

FLAHERTY & CRUMRINE PREFERRED INCOME FUND

To the Shareholders of the Flaherty & Crumrine Preferred Income Fund (“PFD”):

During the Fund’s 3rd fiscal quarter, the economy slowed from its rapid growth earlier in the year and, for the first time in two years, the Federal Reserve paused in its ratcheting up of short-term interest rates. In this environment, the Fund performed very well, earning a total return of +3.0% on its net asset value (NAV) in the three months ended August 31st and +5.5% over its fiscal year-to-date.

In a reversal of the weak markets for Treasury securities earlier in the year, when the Fund’s hedging strategies contributed significantly to results, long-term interest rates declined during the recent fiscal quarter and the interest-rate hedge proved unnecessary. However, as always, we follow the Fund’s investment strategy of maintaining the hedge in place, while attempting to control its cost. Doing so helps protect the value of the Fund’s holdings against significant increases in long-term interest rates and potentially results in an increase in the Fund’s distributable income. During the recent fiscal quarter, the Fund’s NAV performed very well, even after absorbing the cost of the hedge.

Conditions in the market for preferred securities continue to be positive. This market is somewhat amorphous, so we find it useful to break it down into smaller groups of similarly-structured issues. The market for traditional preferred *stock* (issues that pay dividends and may have tax advantages to certain investors which the Fund can pass through to its shareholders) has been delivering strong relative returns for some time. As of August 31st, this type of security comprised 62% of the Fund’s portfolio.

Since the beginning of 2006, fourteen new traditional preferred stock issues totaling \$5.7 billion have been brought to market (increasing the sector total by roughly 10%); the additional supply has helped focus interest on traditional preferred stock and appears to have attracted new investors. Several of these recent issues have dividend rates that adjust every quarter to reflect changes in short-term interest rates. This floating-rate feature fits the Fund nicely because it tends to offset changes in the cost of the Fund’s leverage and requires only a minimal interest-rate hedge. However, unless the level of income we can earn on this type of security goes up, we don’t anticipate increasing the Fund’s holdings much beyond present levels.

The other major category of the preferred market is the fully taxable or “hybrid” preferred. Income from these issues is taxed as ordinary income to investors and is a deductible expense to the issuer. Taxable preferred securities comprise the lion’s share of the preferred market, and the segment continues to grow rapidly. Over \$24 billion of new taxable preferred securities have come to market in 2006. As of August 31st, 33% of the Fund’s portfolio was invested in fully-taxable preferred securities.

Much of the recent growth in taxable preferred securities has come from issuance of “enhanced” preferreds. These issues have certain terms and conditions which may result in better credit ratings for the issuer (which in turn helps keep their borrowing costs down). Since most of these features favor the issuer, investors should require a higher return. In our view, too often this is not the case. As a result, the portfolio’s allocation to enhanced preferreds has increased at a much slower pace than that of the overall market.

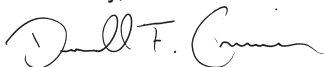
While changes in short-term interest rates affect the valuation of some of the Fund’s securities (and therefore its NAV), short-term rates more directly affect the Fund’s income and the amount of its dividend by influencing both the cost of its Money Market Preferred™ Stock (MMP®) leverage and its hedging strategy. The Fund’s leverage generally produces additional distributable income for its Common Stock shareholders. The amount of this additional income is influenced by the “spread” between the income generated by the portfolio and the cost of leverage.

As the Fed increased short-term interest rates through June 2006, these spreads narrowed significantly and the Fund generated less additional distributable income. If the Fed maintains its pause on short-term rates, and long-term rates do not decrease materially, the Fund's leverage should continue to produce the same additional distributable income as it does now. Of course, if the Fed lowers short-term interest rates, the Fund should see a greater benefit from its use of leverage and consequently have more additional distributable income for its Common Stock shareholders.

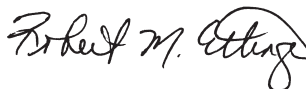
The cost of the Fund's hedging strategy is also directly affected by the slope of the yield curve (in other words, the difference between short- and long-term interest rates). When the yield curve is steep – as it was for most of the period from mid-2001 through 2004 – hedging tends to be expensive, because the market charges the difference between long- and short-term yields to those hedging. However, if the slope of the yield curve is as flat as it has been this year, the market will not charge as much to hedge and the Fund should not need to spend as much on its hedging strategy as it has over the past few years.

We hope investors will take advantage of the Fund's website, www.preferredincome.com. On it, there is a more extensive discussion of enhanced hybrid preferred securities, the impact of changing short-term interest rates on the additional distributable income provided by the Fund's leverage and how the slope of the yield curve affects the cost of the Fund's hedging strategy. It also contains a wide range of additional information about the Fund.

Sincerely,



Donald F. Crumrine
Chairman of the Board



Robert M. Ettinger
President

October 19, 2006

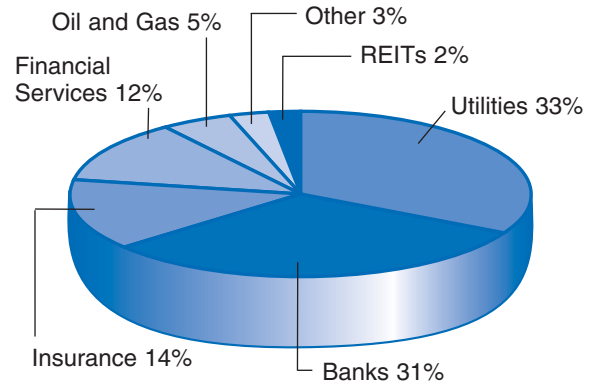
PORTFOLIO OVERVIEW
August 31, 2006 (Unaudited)

Fund Statistics on 08/31/06

Net Asset Value	\$	15.29
Market Price	\$	16.51
Premium		7.98%
Yield on Market Price		6.25%
Common Stock Shares Outstanding		10,444,513

Industry Categories

% of Portfolio



Moody's Ratings	% of Portfolio
AAA	0.4%
AA	4.6%
A	21.4%
BBB	48.1%
BB	12.0%
Not Rated	11.7%
Below Investment Grade*	14.9%

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

Top 10 Holdings by Issuer	% of Portfolio
Interstate Power & Light	4.9%
HSBC	3.9%
FBOP Corporation	3.8%
Goldman Sachs	3.6%
North Fork Bancorporation	3.5%
SLM Corporation	3.4%
Xcel Energy	3.1%
Lehman Brothers	2.9%
First Republic Bank	2.9%
Cobank	2.8%

	% of Portfolio**
Holdings Generating Qualified Dividend Income (QDI) for Individuals	67%
Holdings Generating Income Eligible for the Corporate Dividend Received Deduction (DRD)	62%

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

PORTFOLIO OF INVESTMENTS**August 31, 2006 (Unaudited)**

<u>Shares/\$ Par</u>		<u>Value</u>
Preferred Securities — 94.4%		
Banking — 31.2%		
\$ 3,000,000	Astoria Capital Trust I, 9.75% 11/01/29 Capital Security, Series B	\$ 3,405,360
	Auction Pass-Through Trust, Cl. B:	
11	Series 2006-5, Variable Rate Pfd., 144A****	328,625*
11	Series 2006-6, Variable Rate Pfd., 144A****	328,625*
54,700	BAC Capital Trust I, 7.00% Pfd. 12/15/31	1,398,132
6,000	BAC Capital Trust II, 7.00% Pfd. 02/01/32	151,320
\$ 1,500,000	Barclays Bank PLC, Adj. Rate Pfd.	1,405,957**(1)
\$ 800,000	Barnett Capital II, 7.95% 12/01/26 Capital Security	835,068
\$ 2,000,000	Capital One Capital III, 7.686% Pfd.	2,089,970
74,700	Citigroup Capital VIII, 6.95% Pfd. 09/15/31	1,901,115
	Cobank, ACB:	
50,000	7.00% Pfd., 144A****	2,589,750*
75,000	Adj. Rate Pfd., 144A****	4,087,125*
	Comerica (Imperial) Capital Trust I:	
5,000	7.60% Pfd. 07/01/50	127,350
\$ 500,000	9.98% 12/31/26 Capital Security, Series B	539,657
\$ 1,500,000	Dime Capital Trust I, 9.33% 05/06/27 Capital Security, Series A	1,589,137
9,000	FBOP Corporation, Adj. Rate Pfd., 144A****	9,180,000*
\$ 2,250,000	First Hawaiian Capital I, 8.343% 07/01/27 Capital Security, Series B	2,371,241(1)
	First Republic Bank:	
200,000	6.25% Pfd.	4,914,000*
53,700	6.70% Pfd.	1,363,174*
22,500	First Republic Preferred Capital Corporation II, 8.75% Pfd., Series B, 144A**** ..	605,813
\$ 1,500,000	First Union Capital II, 7.95% 11/15/29 Capital Security	1,787,393
16,500	Fleet Capital Trust VII, 7.20% Pfd. 12/15/31	420,833
5,000	Fleet Capital Trust VIII, 7.20% Pfd. 03/15/32	128,450
\$ 7,820,000	GreenPoint Capital Trust I, 9.10% 06/01/27 Capital Security	8,309,102
\$ 3,000,000	HBOS Capital Funding LP, 6.85% Pfd.	3,040,650(1)
5,000	HSBC Series II, Variable Inverse Pfd., Pvt.	5,510,000*
	HSBC USA, Inc.:	
140,000	6.50% Pfd., Series H	3,700,900*
3,250	\$2.8575 Pfd.	163,296*
\$ 270,000	Keycorp Institutional Capital B, 8.25% 12/15/26 Capital Security	282,701
\$ 674,000	NB Capital Trust II, 7.83% 12/15/26 Capital Security	702,399
16,000	PFGI Capital Corporation, 7.75% Pfd.	412,960
\$ 650,000	RBS Capital Trust B, 6.80% Pfd.	655,629**(1)
10	Roslyn Real Estate, 8.95% Pfd., Series C, 144A****	1,093,816
77,600	Sovereign Bancorp, 7.30% Pfd., Series C	2,068,816*
30,600	Sovereign Capital Trust V, 7.75% Pfd. 05/22/36	807,228

PORTFOLIO OF INVESTMENTS (Continued)**August 31, 2006 (Unaudited)**

<u>Shares/\$ Par</u>		<u>Value</u>
Preferred Securities — (continued)		
Banking — (continued)		
1,100	SunTrust Capital V, 7.05% Pfd. 12/15/31	\$ 28,028
9,100	USB Capital V, 7.25% Pfd. 12/15/31	231,959
16,000	USB Capital VII, 5.875% Pfd. 08/15/35	369,760
96,700	USB Capital VIII, 6.35% Pfd. 12/29/65	2,403,479
7,300	USB Capital X, 6.50% Pfd. 04/12/66	182,245
\$ 2,400,000	Washington Mutual Preferred Funding, Variable Rate Pfd., 144A****	2,355,636
40,000	Zions Capital Trust B, 8.00% Pfd. 09/01/32	1,031,200
		<u>74,897,899</u>
Financial Services — 11.1%		
Goldman Sachs Group, Inc.:		
100,000	Adj. Rate Pfd., Series D	2,557,500*
25	Pass-Through Certificates, Class B, 144A****	2,667,500*
2,500	STRIPES Custodial Receipts, Pvt.	2,660,000*
Lehman Brothers Holdings, Inc.:		
36,280	5.67% Pfd., Series D	1,776,632*
104,475	5.94% Pfd., Series C	5,293,226*
3,000	Merrill Lynch Series II STRIPES Custodial Receipts, Pvt.	3,072,000*
9,200	Morgan Stanley Capital Trust IV, 6.25% Pfd.	226,550
5,870	Morgan Stanley Capital Trust VI, 6.60% Pfd.	147,601
SLM Corporation:		
136,855	6.97% Pfd., Series A	7,362,115*
7,500	Adj. Rate Pfd., Series B	766,312*
		<u>26,529,436</u>
Insurance — 11.6%		
15,000	ACE Ltd., 7.80% Pfd., Series C	387,450**(1)
Aegon NV:		
27,750	6.375% Pfd.	694,027**(1)
25,000	6.50% Pfd.	626,000**(1)
10,000	Arch Capital Group Ltd., 7.875% Pfd., Series B	255,550**(1)
Axis Capital Holdings:		
70,750	7.25% Pfd., Series A	1,806,601**(1)
9,300	Variable Rate Pfd., Series B	942,601(1)
27,000	Berkley W.R. Capital Trust II, 6.75% Pfd. 07/26/45	664,740
61,200	Endurance Specialty Holdings, 7.75% Pfd.	1,521,738**(1)
18,250	Everest Re Capital Trust II, 6.20% Pfd., Series B	419,020(1)
140,000	MetLife Inc., 6.50% Pfd., Series B	3,602,200*

PORTFOLIO OF INVESTMENTS (Continued)

August 31, 2006 (Unaudited)

<u>Shares/\$ Par</u>		<u>Value</u>
Preferred Securities — (continued)		
Insurance — (continued)		
\$ 1,625,000	Oil Insurance Ltd., Variable Rate Pfd., 144A****	\$ 1,657,597 ⁽¹⁾
13,900	PartnerRe Capital Trust I, 7.90% Pfd. 12/31/31	353,546 ^{** (1)}
2,010	PartnerRe Ltd., 6.75% Pfd., Series C	50,180 ^{** (1)}
151,800	Principal Financial Group, 6.518% Pfd.	4,191,957*
\$ 357,000	Provident Financing Trust I, 7.405% 03/15/38 Capital Security	339,248
\$ 4,500,000	Renaissancere Capital Trust, 8.54% 03/01/27 Capital Security, Series B	4,738,973 ⁽¹⁾
	Renaissancere Holdings Ltd.:	
25,200	6.08% Pfd., Series C	560,952 ^{** (1)}
6,300	7.30% Pfd., Series B	157,973 ^{** (1)}
6,100	8.10% Pfd., Series A	153,415 ^{** (1)}
119,500	Scottish Re Group Ltd., 7.25% Pfd.	2,364,308 ^{** (1)}
7,500	St. Paul Capital Trust I, 7.60% Pfd. 10/15/50	190,500
\$ 1,250,000	USF&G Capital, 8.312% 07/01/46 Capital Security, 144A****	1,501,763
22,850	XL Capital Ltd., 8.00% Pfd., Series A	589,302 ^{** (1)}
		<u>27,769,641</u>
Utilities — 31.7%		
	Alabama Power Company:	
300	4.52% Pfd.	25,717*
5,734	4.72% Pfd.	513,308*
10,000	Baltimore Gas & Electric Company, 6.70% Pfd., Series 1993	1,041,500*
10,000	Calenergy Capital Trust III, 6.50% Pfd. 09/01/27	472,400
	Central Hudson Gas & Electric Corporation:	
5,000	4.35% Pfd., Series D, Pvt.	417,875*
900	4.96% Pfd., Series E, Pvt.	80,469*
11,119	Central Vermont Public Service Corporation, 8.30% Sinking Fund Pfd., Pvt.	1,155,209*
	Connecticut Light & Power Company:	
12,124	4.50% Pfd., Series 1963, Pvt.	469,441*
34,300	5.28% Pfd., Series 1967	1,586,889*
1,905	6.56% Pfd., Series 1968	100,003*
15,778	\$3.24 Pfd.	832,132*
2,100	Consolidated Edison Company of New York, 4.65% Pfd., Series C	184,506*
2,886	Dayton Power and Light Company, 3.90% Pfd., Series C	193,593*

PORTFOLIO OF INVESTMENTS (Continued)**August 31, 2006 (Unaudited)**

<u>Shares/\$ Par</u>		<u>Value</u>
Preferred Securities — (continued)		
Utilities — (continued)		
\$ 1,500,000	Dominion Resources Capital Trust III, 8.40% 01/15/31 Capital Security	\$ 1,732,327
	Duquesne Light Company:	
7,675	4.10% Pfd.	278,142*
9,190	4.15% Pfd.	337,089*
910	4.20% Pfd.	33,779*
40,575	6.50% Pfd.	2,060,196*
5,490	\$2.10 Pfd., Series A	203,789*
100,000	Entergy Arkansas, Inc., 6.45% Pfd.	2,571,000*
4,555	Entergy Gulf States, Inc., 7.56% Pfd.	439,626*
36,000	Entergy Louisiana, Inc., 6.95% Pfd., 144A****	3,729,780*
5,000	Entergy Mississippi, Inc., 4.92% Pfd.	401,575*
	Florida Power Company:	
5,157	4.60% Pfd.	447,009*
18,535	4.75% Pfd.	1,658,975*
13,100	Georgia Power Capital Trust, 6.125% Pfd.	336,997*
50,000	Georgia Power Capital Trust V, 7.125% Pfd. 03/31/42	1,279,000
2,010	Great Plains Energy, Inc., 4.50% Pfd.	165,523*
24,000	Gulf Power Company, 6.00% Pfd., Series 1	2,506,200*
50,000	Hawaiian Electric Company, Inc., 5.25% Pfd., Series H, Pvt.	879,000*
\$ 3,500,000	Houston Light & Power Capital Trust II, 8.257% 02/01/37 Capital Security	3,677,187
32,650	Indianapolis Power & Light Company, 5.65% Pfd.	3,023,063*
384,000	Interstate Power & Light Company, 8.375% Pfd., Series B	11,813,760*
	Pacific Enterprises:	
27,430	\$4.50 Pfd.	2,317,561*
10,000	\$4.75 Pfd., Series 53	891,800*
	Pacific Gas & Electric Co.:	
7,600	4.50% Pfd., Series H	151,278*
41,500	5.00% Pfd., Series D	909,680*
79,086	5.00% Pfd., Series E	1,780,226*
	PacifiCorp:	
1,095	5.40% Pfd.	110,896*
1,225	\$4.56 Pfd.	99,874*
14,542	\$4.72 Pfd.	1,227,127*
10,278	\$7.48 Sinking Fund Pfd.	1,045,530*
\$ 500,000	PECO Energy Capital Trust III, 7.38% 04/06/28 Capital Security, Series D	533,540
8,137	Portland General Electric, 7.75% Sinking Fund Pfd.	829,364*
5,000	PPL Electric Utilities Corporation, 6.75% Pfd.	522,125*
10,000	Public Service Company of New Mexico, 4.58% Pfd., Series 1965	773,600*

PORTFOLIO OF INVESTMENTS (Continued)

August 31, 2006 (Unaudited)

<u>Shares/\$ Par</u>		<u>Value</u>
Preferred Securities — (continued)		
Utilities — (continued)		
	San Diego Gas & Electric Company:	
1,200	4.40% Pfd.	\$ 19,734*
700	4.50% Pfd.	11,774*
77,000	\$1.70 Pfd.	1,997,380*
	South Carolina Electric & Gas Company:	
24,924	5.125% Purchase Fund Pfd., Pvt.	1,280,844*
6,703	6.00% Purchase Fund Pfd., Pvt.	341,250*
10,600	Southern California Edison, 6.00% Pfd.	1,051,859*
75,000	Southern Union Company, 7.55% Pfd.	1,948,875*
\$ 750,000	TXU Electric Capital V, 8.175% 01/30/37 Capital Security	789,866
	Union Electric Company:	
14,150	4.56% Pfd.	1,264,798*
8,800	\$7.64 Pfd.	908,644*
12,500	Virginia Electric & Power Company, \$7.05 Pfd.	1,279,188*
13,500	Virginia Power Capital Trust, 7.375% Pfd. 07/30/42	345,668
	Wisconsin Power & Light Company:	
1,220	4.50% Pfd.	103,956*
546	4.80% Pfd.	49,626*
13,000	6.20% Pfd.	1,332,435*
	Xcel Energy, Inc.:	
16,030	\$4.08 Pfd., Series B	1,255,710*
26,200	\$4.10 Pfd., Series C	2,062,464*
22,000	\$4.11 Pfd., Series D	1,736,130*
17,750	\$4.16 Pfd., Series E	1,417,693*
10,000	\$4.56 Pfd., Series G	875,500*
		<u>75,913,054</u>
Oil and Gas — 4.5%		
8,000	Devon Energy Corporation, 6.49% Pfd., Series A	816,000*
\$ 1,021,000	Enterprise Products Partners, Variable Rate Pfd.	1,062,463
5,985	EOG Resources, Inc., 7.195% Pfd., Series B	6,267,552*
\$ 1,675,000	KN Capital Trust III, 7.63% 04/15/28 Capital Security	1,511,603
10,000	Lasmo America Limited, 8.15% Pfd., 144A****	1,068,800*(1)
		<u>10,726,418</u>
Real Estate Investment Trust (REIT) — 2.4%		
21,400	BRE Properties, Inc., 8.08% Pfd., Series B	549,017
20,000	Duke Realty Corporation, 6.625% Pfd., Series J	490,600

PORTFOLIO OF INVESTMENTS (Continued)**August 31, 2006 (Unaudited)**

<u>Shares/\$ Par</u>		<u>Value</u>
Preferred Securities — (continued)		
Real Estate Investment Trust (REIT) — (continued)		
10,000	Equity Office Property Trust, 7.75% Pfd., Series G	\$ 253,900
1,000	Equity Residential Properties, 8.29% Pfd., Series K	59,105
16,000	PS Business Parks, Inc., 7.00% Pfd., Series H	398,320
	Public Storage, Inc.:	
19,000	6.18% Pfd., Series D	450,870
123,270	6.45% Pfd., Series F	2,990,530
10,000	6.45% Pfd., Series X	245,450
3,500	6.60% Pfd., Series C	86,573
2,800	6.75% Pfd., Series E	70,322
10,000	7.25% Pfd., Series K	254,750
		<u>5,849,437</u>
Miscellaneous Industries — 1.9%		
13,600	E.I. Du Pont de Nemours and Company, \$4.50 Pfd., Series B	1,120,504*
40,000	Ocean Spray Cranberries, Inc., 6.25% Pfd., 144A****	3,470,400*
26,000	Touch America Holdings, \$6.875 Pfd.	—†
		<u>4,590,904</u>
	Total Preferred Securities	
	(Cost \$215,118,029)	<u>226,276,789</u>
Corporate Debt Securities — 4.5%		
Financial Services — 0.4%		
36,300	Saturns-GS, 6.00% 02/15/33, Series Goldman Sachs	864,121
		<u>864,121</u>
Insurance — 2.3%		
\$ 900,000	Farmers Exchange Capital, 7.20% 07/15/48, 144A****	895,990
	Liberty Mutual Insurance:	
\$ 572,000	7.50% 08/15/36, 144A****	588,777
\$ 4,142,000	7.697% 10/15/97, 144A****	4,133,033
		<u>5,617,800</u>
Utilities — 0.9%		
\$ 1,000,000	Duquesne Light Holdings, 6.25% 08/15/35	926,850
5,000	Entergy Louisiana LLC, 7.60% 04/01/32	127,775
45,000	Northern States Power Company, 8.00%	1,169,550
		<u>2,224,175</u>

PORTFOLIO OF INVESTMENTS (Continued)

August 31, 2006 (Unaudited)

<u>Shares/\$ Par</u>	<u>Value</u>
Corporate Debt Securities — (continued)	
Oil and Gas — 0.9%	
\$ 2,000,000 KN Energy, Inc., 7.45% 03/01/98	\$ 1,766,990
15,000 Nexen, Inc., 7.35% Subordinated Notes	381,750 ⁽¹⁾
	<u>2,148,740</u>
Total Corporate Debt Securities (Cost \$10,612,460)	<u>10,854,836</u>
Option Contracts — 0.0%	
1,273 December Put Options on December U.S. Treasury Bond Futures, Expiring 11/21/06	139,234†
312 October Put Options on December U.S. Treasury Bond Futures, Expiring 09/22/06	4,875†
	<u>144,109</u>
Total Option Contracts (Cost \$822,205)	<u>144,109</u>
Money Market Fund — 0.4%	
867,667 BlackRock Provident Institutional, TempFund	867,667
	<u>867,667</u>
Total Money Market Fund (Cost \$867,667)	<u>867,667</u>
Total Investments (Cost \$227,420,361 ^{***})	99.3% 238,143,401
Other Assets And Liabilities (Net)	0.7% <u>1,585,026</u>
Total Net Assets Available to Common and Preferred Stock	<u>100.0%‡ \$ 239,728,427</u>
Money Market Cumulative Preferred™ Stock (MMP®) Redemption Value	<u>(80,000,000)</u>
Total Net Assets Available To Common Stock	<u>\$ 159,728,427</u>

* Securities eligible for the Dividends Received Deduction and distributing Qualified Dividend Income.

** Securities distributing Qualified Dividend Income only.

*** Aggregate cost of securities held.

**** Securities exempt from registration under Rule 144A of the Securities Act of 1933. These securities may be resold in transactions exempt from registration to qualified institutional buyers. These securities have been determined to be liquid under the guidelines established by the Board of Directors.

⁽¹⁾ Foreign Issuer.

† 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.

ABBREVIATIONS:

Pfd. — Preferred Securities

Pvt. — Private Placement Securities

REIT — Real Estate Investment Trust

STATEMENT OF CHANGES IN NET ASSETS AVAILABLE TO COMMON STOCK⁽¹⁾
For the period from December 1, 2005 through August 31, 2006 (Unaudited)

	<u>Value</u>
OPERATIONS:	
Net investment income	\$ 9,932,653
Net realized gain/(loss) on investments sold during the period	3,748,887
Change in net unrealized appreciation/depreciation of investments held during the period.	(2,740,350)
Distributions to MMP ^{®*} Shareholders from net investment income, including changes in accumulated undeclared distributions	<u>(2,394,848)</u>
Net increase in net assets resulting from operations.	8,546,342
DISTRIBUTIONS:	
Dividends paid from net investment income to Common Stock Shareholders ⁽²⁾	<u>(8,199,831)</u>
Total Distributions to Common Stock Shareholders	(8,199,831)
FUND SHARE TRANSACTIONS:	
Increase from shares issued under the Dividend Reinvestment and Cash Purchase Plan	<u>1,104,548</u>
Net increase in net assets available to Common Stock resulting from Fund share transactions.	1,104,548
NET INCREASE IN NET ASSETS AVAILABLE TO COMMON STOCK FOR THE PERIOD	<u><u>\$ 1,451,059</u></u>

NET ASSETS AVAILABLE TO COMMON STOCK:

Beginning of period.	\$ 158,277,368
Net increase in net assets during the period	<u>1,451,059</u>
End of period	<u><u>\$ 159,728,427</u></u>

* Money Market Cumulative Preferred[™] Stock.

⁽¹⁾ These tables summarize the nine months ended August 31, 2006 and should be read in conjunction with the Fund's audited financial statements, including footnotes, in its Annual Report dated November 30, 2005.

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

FINANCIAL HIGHLIGHTS⁽¹⁾

For the period from December 1, 2005 through August 31, 2006 (Unaudited)

For a Common Stock share outstanding throughout the period.

PER SHARE OPERATING PERFORMANCE:

Net asset value, beginning of period \$ 15.26

INVESTMENT OPERATIONS:

Net investment income 0.96

Net realized and unrealized gain/(loss) on investments 0.09

DISTRIBUTIONS TO MMP^{®*} SHAREHOLDERS:

From net investment income (0.23)

From net realized capital gains —

Total from investment operations 0.82

DISTRIBUTIONS TO COMMON STOCK SHAREHOLDERS:

From net investment income (0.79)

From net realized capital gains —

Total distributions to Common Stock Shareholders (0.79)

Net asset value, end of period \$ 15.29

Market value, end of period \$ 16.51

Common Stock shares outstanding, end of period 10,444,513

RATIOS TO AVERAGE NET ASSETS AVAILABLE TO COMMON STOCK SHAREHOLDERS:

Net investment income† 6.32%**

Operating expenses 1.51%**

SUPPLEMENTAL DATA:††

Portfolio turnover rate 54%***

Total net assets available to Common and Preferred Stock, end of period (in 000's) . . . \$ 239,728

Ratio of operating expenses to total average net assets available to
Common and Preferred Stock 1.00%**

⁽¹⁾ These tables summarize the nine months ended August 31, 2006 and should be read in conjunction with the Fund's audited financial statements, including footnotes, in its Annual Report dated November 30, 2005.

* Money Market Cumulative PreferredTM Stock.

** Annualized.

*** Not Annualized.

† The net investment income ratios reflect income net of operating expenses and payments to MMP^{®*} Shareholders.

†† Information presented under heading Supplemental Data includes MMP^{®*}.

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

	Total Dividends Paid	Net Asset Value	NYSE Closing Price	Dividend Reinvestment Price⁽¹⁾
December 31, 2005	\$0.0905	\$15.38	\$16.09	\$15.38
January 28, 2006	0.0905	15.43	16.89	16.05
February 28, 2006	0.0905	15.57	16.65	15.82
March 31, 2006	0.0860	15.40	16.08	15.40
April 30, 2006	0.0860	15.23	15.55	15.23
May 31, 2006	0.0860	15.10	15.55	15.10
June 30, 2006	0.0860	14.94	15.19	14.94
July 31, 2006	0.0860	14.89	15.73	14.94
August 31, 2006	0.0860	15.29	16.51	15.68

⁽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.

NOTES TO FINANCIAL STATEMENTS (Unaudited)

1. Aggregate Information for Federal Income Tax Purposes

At August 31, 2006, the aggregate cost of securities for federal income tax purposes was \$227,705,319, the aggregate gross unrealized appreciation for all securities in which there is an excess of value over tax cost was \$15,485,858, and the aggregate gross unrealized depreciation for all securities in which there is an excess of tax cost over value was \$5,047,776.

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Directors

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

Officers

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

Investment Adviser

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

Questions concerning your shares of Flaherty & Crumrine Preferred Income Fund?

- If your shares are held in a Brokerage Account, contact your Broker.
- If you have physical possession of your shares in certificate form, contact the Fund's Transfer Agent & Shareholder Servicing Agent —
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 Incorporated for their information. It is not a Prospectus, circular or representation intended for use in the purchase or sale of shares of the Fund or of any securities mentioned in this report.



Flaherty & Crumrine
PREFERRED INCOME FUND

Quarterly Report

August 31, 2006

www.preferredincome.com