

PREFERRED INCOME FUND INCORPORATED

Dear Shareholder:

This is being written as America is just beginning to recover from the tragedies at the World Trade Center and the Pentagon. The Federal Reserve Bank has clearly indicated its willingness to pump enough money into the economy to prevent potential cash crunches. In addition, the securities markets have resumed orderly operations. Once again, the country seems determined to demonstrate its extraordinary resiliency in the face of events that may change the course of history.

The performance of the Preferred Income Fund through August 31, 2001 has been a positive note in a generally difficult year for investors. Total returns on net asset value ("NAV") were 7.0% for the most recent quarter and 14.4% for the first nine months of fiscal 2001. We are very pleased with these results.

Hybrid preferreds have been star performers so far in fiscal 2001. Traditional preferreds (those which provide special tax benefits to corporate investors) lagged behind hybrids earlier, but turned in good results in recent months. That was the equivalent of the portfolio "hitting on all cylinders", which produced the very strong returns in the latest quarter.

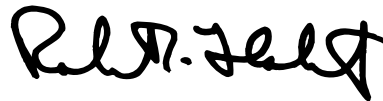
We have taken advantage of attractive opportunities to move from hybrids into traditional preferreds when these two primary sectors of the preferred market have been "out of sync". As a result, traditional preferreds accounted for approximately 67% of the Fund's portfolio on August 31, 2001, up approximately 9 percentage points since the beginning of fiscal 2001. We are always searching for the cheapest preferreds available.

Falling short-term interest rates have helped by reducing the cost of the Money Market Cumulative™ preferred ("MMP") shares issued by the Fund to create leverage. The current cost of the Fund's leverage is 2.75%, which is adjusted to market levels every 49 days through an auction process. We have not yet had an auction following the events of September 11, but short-term rates have declined further since then.

We can now write a happy ending to a matter previously discussed in these reports. Moody's has completed the restructuring of its rating system for preferred stocks as expected. The steps taken by the Fund in anticipation of this, including amending its corporate articles, successfully avoided the problems that were potentially posed for the Fund's MMP. "A stitch in time saves nine!"

The market price of the Fund's shares has stayed fairly close to net asset value recently. This may reflect a general increase in investors' interest in income oriented investments caused by the decline in short-term interest rates and the problems with common stocks. In response, we are enclosing a brief description of the Fund's dividend reinvestment plan, which provides a very convenient and cost efficient way to acquire additional shares of the Fund.

Sincerely,



Robert T. Flaherty
Chairman of the Board

September 20, 2001

Preferred Income Fund Incorporated
SUMMARY OF INVESTMENTS
August 31, 2001 (Unaudited)

	<u>Value (000's)</u>	<u>Percent of Total Net Assets</u>
Adjustable Rate Preferred Stocks		
Utilities	\$ 6,619	3.3%
Banking	34,573	17.2
Financial Services	<u>1,044</u>	<u>0.5</u>
Total Adjustable Rate	<u>42,236</u>	<u>21.0</u>
Fixed Rate Preferred Stocks and Securities		
Utilities	59,130	29.3
Banking	35,722	17.7
Financial Services	31,418	15.6
Insurance	17,335	8.6
Oil and Gas	6,858	3.4
Miscellaneous Industries	<u>4,595</u>	<u>2.3</u>
Total Fixed Rate	<u>155,058</u>	<u>76.9</u>
TOTAL PREFERRED STOCKS AND SECURITIES	197,294	97.9
SHORT TERM INVESTMENT FUND	868	0.4
PURCHASED PUT OPTIONS	<u>656</u>	<u>0.4</u>
TOTAL INVESTMENTS	198,818	98.7
OTHER ASSETS AND LIABILITIES (Net)	<u>2,679</u>	<u>1.3</u>
TOTAL NET ASSETS	<u>\$201,497</u>	<u>100.0%</u>

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, 2000	\$0.0820	\$13.42	\$12.13	\$12.78
January 31, 2001	0.0820	13.68	13.00	13.29
February 28, 2001	0.0820	13.87	13.50	13.66
March 31, 2001	0.0820	13.78	13.50	13.57
April 30, 2001	0.0820	13.69	13.65	13.69
May 31, 2001	0.0820	13.83	13.88	13.83
June 30, 2001	0.0820	13.96	13.60	13.93
July 31, 2001	0.0820	14.37	14.45	14.37
August 31, 2001	0.0820	14.54	13.85	14.21

(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⁽¹⁾
Nine Months Ended August 31, 2001 (Unaudited)

OPERATIONS:	
Net investment income	\$ 9,262,890
Net realized loss on investments sold	(2,440,046)
Net unrealized appreciation of investments during the period	<u>13,530,035</u>
Net increase in net assets from operations	20,352,879
DISTRIBUTIONS:	
Dividends paid from net investment income to MMP* Shareholders	(2,188,657)
Distributions paid from net realized capital gains to MMP* Shareholders	(7,270,549)
Dividends paid from net investment income to Common Stock Shareholders (2)	<u>—</u>
Distributions paid from net realized capital gains to Common Stock Shareholders	<u>—</u>
Total Distributions	<u>(9,459,206)</u>
FUND SHARE TRANSACTIONS:	
Increase from Common Stock transactions	621,024
NET INCREASE IN NET ASSETS:	11,514,697
NET ASSETS:	
Beginning of period	189,982,533
End of period	<u>\$ 201,497,230</u>

FINANCIAL HIGHLIGHTS⁽¹⁾
Nine Months Ended August 31, 2001 (Unaudited)
For a Common share outstanding throughout the period.

OPERATING PERFORMANCE:	
Net asset value, beginning of period	\$ 13.41
Net investment income	0.94
Net realized loss and unrealized appreciation on investments	<u>1.12</u>
Net increase in net asset value resulting from investment operations	2.06
DISTRIBUTIONS:	
Dividends paid from net investment income to MMP* Shareholders (2)	(0.22)
Distributions paid from net realized capital gains to MMP* Shareholders	<u>—</u>
Dividends paid from net investment income to Common Stock Shareholders (2)	(0.74)
Distributions paid from net realized capital gains to Common Stock Shareholders	<u>—</u>
Change in accumulated undeclared dividends on MMP*	0.03
Total distributions	<u>(0.93)</u>
Net asset value, end of period	\$ 14.54
Market value, end of period	\$ 13.85
Common shares outstanding, end of period	<u>9,883,108</u>
RATIOS TO AVERAGE NET ASSETS AVAILABLE TO COMMON STOCK SHAREHOLDERS:	
Net investment income	7.20%**
Operating expenses	1.42%**
SUPPLEMENTAL DATA:††	
Portfolio turnover rate fiscal year to date	30%
Net assets, end of period (in 000's)	\$ 201,497
Ratio of operating expenses to total average net assets including MMP*	1.00%**

(1) These tables summarize the nine months ended August 31, 2001 and should be read in conjunction with the Fund's audited financial statements, including footnotes, in its Annual Report dated November 30, 2000.

(2) Includes dividends earned, but not paid out, in prior fiscal year.

* Money Market Cumulative Preferred™ Stock.

** Annualized.

†† Information presented under Supplemental Data includes MMP*.

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, 2001

web site: www.preferredincome.com