

FLAHERTY & CRUMRINE PREFERRED INCOME FUND INC  
Form N-Q  
April 28, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

**FORM N-Q**

**QUARTERLY SCHEDULE OF PORTFOLIO HOLDINGS OF REGISTERED**

**MANAGEMENT INVESTMENT COMPANY**

Investment Company Act file number 811-06179

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Flaherty & Crumrine Preferred Income Fund Incorporated

(Exact name of registrant as specified in charter)

301 E. Colorado Boulevard, Suite 720

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Pasadena, CA 91101

(Address of principal executive offices) (Zip code)

Donald F. Crumrine

Flaherty & Crumrine Incorporated

301 E. Colorado Boulevard, Suite 720

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Pasadena, CA 91101

(Name and address of agent for service)

Registrant's telephone number, including area code: 626-795-7300

Date of fiscal year end: November 30

Date of reporting period: February 28, 2014

Form N-Q is to be used by management investment companies, other than small business investment companies registered on Form N-5 (§§ 239.24 and 274.5 of this chapter), to file reports with the Commission, not later than 60 days after the close of the first and third fiscal quarters, pursuant to rule 30b1-5 under the Investment Company Act of 1940 (17 CFR 270.30b1-5). The Commission may use the information provided on Form N-Q in its regulatory, disclosure review, inspection, and policymaking roles.

A registrant is required to disclose the information specified by Form N-Q, and the Commission will make this information public. A registrant is not required to respond to the collection of information contained in Form N-Q

unless the Form displays a currently valid Office of Management and Budget ( OMB ) control number. Please direct comments concerning the accuracy of the information collection burden estimate and any suggestions for reducing the burden to the Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549. The OMB has reviewed this collection of information under the clearance requirements of 44 U.S.C. § 3507.

**Item 1. Schedule of Investments.**

The Schedule(s) of Investments is attached herewith.

*FLAHERTY & CRUMRINE PREFERRED INCOME FUND*

To the Shareholders of Flaherty & Crumrine Preferred Income Fund:

PFD's fiscal 2014 got off to a strong start, as preferred securities continued to recover from 2013's mid-year swoon. Total return on net asset value<sup>1</sup> was +4.7% for the first fiscal quarter.<sup>2</sup> Market price performance was even better: The Fund's market price discount to NAV narrowed, generating total return on market value for the fiscal quarter of +7.7%.

After a difficult stretch during the second half of 2013, the preferred securities market seemed ripe for recovery, and it didn't disappoint. One probably would not have concluded that in December, however, when long-term interest rates rose to their highest levels of the year (nearly 4% for the 30-year Treasury bond) after the Federal Reserve began to taper its securities purchases. Many holders of preferred securities—particularly \$25-par issues—sold them to book tax losses before year-end. Such selling pressure hurt prices even more. Preferred securities' prices ended 2013 at or near their lows for the year.

As 2014 began, preferred securities started to turn around. Unusually cold temperatures and heavy snowfall blanketed much of the United States from December through February, dampening economic activity. Job growth sputtered, personal spending eased and housing activity slowed. The 30-year Treasury bond yield drifted back down to finish the fiscal quarter at 3.58%, 0.23% lower than where it started in December. Meanwhile, fundamental credit conditions—profits, balance sheets and loan performance, among others—continued to improve for most preferred issuers.

As fears of sharply higher interest rates faded and tax-loss selling ran its course, preferred investors returned to the market. And they had company! Some investors who typically focus on other fixed-income markets, such as corporate or high-yield bonds, also bought preferred securities, attracted by their higher yields in an otherwise low-yield environment. Those other fixed-income markets dwarf the preferred market in size, so even a small reallocation to preferreds inside a bond portfolio can translate into a lot of dollars being invested in preferreds. Demand for preferred securities picked up noticeably.

Among major issuers, financial companies, especially banks, are adapting to new rules and regulations implemented since the financial crisis. Regular readers of our letters will recall many discussions about Basel III and other regulatory pronouncements. These regulations are intended to strengthen balance sheets and improve transparency—positives for preferred investors. In almost every case in the U.S. and abroad, preferred securities are, or will be, an integral component of capital. As a result, we have seen and will continue to see a steady supply of new preferred issues. However, new issuance has been modest in size and readily absorbed by investors; and spreads on these and secondary-market issues have gradually compressed.

Although interest-rate fears have receded recently, we know many Fund investors remain concerned about the possibility of rising interest rates. Three observations. First, although preferred security prices tend to move with intermediate and long-term Treasury yields, their correlation is not perfect. Yields on preferred securities are high relative to Treasuries and corporate bonds, and they should be able to absorb some increase in Treasury yields while still generating positive total returns. We think improving credit fundamentals support that view.

<sup>1</sup> Following methodology required by the SEC, total return assumes dividend reinvestment and includes income and principal change, plus the impact of the Fund's leverage and expenses.

<sup>2</sup> December 1, 2013–February 28, 2014.

Second, as the Fund's experience in 2013's third fiscal quarter demonstrated, prices of preferred securities can fall when interest rates increase significantly. However, preferred securities pay dividends year-in and year-out. If we have picked our credits correctly, over time, those dividends can turn modest principal losses into positive total returns. Shareholders probably will have to live through some quarter-to-quarter volatility, but we think prospective returns on preferred securities remain attractive for long-term investors.

Third, there are a number of ways we can manage interest-rate risk in a portfolio of preferred securities, even if we exclude outright interest-rate hedging (something the Fund has not done since 2008). In particular, so-called fixed-to-floating rate preferred securities can offer attractive yields with only intermediate duration or interest-rate risk. A typical such security starts with a coupon rate that is fixed for five or 10 years and then floats at a margin over an index (usually 3-month LIBOR). These preferred securities have *credit* risk similar to fixed-rate issues, but they can have much less *interest-rate* risk. Of course, not all fixed-to-floating rate preferred securities are the same, and none are riskless. Investors need to evaluate each issue's creditworthiness, terms and conditions carefully, something we spend a lot of time doing. As of February 28, 2014, roughly 48% of the Fund's portfolio was comprised of fixed-to-floating rate issues, and they fit well with our market outlook.

We expect economic growth to improve in the second quarter as weather effects fade. We don't think weather was the whole story behind sluggish first-quarter growth, but it was an important factor, and one that inevitably will thaw come spring. Stronger growth may push interest rates higher once again. However, for 2014 as a whole, we foresee modest economic growth, improving credit conditions and accommodative monetary policy. That should translate into gradually (if erratically) rising Treasury rates along with narrower yield spreads on preferred securities. Investors should be prepared for some volatility over coming quarters, but we think coupon or coupon minus a bit returns on preferred securities should remain attractive for long-term investors.

As always, we encourage you to visit the Fund's website [www.preferredincome.com](http://www.preferredincome.com), for current information on preferred-securities markets, the Fund and the broader economy.

Sincerely,

The Flaherty & Crumrine Portfolio Management Team:

R. Eric Chadwick

Donald F. Crumrine

Robert M. Ettinger

Bradford S. Stone

March 31, 2014

Flaherty &amp; Crumrine Preferred Income Fund Incorporated

**PORTFOLIO OVERVIEW**

February 28, 2014 (Unaudited)

**Fund Statistics**

Net Asset Value	\$	13.22
Market Price	\$	13.08
Discount		1.06%
Yield on Market Price		8.26%
Common Stock Shares Outstanding		10,985,567

**Moody's Ratings**

	<b>% of Net Assets</b>
A	1.2%
BBB	54.1%
BB	38.2%
Below BB	0.7%
Not Rated*	4.5%
Below Investment Grade**	22.8%

\* Does not include net other assets and liabilities of 1.3%.

\*\* Below investment grade by all of Moody's, S&amp;P, and Fitch.

**Industry Categories****% of Net Assets****Top 10 Holdings by Issuer**

	<b>% of Net Assets</b>
JPMorgan Chase	4.6%
HSBC PLC	4.3%
Banco Santander, S.A.	4.3%
MetLife	4.2%
Liberty Mutual Group	4.0%
Barclays Bank PLC	3.2%
XL Group PLC	2.9%
Goldman Sachs Group	2.7%
Citigroup	2.7%
Wells Fargo & Company	2.6%

**% of Net Assets\*\*\***

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Holdings Generating Qualified Dividend Income (QDI) for Individuals	53%
Holdings Generating Income Eligible for the Corporate Dividends Received Deduction (DRD)	34%

\*\*\* This does not reflect year-end results or actual tax categorization of Fund distributions. These percentages can, and do, change, perhaps significantly, depending on market conditions. Investors should consult their tax advisor regarding their personal situation.  
Net Assets includes assets attributable to the use of leverage.

Flaherty &amp; Crumrine Preferred Income Fund Incorporated

**PORTFOLIO OF INVESTMENTS**

February 28, 2014 (Unaudited)

Shares/\$ Par		Value
<b>Preferred Securities 92.3%</b>		
<b>Banking 41.9%</b>		
17,500	Astoria Financial Corp., 6.50% Pfd., Series C	\$ 415,669*
Banco Santander, S.A.:		
355,000	Banco Santander, 10.50% Pfd., Series 10	9,514,532**(1)(3)
Bank of America:		
\$ 1,500,000	Bank of America Corporation, 8.125%	1,718,145*(1)
2,500	Countrywide Capital IV, 6.75% Pfd. 04/01/33	63,594
15,000	Countrywide Capital V, 7.00% Pfd. 11/01/36	379,373
Barclays Bank PLC:		
\$ 3,250,000	Barclays Bank PLC, 6.278%	3,206,599**(1)(2)(3)
58,000	Barclays Bank PLC, 7.10% Pfd.	1,484,220**(3)
3,700	Barclays Bank PLC, 7.75% Pfd., Series 4	95,312**(3)
90,000	Barclays Bank PLC, 8.125% Pfd., Series 5	2,331,000**(1)(3)
\$ 1,925,000	BNP Paribas, 7.195%, 144A****	2,047,719**(1)(2)(3)
Citigroup:		
70,642	Citigroup, Inc., 6.875% Pfd., Series K	1,838,211*(1)
38,100	Citigroup, Inc., 7.125% Pfd., Series J	1,015,365*
\$ 2,750,000	Citigroup, Inc., 8.40%, Series E	3,042,806*(1)
22,500	City National Corporation, 6.75% Pfd., Series D	604,800*
CoBank ACB:		
16,100	CoBank ACB, 6.125% Pfd., Series G, 144A****	1,394,663*
10,000	CoBank ACB, 6.25% Pfd., 144A****	1,007,500*(1)
\$ 5,210,000	Colonial BancGroup, 7.114%, 144A****	7,815 <sup>(4)(5)</sup>
15,200	Cullen/Frost Bankers, Inc., 5.375% Pfd., Series A	331,550*
90,000	Fifth Third Bancorp, 6.625% Pfd., Series I	2,392,425*(1)
First Horizon:		
795	First Tennessee Bank, Adj. Rate Pfd., 3.75% <sup>(6)</sup> , 144A****	536,873*(1)
\$ 500,000	First Tennessee Capital II, 6.30% 04/15/34, Series B	488,750
1	FT Real Estate Securities Company, 9.50% Pfd., 144A****	1,192,500 <sup>(1)</sup>
112,500	First Niagara Financial Group, Inc., 8.625% Pfd.	3,182,794*(1)
32,050	First Republic Bank, 6.70% Pfd.	806,458*(1)
Goldman Sachs Group:		
\$ 5,751,253	Goldman Sachs Capital I, 6.345% 02/15/34	6,006,321 <sup>(1)(2)</sup>
HSBC PLC:		
\$ 800,000	HSBC Capital Funding LP, 10.176%, 144A****	1,158,000 <sup>(1)(2)(3)</sup>
150,000	HSBC Holdings PLC, 8.00% Pfd., Series 2	4,030,875**(1)(3)
\$ 130,000	HSBC USA Capital Trust I, 7.808% 12/15/26, 144A****	132,112
\$ 145,000	HSBC USA Capital Trust II, 8.38% 05/15/27, 144A****	147,402 <sup>(1)</sup>
128,813	HSBC USA, Inc., 6.50% Pfd., Series H	3,216,306*(1)



Flaherty &amp; Crumrine Preferred Income Fund Incorporated

**PORTFOLIO OF INVESTMENTS (Continued)**

February 28, 2014 (Unaudited)

Shares/\$ Par		Value
<b>Preferred Securities (Continued)</b>		
<b>Banking (Continued)</b>		
	ING Groep NV:	
40,000	ING Groep NV, 6.375% Pfd.	\$ 984,000**(3)
35,000	ING Groep NV, 7.05% Pfd.	891,153**(3)
23,400	ING Groep NV, 7.20% Pfd.	596,759**(3)
47,500	ING Groep NV, 7.375% Pfd.	1,217,900**(3)
	JPMorgan Chase:	
\$ 5,300,000	JPMorgan Chase & Company, 6.75% , Series S	5,591,500*
\$ 4,000,000	JPMorgan Chase & Company, 7.90%, Series I	4,508,800*(1)
\$ 550,000	Lloyds Banking Group PLC, 6.657%, 144A****	550,000**(3)
	M&T Bank Corporation:	
\$ 500,000	M&T Bank Corporation, 6.450%, Series E	519,375*
\$ 2,240,000	M&T Bank Corporation, 6.875%, Series D, 144A****	2,243,958*(1)
	Morgan Stanley:	
49,607	Morgan Stanley, 6.875%, Pfd. , Series F	1,283,829*
55,516	Morgan Stanley, 7.125%, Pfd. , Series E	1,487,912*
82,500	PNC Financial Services Group, Inc., 6.125% Pfd., Series P	2,155,106*(1)
\$ 2,160,000	RaboBank Nederland, 11.00%, 144A****	2,856,600(1)(3)
	Royal Bank of Scotland:	
7,500	Royal Bank of Scotland Group PLC, 6.40%, Pfd., Series M	171,150**(3)
15,000	Royal Bank of Scotland Group PLC, 6.60% Pfd., Series S	346,050**(3)
45,000	Royal Bank of Scotland Group PLC, 7.25% Pfd., Series T	1,125,000**(3)
	Sovereign Bancorp:	
1,750	Sovereign REIT, 12.00% Pfd., Series A, 144A****	2,332,390
10,000	Texas Capital Bancshares Inc., 6.50% Pfd., Series A	232,625*
12,500	US Bancorp, 6.50%, Pfd., Series F	347,266*
	Wells Fargo:	
19,400	Wells Fargo & Company, 6.625% Pfd., Series R	519,144*
\$ 895,000	Wells Fargo & Company, 7.98%, Series K	1,024,775*
144,500	Wells Fargo & Company, 8.00% Pfd., Series J	4,143,176*(1)
	Zions Bancorporation:	
\$ 1,000,000	Zions Bancorporation, 7.20%, Series J	1,040,000*(1)
93,000	Zions Bancorporation, 7.90% Pfd., Series F	2,631,900*(1)
		92,590,057
<b>Financial Services 1.1%</b>		
	Credit Suisse Group:	
\$ 402,000	Claudius, Ltd. - Credit Suisse AG, 7.875%, Series B, 144A****	414,060(3)
\$ 1,000,000	General Electric Capital Corp., 7.125%, Series A	1,136,808*(1)

Flaherty & Crumrine Preferred Income Fund Incorporated

**PORTFOLIO OF INVESTMENTS (Continued)**

February 28, 2014 (Unaudited)

Shares/\$ Par		Value
<b>Preferred Securities (Continued)</b>		
	<b>Financial Services (Continued)</b>	
	HSBC PLC:	
36,537	HSBC Finance Corporation, 6.36% Pfd., Series B	\$