funding Trust,		5,000	4.35% Pfd., Series D, Pvt.	379,525*
	7.68% Pfd., 144A****	1,423,837*	750	4.96% Pfd., Series E, Pvt.	63,821*
	SAFECO Corporation:			Central Illinois Light Company:	
\$ 549,000	SAFECO Capital Trust I,		10,000	4.64% Pfd.	853,850*
	8.072% 07/15/37 Capital Security . . .	616,500	7,000	5.85% Sinking Fund Pfd.	708,400*
	The St. Paul Companies, Inc.:		27,799	Central Vermont Public Service Corporation,	
\$5,800,000	MMI Capital Trust I,			8.30% Pvt. Sinking Fund Pfd.	2,895,405*
	7.625% 12/15/27 Capital Security,			Connecticut Light & Power Company:	
	Series B	6,190,369	5,323	\$3.24 Pfd.	279,245*
12,000	St. Paul Capital Trust I,		9,300	5.28% Pfd.	423,057*
	7.60% Pfd.	321,540	200	6.56% Pfd., Series 1968	10,366*
	UnumProvident Corporation:		2,100	Consolidated Edison Company of New York,	
\$4,000,000	Provident Financing Trust I,			4.65% Pfd., Series C	182,931*
	7.405% 03/15/38 Capital Security . . .	3,454,300	6,870	Dayton Power and Light Company,	
	Zurich RegCaPS Fund Trust I:			3.90% Pfd., Series C	445,554*
6,500	6.01% Pfd., 144A****	6,537,570*	4,556	Duke Energy Corporation:	
1,200	6.58% Pfd., 144A****	<u>1,211,874*</u>	31,965	4.50% Pfd., Series C, Pvt.	369,970*
TOTAL INSURANCE FIXED RATE			519	6.75% Pfd., Series X, Sinking Fund Pfd.	3,328,196*
PREFERRED SECURITIES			25,762	7.04% Pfd., Series Y	53,680*
		<u>22,836,824</u>		7.85% Pfd., Series S	2,675,899*
UTILITIES — 34.6%				Duquesne Light Company:	
	Alabama Power Company:		5,490	\$2.10 Pfd. Series A	180,511*
5,734	4.72% Pfd.	518,411*	7,675	4.10% Pfd.	246,329*
5	4.95% Pfd.	519,218*	6,330	4.15% Pfd.	205,630*
91,100	5.20% Pfd.	2,236,960*	910	4.20% Pfd.	29,921*
2,049	Appalachian Power Company,		5,000	Energy East Capital Trust I,	
	5.92% Sinking Fund Pfd.	206,191*		8.25% TOPrS	134,175

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PORTFOLIO OF INVESTMENTS (Continued)**November 30, 2003**

<u>Shares/\$ Par</u>	<u>Value (Note 2)</u>	<u>Shares/\$ Par</u>	<u>Value (Note 2)</u>
PREFERRED SECURITIES — (Continued)		3,905	Northern Indiana Public Service Company, 7.44% Pfd. \$ 399,638*
FIXED RATE PREFERRED SECURITIES — (Continued)		6,170	Ohio Edison Company, 4.44% Pfd. 419,097*
UTILITIES — (Continued)		2,500	Ohio Power Company, 5.90% Sinking Fund Pfd. 250,238*
	Entergy Arkansas, Inc.:	5,000	PECO Energy Company, \$4.40 Pfd., Series C 405,275*
3,370	7.32% Pfd. \$ 352,569*	5,000	PPL Electric Utilities Corporation, 6.75% Pfd. 523,450*
11,350	7.40% Pfd. 1,183,464*	9,410	PSI Energy, Inc., 4.32% Pfd. 177,990*
1,322	7.88% Pfd. 138,261*		PacifiCorp:
30,000	\$1.96 Pfd. 762,300*	1,225	\$4.56 Pfd. 95,642*
4,440	Entergy Gulf States, Inc., 7.56% Pfd. 452,347*	14,542	\$4.72 Pfd. 1,175,212*
	Entergy Louisiana, Inc.:	16,444	\$7.48 Sinking Fund Pfd. 1,708,038*
260	7.84% Pfd. 27,222*		Pacific Enterprises:
106,138	8.00% Pfd., Series 92 2,681,046*	18,830	\$4.50 Pfd. 1,534,927*
8,500	Entergy Mississippi, Inc., 7.44% Pfd. 881,918*	10,000	\$4.75 Pfd., Series 53 860,400*
	Florida Power Company:	790	Pennsylvania Power Company, 7.75% Pfd. 80,292*
4,448	4.58% Pfd. 375,122*	12,722	Portland General Electric, 7.75% Sinking Fund Pfd. 1,322,325*
5,157	4.60% Pfd. 434,761*	19,209	Potomac Electric Power Company, \$3.40 Sinking Fund Pfd. 962,563*
8,935	4.75% Pfd., Pvt. 777,836*	10,000	Public Service Company of New Mexico, 4.58% Pfd. 678,100*
170	Florida Power & Light Company, 4.50% Pfd., Series A, Pvt. 14,537*		Public Service Enterprise Group, Inc.:
50,000	Georgia Power Capital Trust V, 7.125% Pfd. 1,352,000	10,800	Enterprise Capital Trust I, 7.44% TOPrS, Series A 273,294
2,010	Great Plains Energy, Inc., 4.50% Pfd. 148,137*		Rochester Gas & Electric Corporation:
	Hawaiian Electric Company, Inc.:	4,984	4.10% Pfd., Series H 364,904*
20,000	HECO Capital Trust I, 8.05% QUIPS 509,400	10,000	4.55% Pfd., Series M, Pvt. 812,500*
2,717	Idaho Power Co., 7.68% Pfd., Series 1 281,087*	20,000	6.60% Sinking Fund Pfd., Series V 2,015,100*
8,000	Indiana Michigan Power Company, 6.875% Sinking Fund Pfd. 811,400*		San Diego Gas & Electric Company:
32,650	Indianapolis Power & Light Company, 5.65% Pfd. 2,737,539*	40,000	\$1.70 Pfd 1,045,200*
384,000	Interstate Power & Light Company, 8.375% Pfd., Series B 12,226,560*	23,750	\$1.7625 Sinking Fund Pfd. 611,919*
4,500	Kentucky Utilities Company, 6.53% Pfd. 465,773*	1,200	4.40% Pfd. 19,566*
5,000	Mississippi Power Company, 7.00% Pfd. 522,900*		South Carolina Electric & Gas Company:
14,250	Narragansett Electric Company, 4.64% Pfd. 596,933*	25,373	5.125% Purchase Fund Pfd., Pvt. 1,246,322*
		6,703	6.00% Purchase Fund Pfd., Pvt. 342,791*

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PORTFOLIO OF INVESTMENTS (Continued)**November 30, 2003**

Shares/\$ Par	Value (Note 2)	Shares/\$ Par	Value (Note 2)
PREFERRED SECURITIES — (Continued)		33,250	Ocean Spray Cranberries, Inc., 6.25% Pfd., 144A****
			\$ 2,514,697*
FIXED RATE PREFERRED SECURITIES — (Continued)		26,000	Touch America Holdings, \$6.875 Pfd.
			39,000*†
		9,520	Viad Corporation, \$4.75 Sinking Fund Pfd.
			<u>896,213*</u>
			TOTAL MISCELLANEOUS INDUSTRIES FIXED RATE PREFERRED SECURITIES
			<u>4,731,561</u>
			TOTAL FIXED RATE PREFERRED SECURITIES
			<u>195,961,712</u>
			INVERSE FLOATING RATE PREFERRED — 0.8%
		18	Premium Assets, Series A, Zurich Financial Reg. Capital
			<u>1,854,596*</u>
			TOTAL PREFERRED SECURITIES (Cost \$198,830,795)
			<u>221,133,978</u>
			CORPORATE DEBT SECURITIES — 1.3%
		45,000	Northern States Power Company, 8.00% PINES
			1,244,475
		36,200	Ohio Power Company, 7.375% Senior Notes
			919,661
		\$1,000,000	Oneamerica Financial Partners, 7.00% 10/15/33 Capital Security, 144A****
			<u>985,705</u>
			TOTAL CORPORATE DEBT SECURITIES (Cost \$2,975,617)
			<u>3,149,841</u>
			COMMON STOCKS AND CONVERTIBLE SECURITIES — 4.3%
		5,000	American Electric Power, 9.25% Pfd., Convertible
			210,275
		102,500	CenterPoint Energy, Inc.
			994,250*
		2,308	Conseco, Inc.
			44,579*†
		9,231	Conseco, Inc., Warrants
			59,078*†
		107,500	Duke Energy Corporation
			1,942,525*
		65,000	FPL Group, Inc., 8.50% Pfd., Convertible
			3,668,600
		80,831	Reliant Resources, Inc.
			531,464*†
		40,000	TXU Corporation, 8.75% Pfd., Convertible
			1,283,600

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

PORTFOLIO OF INVESTMENTS (Continued)**November 30, 2003**

<u>Shares/\$ Par</u>	<u>Value (Note 2)</u>
COMMON STOCKS AND CONVERTIBLE SECURITIES — (Continued)	
50,000 UnumProvident Corporation, 8.25% Pfd., Convertible	<u>\$ 1,607,500</u>
TOTAL COMMON STOCKS AND CONVERTIBLE SECURITIES (Cost \$12,203,019)	<u>10,341,871</u>
OPTION CONTRACTS — 1.1% (Cost \$2,307,409)	
1,409 Put Options on U.S. Treasury, Bond March Futures, Expiring 02/21/2004	<u>2,699,859†</u>
MONEY MARKET FUND — 0.6% (Cost \$1,396,193)	
1,396,193 BlackRock Provident Institutional TempFund, 0.95%	<u>1,396,193</u>
TOTAL INVESTMENTS (Cost \$217,713,033***)	99.0% 238,721,742
OTHER ASSETS AND LIABILITIES (Net)	1.0% <u>2,270,266</u>
TOTAL NET ASSETS AVAILABLE TO COMMON AND PREFERRED STOCK	<u>100.0%‡ \$240,992,008</u>
MONEY MARKET CUMULATIVE PREFERRED STOCK (MMP)[™] REDEMPTION VALUE	(80,000,000)
ACCUMULATED UNDECLARED DISTRIBUTIONS TO MMP[™]	<u>(67,837)</u>
TOTAL NET ASSETS AVAILABLE TO COMMON STOCK	<u>\$160,924,171</u>

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.

- * 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.

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

STATEMENT OF ASSETS AND LIABILITIES

November 30, 2003

ASSETS:

Investments, at value (Cost \$217,713,033) (See accompanying Portfolio of Investments)	\$238,721,742
Dividends and interest receivable	2,562,319
Prepaid expenses.	<u>109,589</u>
Total Assets.	<u>241,393,650</u>

LIABILITIES:

Dividends payable to Common Shareholders	\$169,033
Investment advisory fee payable.	109,541
Administration, Transfer Agent and Custodian fees and expenses payable	30,764
Professional fees payable.	59,796
Directors' fees payable	2,969
Accrued expenses and other payables	29,539
Accumulated undeclared distributions to Money Market Cumulative Preferred™ Stock.	<u>67,837</u>
Total Liabilities.	<u>469,479</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. \$160,924,171

NET ASSETS AVAILABLE TO COMMON STOCK consist of:

Undistributed net investment income	\$ 660,652
Accumulated net realized loss on investments sold.	(6,684,704)
Unrealized appreciation of investments.	21,008,709
Par value of Common Stock	101,527
Paid-in capital in excess of par value of Common Stock	<u>145,837,987</u>
Total Net Assets Available to Common Stock	<u><u>\$160,924,171</u></u>

NET ASSET VALUE PER SHARE OF COMMON STOCK:

Common Stock (10,152,716 shares outstanding)	<u><u>\$ 15.85</u></u>
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The accompanying notes are an integral part of the financial statements.

STATEMENT OF OPERATIONS
For the Year Ended November 30, 2003

INVESTMENT INCOME:

Dividends	\$ 12,067,785
Interest	<u>3,291,133</u>
Total Investment Income	15,358,918

EXPENSES:

Investment advisory fee	\$ 1,290,190	
Administrator's fee	233,190	
Money Market Cumulative Preferred™ Stock broker commissions and auction agent fees	222,501	
Professional fees	113,734	
Insurance expense	148,952	
Shareholder servicing agent fees and expenses	94,182	
Directors' fees and expenses	72,693	
Custodian fees and expenses	26,654	
Other	<u>108,935</u>	
Total Expenses		<u>2,311,031</u>

NET INVESTMENT INCOME

13,047,887

REALIZED AND UNREALIZED GAIN/(LOSS) ON INVESTMENTS

Net realized gain on investments sold during the year	3,098,132
Change in net unrealized appreciation of investments during the year	<u>19,645,164</u>

NET REALIZED AND UNREALIZED GAIN ON INVESTMENTS

22,743,296

DISTRIBUTIONS TO MONEY MARKET CUMULATIVE PREFERRED™ STOCK SHAREHOLDERS:

From net investment income (including changes in accumulated undeclared distributions)	<u>(1,055,700)</u>
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NET INCREASE IN NET ASSETS TO COMMON STOCK RESULTING FROM OPERATIONS

\$ 34,735,483

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

STATEMENTS OF CHANGES IN NET ASSETS

	<u>Year Ended</u> <u>November 30, 2003</u>	<u>Year Ended</u> <u>November 30, 2002</u>
OPERATIONS:		
Net investment income	\$ 13,047,887	\$ 12,922,272
Net realized gain/(loss) on investments sold during the year.	3,098,132	(2,835,267)
Change in net unrealized appreciation/(depreciation) of investments held during the year	19,645,164	(7,213,141)
Distributions to Money Market Cumulative Preferred™ Stock Shareholders from net investment income, including changes in accumulated undeclared distributions.	<u>(1,055,700)</u>	<u>(1,253,932)</u>
Net increase in net assets resulting from operations.	34,735,483	1,619,932
DISTRIBUTIONS:		
Dividends paid from net investment income to Common Stock Shareholders	(12,392,105)	(10,982,983)
Distributions paid from net realized capital gains to Common Stock Shareholders	<u>—</u>	<u>—</u>
FUND SHARE TRANSACTIONS:		
Increase from Common Stock transactions	1,830,875	1,963,583
Decrease due to Money Market Cumulative Preferred™ Stock transactions (See Note 6.)	<u>(6,318)</u>	<u>(493,959)</u>
NET INCREASE/(DECREASE) IN NET ASSETS AVAILABLE TO COMMON STOCK FOR THE YEAR.	24,167,935	(7,893,427)
NET ASSETS AVAILABLE TO COMMON STOCK:		
Beginning of year.	<u>136,756,236</u>	<u>144,649,663</u>
End of year (including undistributed net investment income of \$660,652 and \$845,613, respectively)	<u><u>\$160,924,171</u></u>	<u><u>\$136,756,236</u></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.

	Year Ended November 30,				
	2003	2002	2001	2000	1999
PER SHARE OPERATING PERFORMANCE:					
Net asset value, beginning of period	\$ 13.63	\$ 14.62	\$ 13.41	\$ 14.41	\$ 16.43
INVESTMENT OPERATIONS:					
Net investment income	1.28	1.29	1.23	1.32	1.29
Net realized and unrealized gain/(loss) on investments	2.27	(1.01)	1.19	(0.56)	(1.35)
DISTRIBUTIONS TO MMP™* SHAREHOLDERS:					
From net investment income	(0.10)	(0.12)	(0.23)	(0.29)	(0.23)
From net realized capital gains	—	—	—	(0.01)	(0.08)
Total from investment operations	3.45	0.16	2.19	0.46	(0.37)
Cost of Issuance of Additional MMP™* (Note 5)	—	(0.05)	—	—	—
DISTRIBUTIONS TO COMMON SHAREHOLDERS:					
From net investment income	(1.23)	(1.10)	(0.98)	(1.04)	(1.12)
From net realized capital gains	—	—	—	(0.42)	(0.53)
Total distributions to Common Shareholders	(1.23)	(1.10)	(0.98)	(1.46)	(1.65)
Net asset value, end of period	\$ 15.85	\$ 13.63	\$ 14.62	\$ 13.41	\$ 14.41
Market value, end of period	\$ 17.65	\$ 15.00	\$ 14.47	\$ 12.13	\$ 12.75
Total investment return based on net asset value**	25.87%	0.58%	17.01%	4.55%	(1.81)%
Total investment return based on market value**	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)	\$160,924	\$136,756	\$144,650	\$131,892	\$141,802
Operating expenses	1.51%	1.48%	1.42%	1.41%	1.37%
Net investment income***	7.84%	8.32%	7.21%	7.58%	6.66%
SUPPLEMENTAL DATA:†					
Portfolio turnover rate	28%	30%	39%	66%	65%
Total net assets available to Common and Preferred Stock, end of period (in 000's)	\$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%	1.00%	0.98%	0.99%
* Money Market Cumulative Preferred™ Stock.					
** 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>
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.

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

NOTES TO FINANCIAL STATEMENTS

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 shares 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 and (iii) accumulated and unpaid dividends on the outstanding Money Market Cumulative Preferred™ Stock.

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 (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 the 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.

The AICPA Audit and Accounting Guide, Audits of Investment Companies, requires that, for book accounting purposes, the Fund amortize premiums and accrete discounts on those fixed-income securities, such as capital securities, which trade and are quoted on an “accrued income” basis. Prior to December 1, 2001, the Fund was not required to amortize premiums and accrete discounts for these securities. Adopting these accounting principles has not affected the Fund’s net asset value, but changes the classification of certain amounts between interest income and realized and unrealized gain/loss in the Statement of Operations. The adoption of this principle was not material to the financial statements.

The Statements of Changes in Net Assets and Financial Highlights for prior periods have not been restated to reflect these changes in presentation.

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 (“Shareholder”). The Shareholders of Money Market Cumulative Preferred™ Stock 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.

NOTES TO FINANCIAL STATEMENTS (Continued)

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.

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 2002 was as follows:

	<u>Distributions paid in fiscal year 2003</u>		<u>Distributions paid in fiscal year 2002</u>	
	<u>Ordinary Income</u>	<u>Long-Term Capital Gains</u>	<u>Ordinary Income</u>	<u>Long-Term Capital Gains</u>
Common	\$12,392,105	—	\$10,982,983	—
Preferred	\$ 1,055,700	—	\$ 1,253,932	—

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 is subject to pay an estimated \$21,000 of Federal excise taxes attributable to calendar year 2003. During the fiscal year ending November 30, 2003, the Fund paid \$1,812 of Federal excise taxes attributable to calendar year 2002.

NOTES TO FINANCIAL STATEMENTS (Continued)

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. Effective October 17, 2003, the Audit Committee Chairman will receive an annual fee of \$2,500. In addition, the Fund will reimburse all Directors for travel and out-of-pocket expenses incurred in connection with such meetings.

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 and generally assists in all aspects of the Fund's administration and operation. As compensation for PFPC Inc.'s services as Administrator, the Fund paid PFPC Inc. a monthly fee at an annual rate of 0.10% of the Fund's average monthly total net assets available to Common and Preferred Stock through October 31, 2003. Effective November 1, 2003, the fee structure changed to a monthly fee at an annual rate of 0.10% on the first \$200 million of the Fund's average weekly total managed assets, 0.04% on the next \$300 million of the Fund's average weekly total managed assets, 0.03% on the next \$500 million of the Fund's average weekly total managed assets and 0.02% on 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 paid PFPC Inc. a fee at an annual rate of 0.02% of the Fund's average monthly total net assets available to Common and Preferred Stock plus certain out-of-pocket expenses through October 31, 2003. Effective November 1, 2003, the fee structure changed to a fee at an annual rate of 0.02% on the first \$150 million of the Fund's average weekly net assets attributable to common shares, 0.01% on the next \$350 million of the Fund's average weekly net assets attributable to common shares, 0.005% on the next \$500 million of the Fund's average weekly net assets attributable to common shares and 0.0025% on the Fund's average weekly net assets attributable to common shares 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 shares 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.

NOTES TO FINANCIAL STATEMENTS (Continued)

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 paid PFPC Trust a monthly fee at the annual rate of 0.01% of the Fund's average monthly total net assets available to Common and Preferred Stock through October 31, 2003. Effective November 1, 2003, the fee structure changed to a monthly fee at an annual rate of 0.010% on the first \$200 million of the Fund's average weekly total managed assets, 0.008% on the next \$300 million of the Fund's average weekly total managed assets, 0.006% on the next \$500 million of the Fund's average weekly total managed assets and 0.005% on 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 year ended November 30, 2003, excluding short-term investments, aggregated \$68,428,170 and \$62,098,646, respectively.

At November 30, 2003, aggregate gross unrealized appreciation for all securities in which there is an excess of value over tax cost was \$27,672,886 and aggregate gross unrealized depreciation for all securities in which there is an excess of tax cost over value was \$7,635,274.

5. Common Stock

At November 30, 2003, 240,000,000 shares of \$0.01 par value Common Stock were authorized.

Common Stock transactions, excluding costs arising from additional MMPs™ issuance in June 2002 (See Note 6), were as follows:

	<u>Year Ended</u> <u>11/30/03</u>		<u>Year Ended</u> <u>11/30/02</u>	
	<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	120,171	\$1,830,875	135,557	\$1,963,583

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 Money Market Cumulative Preferred™ Stock 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™ Stock are cumulative.

The Fund is required to meet certain asset coverage tests with respect to the MMP™ Stock. 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™ Stock at a redemption price of \$100,000 per share plus an amount equal to the

NOTES TO FINANCIAL STATEMENTS (Continued)

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.

Under Emerging Issues Task Force (EITF) promulgation Topic D-98, Classification and Measurement of Redeemable Securities, which was issued on July 19, 2001, preferred securities that are redeemable for cash or other assets are to be classified outside of permanent equity to the extent that the redemption is at a fixed or determinable price and at the option of the holder or upon the occurrence of an event that is not solely within the control of the issuer. Subject to the guidance of the EITF, the Fund's MMP™ Stock, which was previously classified as a component of total net assets, has been reclassified outside of permanent equity (net assets available to common stock) in the accompanying financial statements. Prior year amounts have also been reclassified to conform with this presentation. The impact of this reclassification creates no change to the net assets available to Common Stock Shareholders.

If the Fund allocates any net gains or income ineligible for the Dividends Received Deduction to shares of the MMP™ Stock, the Fund is required to make additional distributions to MMP™ Stock 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. Net assets available to MMP™ Stock at November 30, 2003 included an accrued additional distribution of \$57,259. The amount subsequently calculated and then paid to the MMP™ Stock Shareholders for the fiscal year ended November 30, 2003 was \$65,064. (See Note 11 — "Subsequent Events.")

Estimates of additional distributions payable to MMP™ Stock are accrued on a regular basis in advance of declaration by the Board of Directors. The amount of additional distributions payable for any year may be highly uncertain and will not be known until after a fiscal year has been completed.

An auction of the MMP™ Stock 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™ Stock Shareholders may also trade shares in the secondary market between auction dates.

On June 4, 2002, the Fund issued 225 shares of additional MMP™ Stock 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™ Stock 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.

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

NOTES TO FINANCIAL STATEMENTS (Continued)

At November 30, 2003, 800 shares of MMP™ Stock were outstanding at the annual rate of 1.19%. 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 percentage limitation was raised from 15% by the Fund's Board of Directors at its regular board meeting on April 19, 2002.

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 Fund's Investment Adviser, such investments are deemed to be debt-like in key characteristics. Typically, a security will not be considered debt-like (a) if an issuer can defer payment of income for eighteen months or more without triggering an event of default and (b) if such issue is a junior and fully subordinated liability of an issuer or its ultimate guarantor.

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

NOTES TO FINANCIAL STATEMENTS (Continued)

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 November 30, 2003, 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.

REPORT OF INDEPENDENT AUDITORS

The Board of Directors and Shareholders
Flaherty & Crumrine Preferred Income Fund Incorporated:

We have audited the accompanying statement of assets and liabilities of Flaherty & Crumrine Preferred Income Fund Incorporated (formerly, Preferred Income Fund Incorporated), including the fund's portfolio of investments, as of November 30, 2003, and the related statement of operations for the year then ended, statement of changes in net assets for each of the years in the two-year period then ended and financial highlights for each of the years in the three-year period then ended. These financial statements and financial highlights are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements and financial highlights based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform our audit to obtain reasonable assurance about whether the financial statements and financial highlights are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our procedures included confirmation of securities owned as of November 30, 2003 by correspondence with the custodian and brokers. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements and financial highlights referred to above present fairly, in all material respects, the financial position of Flaherty & Crumrine Preferred Income Fund Incorporated as of November 30, 2003, the results of its operations for the year then ended, changes in its net assets for each of the years in the two-year period then ended and financial highlights for each of the years in the three-year period then ended in conformity with accounting principles generally accepted in the United States of America.

KPMG LLP

Boston, Massachusetts
January 16, 2004

SUPPLEMENTARY TAX INFORMATION (Unaudited)

For Fiscal 2003, the distributions attributable both to Common Stock and MMP™ are characterized as follows for purposes of Federal income taxes: for individual investors, 80.56% consisted of Qualified Dividend Income (“QDI”) eligible for the maximum 15% personal tax rate while 19.44% consisted of ordinary income taxable at regular personal tax rates. For corporate investors, 80.21% consisted of income eligible for the inter-corporate Dividends Received Deduction (“DRD”) while 19.79% consisted of ordinary income taxable at regular corporate rates.

For Calendar 2003, the distributions to Common Stock are characterized as follows for purposes of Federal income taxes: for individual investors, 79.82% consisted of Qualified Dividend Income (“QDI”) eligible for the maximum 15% personal tax rate while 20.18% consisted of ordinary income taxable at regular personal tax rates. For corporate investors, 79.46% consisted of income eligible for the inter-corporate Dividends Received Deduction (“DRD”) while 20.54% consisted of ordinary income taxable at regular corporate rates.

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 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 November 30, 2003, \$628 in brokerage commissions were incurred.

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

ADDITIONAL INFORMATION (Unaudited) (Continued)

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 31.

Subsequent Events

As a result of the income realized by the Fund that did not qualify for the inter-corporate Dividends Received Deduction ("DRD"), a portion of the distributions paid to the Fund's Money Market Cumulative Preferred™ Stock shareholders from January 1, 2003 through November 30, 2003 has been designated as being non-DRD income, as required by Internal Revenue Services Ruling 89-81, with respect to the Internal Revenue Code of 1986, as amended. On December 22, 2003, the Fund declared an additional distribution of \$65,064, payable December 24, 2003, to Money Market Cumulative Preferred™ Stock shareholders as required by the Fund's Articles Supplementary (See Note 6.)

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). 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: 54	Director	Class I Director since 1997	President & CEO of Delta Dividend Group, Inc. (investments).	4	Director, Golden State Vintners, Inc. (wine pressing). 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 2004 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: 56	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	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: 66	Director	Class II Director since 1991	Financial Consultant; Trustee, University of Oregon Foundation; Trustee, San Francisco Theological Seminary.	4	Flaherty & Crumrine Preferred Income Opportunity Fund, Flaherty & Crumrine/Claymore Preferred Securities Income Fund and Flaherty & Crumrine/Claymore Total Return Fund.

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Class III Directors – three year term expires at the Fund's 2004 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, Director of Flaherty & Crumrine.	4	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.	2	Flaherty & Crumrine Preferred Income Opportunity Fund.
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.	—	—

* 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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† 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:					
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; 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 US 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: 28	Vice President, Secretary and Assistant Treasurer	Since October 2002	Since August 2001, Vice President of Flaherty & Crumrine from January 1997 through November 1998, portfolio manager of Koch Industries, Inc.	—	—

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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

**Annual
Report**

November 30, 2003

web site: www.preferredincome.com