

## PREFERRED INCOME FUND INCORPORATED

Dear Shareholder:

It all came together for the Preferred Income Fund in the fiscal third quarter that ended August 31, 2000. The result was a very strong total return of 8.0% on the Fund's net asset value. This more than offset the disappointing results in the first half of the year and resulted in a positive total return of 3.2% for fiscal 2000 to date.

The Fund's success in the most recent fiscal quarter was the cumulative result of several factors, none of which was really big news on its own:

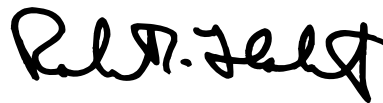
- Yields on long-term Treasury bonds declined somewhat. This helped the value of the Fund's preferred portfolio, but it hurt the results on our hedges. On balance, it did us more good than harm.
- The preferred market moderately outperformed the long-term Treasury bonds on which our hedges are based. Although preferreds only recovered a small portion of the beating that they had taken versus Treasuries in previous quarters, we were happy to have this extra boost.
- Through active management of the Fund's portfolio, we were able to take advantage of out-of-line values in various sectors of the preferred market that were created by the general stress in the fixed income markets. This added a significant layer of "frosting" to the cake.

The rewards for being in the right place at the right time within the preferred market have been particularly great this year. For example, look at the gyrations of "retail hybrid preferreds", i.e. \$25 par value issues that are typically designed to be sold to individual investors. Those preferreds generally got quite cheap relative to other preferreds in December of 1999 (tax selling!), recovered a few months later, became cheap again in the late spring of 2000, and recently recovered again. The Fund's results in the last quarter underscored the benefits of exploiting moves like this, but the groundwork was really laid in previous months.

The Fund's Board of Directors recently approved the purchase of options on interest rate swaps (called "swaptions") as an additional hedging tool that the Fund may use depending on market conditions. Traditionally, the Fund has hedged solely by purchasing put options on Treasury bond futures contracts. In view of the potential shrinkage of the Treasury bond market due to federal budget surpluses, however, we may need greater flexibility going forward. A more detailed discussion of our hedging strategies appears in the Fund's most recent semi-annual report, which is available on our web site at [www.preferredincome.com](http://www.preferredincome.com).

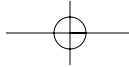
The market price of the Fund's shares has stayed within a fairly narrow range as the net asset value has increased in recent months. As a result, the discount of the market from NAV has increased slightly to roughly 9% at the moment. Our web site at [www.preferredincome.com](http://www.preferredincome.com) also contains continually updated data on the discount.

Sincerely,



Robert T. Flaherty  
*Chairman of the Board*

September 22, 2000



Preferred Income Fund Incorporated  
**SUMMARY OF INVESTMENTS**  
**August 31, 2000 (Unaudited)**

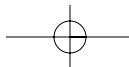
	<u>Value (000's)</u>	<u>Percent of Total Net Assets</u>
<b>Adjustable Rate Preferred Stocks</b>		
Utilities .....	\$ 9,700	5.1%
Banking .....	<u>21,034</u>	<u>11.0</u>
Total Adjustable Rate .....	<u>30,734</u>	<u>16.1</u>
<b>Fixed Rate Preferred Stocks and Securities</b>		
Utilities .....	57,449	30.1
Banking .....	37,673	19.7
Financial Services .....	28,181	14.8
Insurance .....	15,273	8.0
Oil and Gas .....	13,019	6.8
Miscellaneous Industries .....	<u>2,492</u>	<u>1.3</u>
Total Fixed Rate .....	<u>154,087</u>	<u>80.7</u>
<b>TOTAL PREFERRED STOCKS AND SECURITIES .....</b>	<b>184,821</b>	<b>96.8</b>
<b>COMMON STOCKS</b>		
Utilities .....	2,237	1.2
<b>COMMERCIAL PAPER .....</b>	<b>2,200</b>	<b>1.2</b>
<b>PURCHASED PUT OPTIONS .....</b>	<b><u>639</u></b>	<b><u>0.3</u></b>
<b>TOTAL INVESTMENTS .....</b>	<b>189,897</b>	<b>99.5</b>
<b>OTHER ASSETS AND LIABILITIES (Net) .....</b>	<b><u>1,037</u></b>	<b><u>0.5</u></b>
<b>TOTAL NET ASSETS .....</b>	<b><u>\$190,934</u></b>	<b><u>100.0%</u></b>

**FINANCIAL DATA**

**Per Share of Common Stock (Unaudited)**

	<u>Distribution Paid</u>	<u>Net Asset Value</u>	<u>NYSE Closing Price</u>	<u>Dividend Reinvestment Price (1)</u>
December 31, 1999 .....	\$0.5600	\$13.74	\$12.2500	\$12.64
January 31, 2000 .....	0.0820	13.65	12.0000	12.62
February 29, 2000 .....	0.0820	13.45	12.5000	12.49
March 31, 2000 .....	0.0820	13.62	12.1875	12.28
April 30, 2000 .....	0.0820	13.05	12.0625	12.08
May 31, 2000 .....	0.0820	12.75	12.0625	12.22
June 30, 2000 .....	0.0820	13.18	12.1250	12.24
July 31, 2000 .....	0.0820	13.28	12.3125	12.29
August 31, 2000 .....	0.0820	13.50	12.3750	12.47

(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.



Preferred Income Fund Incorporated

**STATEMENT OF CHANGES IN NET ASSETS<sup>(1)</sup>**  
**Nine Months Ended August 31, 2000 (Unaudited)**

<b>OPERATIONS:</b>	
Net investment income . . . . .	\$ 9,773,265
Net realized loss on investments sold . . . . .	(4,178,144)
Net unrealized depreciation of investments during the period . . . . .	(336,177)
Net increase in net assets from operations . . . . .	<u>5,258,944</u>
<b>DISTRIBUTIONS:</b>	
Dividends paid from net investment income to MMP* Shareholders . . . . .	(2,072,566)
Distributions paid from net realized capital gains to MMP* Shareholders (3) . . . . .	(151,753)
Dividends paid from net investment income to Common Stock Shareholders (2) . . . . .	(7,848,553)
Distributions paid from net realized capital gains to Common Stock Shareholders (3) . . . . .	(4,115,149)
Total Distributions . . . . .	<u>(14,188,021)</u>
<b>NET DECREASE IN NET ASSETS:</b> . . . . .	(8,929,077)
<b>NET ASSETS:</b>	
Beginning of period . . . . .	<u>199,863,295</u>
End of period . . . . .	<u>\$ 190,934,218</u>

**FINANCIAL HIGHLIGHTS<sup>(1)</sup>**  
**Nine Months Ended August 31, 2000 (Unaudited)**  
**For a Common share outstanding throughout the period.**

<b>OPERATING PERFORMANCE:</b>	
Net asset value, beginning of period . . . . .	\$ 14.41
Net investment income . . . . .	0.99
Net realized gain and unrealized depreciation on investments . . . . .	(0.46)
Net decrease in net asset value resulting from investment operations . . . . .	<u>0.53</u>
<b>DISTRIBUTIONS:</b>	
Dividends paid from net investment income to MMP* Shareholders . . . . .	(0.21)
Distributions paid from net realized capital gains to MMP* Shareholders (3) . . . . .	(0.01)
Dividends paid from net investment income to Common Stock Shareholders (2) . . . . .	(0.79)
Distributions paid from net realized capital gains to Common Stock Shareholders (3) . . . . .	(0.42)
Change in accumulated undeclared dividends on MMP* . . . . .	(0.01)
Total distributions . . . . .	<u>(1.44)</u>
Net asset value, end of period . . . . .	\$ 13.50
Market value, end of period . . . . .	\$ 12.375
Common shares outstanding, end of period . . . . .	<u>9,838,571</u>
<b>RATIOS TO AVERAGE NET ASSETS AVAILABLE TO COMMON STOCK SHAREHOLDERS:</b>	
Net investment income . . . . .	7.59%**
Operating expenses . . . . .	1.42%**
<b>SUPPLEMENTAL DATA:</b>	
Portfolio turnover rate . . . . .	53%
Ratio of operating expenses to total average net assets including MMP* . . . . .	0.99%**

(1) These tables summarize the nine months ended August 31, 2000 and should be read in conjunction with the Fund's audited financial statements, including footnotes, in its Annual Report dated November 30, 1999.  
(2) Includes dividends earned, but not paid out, in prior fiscal year.  
(3) Paid from capital gains realized, but not paid out, in prior fiscal year.  
\* Money Market Cumulative Preferred™ Stock.  
\*\* Annualized.

### Directors

Martin Brody  
Donald F. Crumrine, CFA  
Robert T. Flaherty, CFA  
David Gale  
Morgan Gust  
Robert F. Wulf, CFA

### Officers

Robert T. Flaherty, CFA  
Chairman of the Board  
and President  
Donald F. Crumrine, CFA  
Vice President  
and Secretary  
Robert M. Ettinger, CFA  
Vice President  
Peter C. Stimes, CFA  
Vice President  
and Treasurer

### Investment Adviser

Flaherty & Crumrine Incorporated  
e-mail: flaherty@fin-mail.com

### Questions concerning your shares of 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 1376  
Boston, MA 02104  
1-800-331-1710

**This report is sent to shareholders of 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.**



## Quarterly Report

August 31, 2000

web site: [www.preferredincome.com](http://www.preferredincome.com)