

Edgar Filing: PREFERRED INCOME STRATEGIES FUND INC - Form N-CSRS

PREFERRED INCOME STRATEGIES FUND INC
Form N-CSRS
June 30, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM N-CSRS

CERTIFIED SHAREHOLDER REPORT OF REGISTERED MANAGEMENT INVESTMENT COMPANIES

Investment Company Act file number 811-21286

Name of Fund: Preferred Income Strategies Fund, Inc.

Fund Address: P.O. Box 9011
Princeton, NJ 08543-9011

Name and address of agent for service: Terry K. Glenn, President, Preferred
Income Strategies Fund, Inc., 800 Scudders Mill Road, Plainsboro, NJ,
08536. Mailing address: P.O. Box 9011, Princeton, NJ, 08543-9011

Registrant's telephone number, including area code: (609) 282-2800

Date of fiscal year end: 10/31/04

Date of reporting period: 11/01/03 - 04/30/04

Item 1 - Report to Stockholders

[LOGO] Merrill Lynch Investment Managers

www.mlim.ml.com

Preferred Income
Strategies Fund, Inc.

Semi-Annual Report
April 30, 2004

[LOGO] Merrill Lynch Investment Managers

Preferred Income Strategies Fund, Inc.

The Benefits and Risks of Leveraging

Preferred Income Strategies Fund, Inc. utilizes leveraging through borrowings or issuance of short-term debt securities or shares of Preferred Stock. The concept of leveraging is based on the premise that the cost of assets to be obtained from leverage will be based on short-term interest or dividend rates, which normally will be lower than the income earned by the Fund on its longer-term portfolio investments. To the extent that the total assets of the Fund (including the assets obtained from leverage) are invested in higher-yielding portfolio investments, the Fund's Common Stock shareholders are the beneficiaries of the incremental yield.

Leverage creates risks for holders of Common Stock including the likelihood of greater net asset value and market price volatility. In addition, there is the risk that fluctuations in interest rates on borrowings (or in the dividend rates

Edgar Filing: PREFERRED INCOME STRATEGIES FUND INC - Form N-CSRS

on any Preferred Stock, if the Fund were to issue Preferred Stock) may reduce the Common Stock's yield and negatively impact its net asset value and market price. If the income derived from securities purchased with assets received from leverage exceeds the cost of leverage, the Fund's net income will be greater than if leverage had not been used. Conversely, if the income from the securities purchased is not sufficient to cover the cost of leverage, the Fund's net income will be less than if leverage had not been used, and therefore the amount available for distribution to Common Stock shareholders will be reduced.

Officers and Directors

Terry K. Glenn, President and Director
David O. Beim, Director
James T. Flynn, Director
W. Carl Kester, Director
Karen P. Robards, Director
John Burger, Vice President
Thomas Musmanno, Vice President
Donald C. Burke, Vice President and Treasurer
Phillip S. Gillespie, Secretary

Todd Goodwin and George W. Holbrook, Directors of Preferred Income Strategies Fund, Inc., have recently retired. The Fund's Board of Directors wishes Messrs. Goodwin and Holbrook well in their retirements.

Custodian

State Street Bank and Trust Company
P.O. Box 351
Boston, MA 02101

Transfer Agent

Common Stock:

EquiServe
P.O. Box 43010
Providence, RI 02940-3010

Preferred Stock:

The Bank of New York
101 Barclay Street -- 7 West
New York, NY 10286

NYSE Symbol

PSY

Electronic Delivery

The Fund offers electronic delivery of communications to its shareholders. In order to receive this service, you must register your account and provide us with e-mail information. To sign up for this service, simply access this website <http://www.icsdelivery.com/live> and follow the instructions. When you visit this site, you will obtain a personal identification number (PIN). You will need this PIN should you wish to update your e-mail address, choose to discontinue this service and/or make any other changes to the service. This service is not available for certain retirement accounts at this time.

Edgar Filing: PREFERRED INCOME STRATEGIES FUND INC - Form N-CSRS

2

PREFERRED INCOME STRATEGIES FUND, INC.

APRIL 30, 2004

A Letter From the President

Dear Shareholder

Index returns during the most recent six-month reporting period indicate that fixed income markets continued to reward those investors who were willing to accept greater risk. The high yield market, as measured by the Credit Suisse First Boston High Yield Index, provided a return of +6.33% for the six months ended April 30, 2004. By comparison, the Merrill Lynch U.S. Corporate Master Index and the Merrill Lynch AAA U.S. Treasuries/Agencies 1 - 10 Year Index returned +1.89% and +.67%, respectively, for the same period.

Throughout the period, short-term interest rates remained at historic lows and kept the short end of the yield curve relatively flat, making it increasingly difficult to find attractive income opportunities. As of April month-end, the Federal Reserve Board maintained its accommodative policy stance, although a better-than-expected employment report for the month of March prompted speculation that an interest rate increase could come sooner than many had expected. On April 2, 2004, the good news on the employment front -- previously the one dim spot in an otherwise bright economic picture -- helped prompt the yield on the 10-year Treasury note to spike nearly 25 basis points (.25%), from 3.91% to 4.15%. Market watchers continue to monitor economic data and Federal Reserve Board language for indications of interest rate direction. If economic growth maintains its recent pace and employment figures continue to improve, many believe it is just a matter of time before interest rates move upward.

Equity markets, in the meantime, gleaned support from the improving economic environment and provided attractive returns. For the six-month period ended April 30, 2004, the Standard & Poor's 500 Index returned +6.27%. Significant fiscal and monetary stimulus in 2003, including low interest rates and tax cuts, has opened the door to consumer spending, capital spending, increases in exports and long-awaited job growth. As expected, these developments have led the way to improvements in corporate earnings -- a positive for stock markets.

The events and efforts of the past year leave us with a much stronger economy today. Of course, markets will always fluctuate, and there are many uncertainties -- not the least of which are geopolitical in nature -- which can translate into negative market movements. Keeping this in mind, however, we encourage you to revisit your portfolio and your asset allocation strategy to ensure you are well positioned to take advantage of the opportunities that lie ahead. Importantly, your financial advisor can help you develop a strategy most suitable for your circumstances through all types of market and economic cycles.

We thank you for trusting Merrill Lynch Investment Managers with your investment assets, and we look forward to serving you in the months and years ahead.

Sincerely,

/s/ Terry K. Glenn

Terry K. Glenn
President and Director

PREFERRED INCOME STRATEGIES FUND, INC.

APRIL 30, 2004

3

Edgar Filing: PREFERRED INCOME STRATEGIES FUND INC - Form N-CSRS

[LOGO] Merrill Lynch Investment Managers

A Discussion With Your Fund's Portfolio Managers

The Fund recorded a positive return and outperformed its benchmark in a period characterized by generally rising interest rates.

How did the Fund perform during the period in light of the existing market conditions?

For the six-month period ended April 30, 2004, the Common Stock of Preferred Income Strategies Fund, Inc. had net annualized yields of 9.50% and 10.39%, based on a period-end per share net asset value of \$23.91 and a per share market price of \$21.85, respectively, and \$1.132 per share income dividends. For the same period, the total investment return on the Fund's Common Stock was +2.53%, based on a change in per share net asset value from \$24.53 to \$23.91, and assuming reinvestment of \$1.127 per share ordinary income dividends and \$.094 per share capital gains distributions. For the same period, the unmanaged Merrill Lynch Preferred Stock Fixed Rate Index returned -.03%.

For a description of the Fund's total investment return based on a change in the per share market value of the Fund's Common Stock (as measured by the trading price of the Fund's shares on the New York Stock Exchange), and assuming reinvestment of dividends, please refer to the Financial Highlights section included in this report. As a closed-end fund, the Fund's shares may trade in the secondary market at a premium or discount to the Fund's net asset value. As a result, total investment returns based on changes in the market value of the Fund's Common Stock can vary significantly from total investment returns based on changes in the Fund's net asset value.

Long-term interest rates declined somewhat early in the period, then rose significantly in April. Throughout the period, we positioned the Fund with a duration that was relatively short versus that of its benchmark, the Merrill Lynch Preferred Stock Fixed Rate Index. This strategy proved successful as the 10-year U.S. Treasury note declined 1.36% between October 31, 2003 and April 30, 2004, while its yield increased from 4.30% to 4.50%. The unmanaged Merrill Lynch U.S. Corporate Master Index and the Merrill Lynch U.S. Treasury/Agency Master Index returned +1.89% and +.80%, respectively, for the same period.

Our use of hedge strategies also enhanced Fund performance. Hedges were used in an effort to reduce the risk of loss associated with rising interest rates. Among the hedges we implemented during the period were interest rate swaps, U.S. Treasury futures and options on Treasury futures. During the period, we swapped some fixed rate securities for variable rate issues. When interest rates increase, the value of a variable rate security does not fall as much as that of a fixed rate issue because its interest payments would adjust periodically to keep pace with rising interest rates. Therefore, these swaps had a positive effect on the Fund's return as interest rates moved higher late in the period. Conversely, a fixed rate security would generally outperform a variable rate obligation in a declining interest rate environment.

Our holdings in institutional preferred issues and underweights in \$25 par retail preferred and agency preferred securities also had a positive effect on the Fund's comparative performance.

What is the Fund's investment objective?

The Fund's primary objective is to provide shareholders with current income. The secondary objective is to seek capital appreciation. To these ends, we invest primarily in a diversified portfolio of preferred securities, including convertible preferred securities that may be converted into common stock or other securities of the same or a different issuer. At least 80% of the Fund's

Edgar Filing: PREFERRED INCOME STRATEGIES FUND INC - Form N-CSRS

total assets are invested in securities rated in the investment grade rating categories of the established bond rating services. Unrated securities held in the portfolio would be those that we consider to be of comparable credit quality.

What changes were made to the portfolio during the period?

As interest rates moved higher, we reduced the portfolio's duration -- which already was shorter than that of its benchmark -- by two years. We trimmed the Fund's exposure to

4 PREFERRED INCOME STRATEGIES FUND, INC. APRIL 30, 2004

insurance, utilities and U.S. agencies, and added to its holdings in the banking sector. The insurance sector had outperformed the overall preferred securities market for some time, so we took profits on some of our holdings. We increased the Fund's position in banking because we believed it was the highest quality sector within the market.

Additionally, late in the period we reduced our holdings in preferred securities that trade on the New York Stock Exchange and reinvested the proceeds in preferred securities that trade in the over-the-counter market. Exchange traded preferred securities are more vulnerable to extended rises in interest rates and the reduction in exposure was a positive contribution to performance as interest rates rose.

How would you characterize the Fund's position at the close of the period?

We have positioned the Fund with a short duration relative to its benchmark index, as we believe long-term interest rates will continue to rise. The portfolio also has extensive positive convexity. That is, as interest rates move up, the portfolio's duration will fall, and vice versa. We believe the Fund's duration will decrease further as interest rates continue to rise.

The portfolio is well diversified among issuers, and we intend to maintain the diversification of our holdings across issuers and sectors. We also will consider options to increase the Fund's yield and hedges to extend its duration relative to the benchmark.

At April 30, 2004, the Fund was approximately 36% leveraged. (For a more complete explanation of the benefits and risks of leveraging, see page 2 of this report to shareholders.) Also at period-end, the portfolio carried an average credit rating of Baa1 from Moody's, down slightly from an A3 rating at the beginning of the period. Approximately 85.1% of the Fund's assets was invested in securities rated Baa1 or higher at April 30, 2004.

John Burger
Vice President and Portfolio Manager

Thomas Musmanno
Vice President and Portfolio Manager

May 11, 2004

PREFERRED INCOME STRATEGIES FUND, INC. APRIL 30, 2004 5

[LOGO] Merrill Lynch Investment Managers

Edgar Filing: PREFERRED INCOME STRATEGIES FUND INC - Form N-CSRS

Schedule of Investments

(in U.S. dollars)

=====

Preferred Securities

| Industry+ | S&P Ratings | Moody's Ratings | Face Amount | Capital Trusts |
|----------------------|----------------|--------------------|----------------|--|
| Auto--1.3% | BB | Baa3 | \$13,000,000 | Delphi Trust II, 6.197% due 11/15/203 |
| Banks--15.0% | A- | A3 | 12,035,000 | ABN AMRO North America Holding Prefer Repackaging Trust I, 6.523% (a) (b) (d) |
| | A- | A2 | 11,000,000 | Abbey National Capital Trust I, 8.963 |
| | BBB+ | A1 | 2,000,000 | Bank One Capital III, 8.75% due 9/01/ |
| | A- | A2 | 1,000,000 | Chase Capital I, 7.67% due 12/01/2026 |
| | A- | A2 | 5,000,000 | Chase Capital II, 1.679% due 2/01/202 |
| | BBB+ | A3 | 37,000,000 | Dresdner Funding Trust I, 8.151% due |
| | A | NR* | 7,500,000 | HBOS Capital Funding LP, 6.85% (d) |
| | A- | A2 | 2,000,000 | HSBC Americas Capital Trust I, 7.808% due 12/15/2026 (a) |
| | A- | A2 | 15,835,000 | HSBC Capital Funding LP, 10.176% (a) (|
| | NR* | NR* | 12,275,000 | Hubco Capital Trust II, 7.65% due 6/1 |
| | A+ | Aa2 | 5,000,000 | Lloyds TSB Bank PLC, 6.90% (d) |
| | A- | Aa3 | 5,000,000 | NB Capital Trust III, 1.69% due 1/15/ |
| | A | A1 | 970,000 | RBS Capital Trust I, 4.709% (b) (d) |
| | A- | A2 | 2,000,000 | Republic New York Capital II, 7.53% d |
| | A- | A2 | 10,000,000 | Westpac Capital Trust III, 5.819% (a) |
| Electric--5.3% | BBB- | Baa2 | 10,000,000 | Dominion Resources Capital Trust I, 7 due 12/01/2027 |
| | BBB- | Baa2 | 15,000,000 | Dominion Resources Capital Trust III, due 1/15/2031 |
| | BB+ | Ba2 | 14,950,000 | REI Capital Trust II, 8.257% due 2/01 |
| | BB+ | Baa2 | 9,500,000 | SWEPSCO Capital Trust I, 5.25% due 10/ |
| Finance--3.5% | BBB+ | A3 | 10,000,000 | CIT Capital Trust I, 7.70% due 2/15/2 |
| | A- | A1 | 11,300,000 | Goldman Sachs Capital I, 6.345% due 2 |
| | BB+ | Baa3 | 1,000,000 | MBNA Capital A, 8.278% due 12/01/2026 |
| | A+ | A1 | 10,000,000 | Sun Life of Canada (U.S.) Capital Tru 8.526% (a) (d) |
| Financial--0.5% | NR* | Baa1 | 4,500,000 | St.George Bank Funding Company, LLC, |
| Financial Services-- | A- | A2 | 998,000 | JPM Capital Trust I, 7.54% due 1/15/2 |
| Other--0.1% | | | | |
| Gas--0.6% | BBB | Baa2 | 5,000,000 | AGL Capital Trust, 8.17% due 6/01/203 |
| Insurance--7.0% | BBB | Baa3 | 28,165,000 | AON Capital Trust, 8.205% due 1/01/20 |
| | AA | Aa1 | 2,000,000 | American General Institutional Capita due 3/15/2046 (a) |
| | A- | A2 | 6,066,000 | ING Capital Funding Trust III, 8.439% |

Edgar Filing: PREFERRED INCOME STRATEGIES FUND INC - Form N-CSRS

| | | | | |
|---|--|--------------------|----------------|--|
| | BB | Ba1 | 1,000,000 | Markel Capital Trust I, 8.71% due 1/0 |
| | A+ | A2 | 6,325,000 | Principal Life Insurance Company, 8% due 3/01/2044 (a) |
| | BBB | Baa1 | 14,000,000 | QBE Insurance Group Limited, 5.647% due 7/01/2023 (a) (b) |
| | A- | Baa1 | 6,225,000 | Transamerica Capital III, 7.625% due |
| ===== | | | | |
| Insurance-- | BBB+ | A3 | 23,725,000 | Axa, 8.60% due 12/15/2030 (Surplus No |
| Multiline--4.5% | BBB+ | A3 | 1,000,000 | GenAmerica Capital I, 8.525% due 6/30 |
| | BBB- | Baa2 | 11,566,000 | Safeco Capital Trust I, 8.072% due 7/ |
| ===== | | | | |
| Oil--2.1% | BBB | Baa2 | 9,850,000 | ConocoPhillips Capital Trust II, 8% due 1/15/2037 (a) |
| | A- | A2 | 10,000,000 | Oil Insurance Limited, 5.15% due 8/15 |
| ===== | | | | |
| Pipelines--0.8% | BB+ | Baa3 | 5,000,000 | K N Capital Trust I, 8.56% due 4/15/2 |
| | BB+ | Baa3 | 1,750,000 | K N Capital Trust III, 7.63% due 4/15 |
| ===== | | | | |
| 6 | PREFERRED INCOME STRATEGIES FUND, INC. | | APRIL 30, 2004 | |
| Schedule of Investments (continued) (in U.S. dollars) | | | | |
| ===== | | | | |
| Preferred Securities (continued) | | | | |
| ----- | | | | |
| Industry+ | S&P Ratings | Moody's Ratings | Face Amount | Capital Trusts |
| ===== | | | | |
| Reinsurance--4.2% | BBB- | Baa1 | \$22,100,000 | ACE Capital Trust II, 9.70% due 4/01/ |
| | A- | Baa2 | 10,000,000 | Zurich Capital Trust I, 8.376% due 6/ |
| ===== | | | | |
| Savings & Loan Associations--2.9% | BB | Ba1 | 5,000,000 | Astoria Capital Trust I: 9.75% due 11/01/2029 |
| | BB | Ba2 | 1,000,000 | 9.75% due 11/01/2029 (a) |
| | BB | Baa2 | 12,765,000 | GreenPoint Capital Trust I, 9.10% due |
| | BB | NR* | 5,775,000 | Webster Capital Trust I, 9.36% due 1/ |
| ===== | | | | |
| Special Situations-- 4.4% | NR* | NR* | 15,000,000 | AgFirst Farm Credit Bank, 8.393% due |
| | BBB+ | Baa3 | 15,000,000 | Farmers Exchange Capital, 7.05% due 7 |
| | AA- | Aa3 | 11,000,000 | Swedish Export Credit Corporation, 6. |
| ----- | | | | |

Edgar Filing: PREFERRED INCOME STRATEGIES FUND INC - Form N-CSRS

Total Investments in Capital Trusts
(Cost--\$497,953,471)--52.2%

| | Shares Held | Preferred Stocks |
|--|----------------|---|
| Banks--7.8% | 150 | BBVA Privanza International (Gibraltar) 7.764% (a) |
| | 435,200 | Banco Santander Central Hispano SA, 6% |
| | 320,000 | CoBank, ACB, 7% |
| | 200,000 | MBNA Corporation, 5.50% (b) |
| | 1,250,000 | Royal Bank of Scotland Group PLC, 5.7% |
| Electric--3.4% | 14,000 | Alabama Power Company, 5.83% |
| | 11,109 | Connecticut Light and Power Company, |
| | 11,394 | Delmarva Power & Light Company, 4.20% |
| | 21,250 | Delmarva Power & Light Company, 4.28% |
| | 8,200 | Delmarva Power & Light Company, 4.56% |
| | 200,000 | Interstate Power and Light Company, 8% |
| | 12,400 | Public Service Electric and Gas Company, |
| | 17,372 | South Carolina Electric & Gas Company, |
| | 200,000 | TXU Corporation, 7.24% (b) |
| Electric Utilities--0.4% | 80,000 | Duquesne Light Company, 6.50% |
| Finance--4.6% | 334,000 | Federal National Mortgage Association |
| | 120,000 | Lehman Brothers Holdings, Inc., 3% (b) |
| | 200,000 | Lehman Brothers Holdings, Inc., 5.94% |
| | 600,000 | Lehman Brothers Holdings, Inc., 6.50% |
| Gas--1.7% | 626,000 | Southern Union Company, 7.55% |
| Insurance--2.5% | 880,000 | ACE Limited, 7.80% |
| Miscellaneous Materials & Commodities--3.0% | 26,000 | SG Preferred Capital II, 6.302% |
| Oil--0.7% | 64,500 | Apache Corporation, 5.68% |
| Printing & Publishing-- 0.5% | 200,000 | Newscorp Overseas Limited, 5.75% (b) |
| Reinsurance--3.8% | 25,000 | Zurich Regcaps Funding Trust I, 6.01% |
| | 10,000 | Zurich Regcaps Funding Trust II, 6.58% |

PREFERRED INCOME STRATEGIES FUND, INC.

APRIL 30, 2004

7

[LOGO] Merrill Lynch Investment Managers

Edgar Filing: PREFERRED INCOME STRATEGIES FUND INC - Form N-CSRS

Schedule of Investments (continued)

(in U.S. dollars)

Preferred Securities (continued)

| Industry+ | Shares Held | Preferred Stocks |
|--|-------------|---|
| Sovereign Government Obligations--0.9% | 9,000,000 | Farm Credit Bank of Texas, 7.561% (b) |
| Specialty Markets--0.2% | 80,000 | Corporate-Backed Trust Certificates, |
| Wireless Communication--4.0% | 30,423 | Centaur Funding Corporation, 9.08% |
| | | Total Investments in Preferred Stocks (Cost--\$314,737,865)--33.5% |

Real Estate Investment Trusts

| | | |
|-------------------------------|-----------|---|
| Real Estate Investment Trusts | 196,000 | AMB Property Corporation, 6.50% |
| | 124,000 | AMB Property Corporation, 6.75% |
| | 290,000 | BRE Properties, Inc., 6.75% |
| | 400,000 | CBL & Associates Properties, Inc., 7.50% |
| | 600,000 | CarrAmerica Realty Corporation, 7.50% |
| | 200,000 | Cousins Properties, Inc., 7.75% |
| | 280,000 | Developers Diversified Realty Corpora |
| | 780,000 | Developers Diversified Realty Corpora |
| | 270,000 | Duke Realty Corporation, 6.50% |
| | 100,000 | Duke Realty Corporation, 6.625% |
| | 787,000 | Equity Residential Properties Trust, |
| | 4,000 | Firststar Realty LLC, 8.875% (a) |
| | 768,000 | Health Care Property Investors, Inc., |
| | 686,000 | Kimco Realty Corporation, 6.65% |
| | 1,600,000 | New Plan Excel Realty Trust, 7.625% |
| | 161,400 | PS Business Parks, Inc., 7% |
| | 320,000 | Public Storage, Inc., 6.45% |
| | 607,550 | Regency Centers Corporation, 7.45% |
| | 11,857 | Sovereign Real Estate Investment Trus |
| | 130,000 | Wachovia Preferred Funding Corporatio |
| | 600,000 | Weingarten Realty Investors, Inc., 6. |
| | | Total Investments in Real Estate Inve (Cost--\$244,672,085)--25.0% |

| | S&P Ratings | Moody's Ratings | Face Amount | Trust Preferred |
|---------------------------|-------------|-----------------|--------------|------------------------------|
| Aerospace & Defense--3.1% | NR* | NR* | \$27,450,000 | RC Trust I, 7% due 5/15/2006 |

Edgar Filing: PREFERRED INCOME STRATEGIES FUND INC - Form N-CSRS

| | | | | |
|----------------|------|------|------------|---------------------------------------|
| Auto--1.1% | BB | Baa3 | 10,000,000 | Delphi Trust I, 8.25% due 10/15/2033 |
| Banks--0.7% | A- | A2 | 7,375,000 | J.P. Morgan Chase Capital XI, 5.875% |
| Electric--1.6% | A | A2 | 11,750,000 | Georgia Power Company, 5.90% due 4/15 |
| | BBB- | Baa2 | 3,000,000 | HECO Capital Trust III, 6.50% due 3/1 |
| | BB+ | Baa1 | 280,000 | Met-Ed Capital Trust, 7.35% due 9/01/ |
| | BB+ | Baa3 | 397,425 | PSEG Funding Trust II, 8.750% due 12/ |
| | BBB | Baa1 | 950,000 | Virginia Power Capital Trust II, 7.37 |

8 PREFERRED INCOME STRATEGIES FUND, INC. APRIL 30, 2004

Schedule of Investments (continued) (in U.S. dollars)

Preferred Securities (concluded)

| Industry+ | S&P Ratings | Moody's Ratings | Face Amount | Trust Preferred |
|-----------------------------------|-------------|-----------------|--------------|---|
| Finance--3.6% | BBB+ | Baa1 | \$27,000,000 | Countrywide Capital IV, 6.75% due 4/0 |
| | NR* | A1 | 1,000,000 | Household Finance Corporation, 6.875% |
| | BBB+ | A3 | 875,000 | Lehman Brothers Holdings Capital Trus due 3/15/2052 |
| | A- | A1 | 3,317,000 | Morgan Stanley Capital Trust III, 6.2 |
| | NR* | NR* | 4,000,000 | Principal Protected PreTSL IX, Ltd., due 4/03/2033 |
| Gas--0.9% | BB | Baa3 | 8,750,000 | Southwest Gas Capital II, 7.70% due 9 |
| Insurance--2.1% | A | A3 | 16,000,000 | ABN AMRO North America Capital Fundin 1.225% (a) (b) (d) |
| | BBB | Baa1 | 5,000,000 | Lincoln National Capital VI, 6.75% du |
| Pipelines--0.0% | BBB- | Baa1 | 500,000 | Dominion-CNG Capital Trust I, 7.80% d |
| Reinsurance--0.1% | BBB | Baa1 | 1,000,000 | Everest Re Capital Trust, 7.85% due 1 |
| Savings & Loan Associations--0.6% | NR* | NR* | 6,000,000 | Dime Community Capital I, 7% due 4/14 |
| Special Situations--0.5% | BBB+ | A3 | 5,000,000 | Natural Rural Utilities Cooperative F Corporation, 6.75% due 2/15/2043 |
| | | | | Total Investments in Trust Preferred (Cost--\$140,768,536)--14.3% |
| | | | | Total Investments in Preferred Securi |

Edgar Filing: PREFERRED INCOME STRATEGIES FUND INC - Form N-CSRS

(Cost--\$1,198,131,957)--125.0%

Corporate Bonds

| | | | | |
|---------------------------------|------|------|------------|---|
| Auto--1.0% | BBB- | Baa1 | 10,000,000 | Ford Motor Company, 7.45% due 7/16/20 |
| Broadcasting/Media--1.0% | BBB- | Baa3 | 10,000,000 | Liberty Media Corporation, 5.70% due |
| Cable Television Services--1.1% | BBB | Baa3 | 10,000,000 | Comcast Corporation, 7.05% due 3/15/2 |
| Cellular Telephones--3.5% | BBB | Baa2 | 28,000,000 | AT&T Wireless Services, Inc., 8.75% d |
| Diversified Financials--5.1% | B+ | Baa2 | 11,500,000 | Fuji JGB Investment LLC, 9.87% (a) (b) |
| | BBB | A3 | 29,000,000 | General Motors Acceptance Corporation due 11/01/2031 |
| | B+ | Baa3 | 5,000,000 | SB Treasury Company LLC, 9.40% (a) (b) |
| Electronics--1.1% | BB+ | Baa3 | 10,000,000 | FirstEnergy Corp., 6.45% due 11/15/20 |
| Finance--1.6% | AAA | Aaa | 15,000,000 | Sigma Finance Corporation, 1.12% due |
| Foods--0.5% | BBB | Baa3 | 4,800,000 | Tyson Foods, Inc., 7% due 1/15/2028 |
| Multimedia--2.6% | | | | Time Warner Inc.: |
| | BBB+ | Baa1 | 5,000,000 | 7.625% due 4/15/2031 |
| | BBB+ | Baa1 | 18,000,000 | 7.70% due 5/01/2032 |
| Oil Field Services--2.0% | BBB | Baa2 | 16,575,000 | Duke Energy Field Services, LLC, 8.12% due 8/16/2030 |
| Reinsurance--1.2% | A- | A1 | 10,000,000 | GE Global Insurance Holding Corporation due 6/15/2030 |

PREFERRED INCOME STRATEGIES FUND, INC.

APRIL 30, 2004

9

[LOGO] Merrill Lynch Investment Managers

Schedule of Investments (continued)

(in U.S. dollars)

| Industry+ | S&P Ratings | Moody's Ratings | Face Amount | Corporate Bonds |
|-----------------------------------|-------------|-----------------|--------------|---------------------------------------|
| Savings & Loan Associations--0.8% | NR* | NR* | \$ 8,000,000 | Roslyn Real Estate Asset Corporation, |
| Telephone--6.9% | BBB+ | Baa2 | 28,000,000 | France Telecom, 9.50% due 3/01/2031 |

Edgar Filing: PREFERRED INCOME STRATEGIES FUND INC - Form N-CSRS

| | | | |
|------|------|------------|-----------------------------|
| | | | Sprint Capital Corporation: |
| BBB- | Baa3 | 2,000,000 | 6.90% due 5/01/2019 |
| BBB- | Baa3 | 24,000,000 | 8.75% due 3/15/2032 |

 Total Investments in Corporate Bonds
 (Cost--\$266,042,673)--28.4%
 =====

Beneficial Interest/
 Face Amount Short-Term Securities
 =====

| | |
|--------------|--|
| \$ 4,132,734 | Merrill Lynch Liquidity Series, LLC C Series I (c) |
| \$ 8,000,000 | U.S. Treasury Bills, 0.898% due 5/06/ |

 Total Investments in Short-Term Secur
 (Cost--\$12,132,135)--1.3%
 =====

Options

| | | |
|--|------------------------|-----------------------|
| | Number of Contracts | Put Options Purchased |
|--|------------------------|-----------------------|

=====

| | |
|-------|---|
| 97 | Swaption, expiring September 2008 at Lehman Brothers Special Finance (e) |
| 1,010 | U.S. Treasury Bonds, expiring May 2008 Broker HSBC Securities Inc. |
| 1,250 | U.S. Treasury Bonds, expiring May 2008 Broker Greenwich Capital Markets |
| 504 | U.S. Treasury Bonds, expiring May 2008 Broker HSBC Securities Inc. |
| 746 | U.S. Treasury Bonds, expiring May 2008 Broker Greenwich Capital Markets |
| 1,250 | U.S. Treasury Notes, expiring June 2008 Broker Greenwich Capital Markets |
| 625 | U.S. Treasury Notes, expiring June 2008 Broker HSBC Securities Inc. |
| 1,250 | U.S. Treasury Notes, expiring June 2008 Broker HSBC Securities Inc. |

 Total Options Purchased
 (Premiums Paid--\$13,207,351)--1.3%
 =====

Total Investments (Cost--\$1,489,514,1
 =====

Put Options Written
 =====

| | |
|-------|--|
| 175 | Swaption, expiring September 2008 at Lehman Brothers Special Finance (e) |
| 1,250 | U.S. Treasury Notes, expiring June 2008 |

Edgar Filing: PREFERRED INCOME STRATEGIES FUND INC - Form N-CSRS

Broker HSBC Securities, Inc.

 Total Options Written
 (Premiums Received--\$11,127,500)--(0.0%)
 =====
 Total Investments, Net of Options Written (Cost--\$1,478,386,616)--155.1%
 Other Assets Less Liabilities--1.6%
 Preferred Stock, at Redemption Value--(56.7%)
 Net Assets Applicable to Common Stock--100.0%

- * Not Rated.
- + For Fund compliance purposes, "Industry" means any one or more of the industry sub-classifications used by one or more widely recognized market indexes or ratings group indexes, and/or as defined by Fund management. This definition may not apply for purposes of this report, which may combine such industry sub-classifications for reporting ease.
 - (a) The security may be offered and sold to "qualified institutional buyers" under Rule 144A of the Securities Act of 1933.
 - (b) Floating rate note.

10 PREFERRED INCOME STRATEGIES FUND, INC. APRIL 30, 2004

Schedule of Investments (concluded) (in U.S. dollars)

- (c) Investments in companies considered to be an affiliate of the Fund (such companies are defined as "Affiliated Companies" in Section 2(a)(3) of the Investment Company Act of 1940) are as follows:

| Affiliate | Net Activity | Interest Income |
|--|-----------------|--------------------|
| Merrill Lynch Liquidity Series, LLC Cash Sweep Series I | (17,634,679) | \$39,316 |

- (d) The security is a perpetual bond and has no definite maturity date.
- (e) This European style swaption, which can be exercised only on the expiration date, represents a standby commitment whereby the Fund is obligated to enter into a predetermined interest rate swap contract upon exercise of the swaption. One swaption contract represents a notional amount of \$1,000,000.
- (f) Certain U.S. Government Obligations are traded on a discount basis; the interest rate shown reflects the discount rate paid at the time of purchase by the Fund.

Swap contracts entered into as of April 30, 2004 were as follows:

| | |
|--|------------------|
| | Notion Amount |
|--|------------------|

Edgar Filing: PREFERRED INCOME STRATEGIES FUND INC - Form N-CSRS

| | |
|--|-----------|
| Receive a variable rate equal to 1-month LIBOR at quarterly reset date and pay a fixed rate of 1.31%. Broker, UBS Warburg Expires June 2005 | \$150,000 |
| Receive a variable rate equal to 1-month LIBOR at quarterly reset date and pay a fixed rate of 1.32%. Broker, UBS Warburg Expires June 2005 | \$ 25,000 |
| Receive a variable rate equal to 1-month LIBOR at quarterly reset date and pay a fixed rate of 1.3275%. Broker, J.P. Morgan Chase Bank Expires June 2005 | \$125,000 |
| Receive a variable rate equal to 1-month LIBOR at quarterly reset date and pay a fixed rate of 1.33%. Broker, Morgan Stanley Capital Services, Inc. Expires June 2005 | \$125,000 |
| Receive a variable rate equal to 3-month LIBOR at quarterly reset date and pay a fixed rate of 5.075%. Broker, J.P. Morgan Chase Bank Expires July 2014 | \$250,000 |
| Receive a variable rate equal to 3-month LIBOR at quarterly reset date and pay a fixed rate of 5.216%. Broker, Morgan Stanley Capital Services, Inc. Expires July 2014 | \$300,000 |
| ----- | |
| Total | |

See Notes to Financial Statements.

PREFERRED INCOME STRATEGIES FUND, INC. APRIL 30, 2004 11

[LOGO] Merrill Lynch Investment Managers

Statement of Net Assets

As of April 30, 2004

Assets

| | |
|--|-------------|
| Investments in unaffiliated securities, at value (identified cost--\$1,472,174,031) | |
| Investments in affiliated securities, at value (identified cost--\$4,132,734) | |
| Options purchased, at value (premiums paid--\$13,207,351) ... | |
| Unrealized appreciation on swaps | |
| Cash | |
| Receivables: | |
| Interest (including \$115 from affiliates) | \$ 18,002,1 |
| Dividends | 816,2 |
| | ----- |

Edgar Filing: PREFERRED INCOME STRATEGIES FUND INC - Form N-CSRS

Prepaid expenses
 Total assets

Liabilities

Unrealized depreciation on swaps
 Options written, at value (premiums received--\$11,127,500) .
 Payables:
 Swaps 1,900,3
 Dividends to Common Stock shareholders 1,207,2
 Investment adviser 884,8
 Offering costs 36,2
 Other affiliates 10,6

 Accrued expenses and other liabilities
 Total liabilities

Preferred Stock

Preferred Stock, at redemption value, par value \$.10 per
 share (2,800 Series M7 Shares, 2,800 Series T7 Shares, 2,800
 Series W7 Shares, 2,800 Series TH7 Shares, 2,800 Series F7
 Shares, 4,000 Series W28 Shares and 4,000 Series TH28 Shares
 of AMPS* issued and outstanding at \$25,000 per share
 liquidation preference)

Net Assets Applicable to Common Stock

Net assets applicable to Common Stock

Analysis of Net Assets Applicable to Common Stock

Common Stock, par value \$.10 per share (40,593,070 shares
 issued and outstanding)
 Paid-in capital in excess of par
 Undistributed investment income--net \$ 3,049,6
 Accumulated realized capital losses on investments--net (22,473,4
 Unrealized appreciation on investments--net 27,278,4

 Total accumulated earnings--net
 Total--Equivalent to \$23.91 net asset value per share of
 Common Stock (market price--\$21.85)

* Auction Market Preferred Stock
 See Notes to Financial Statements.

Edgar Filing: PREFERRED INCOME STRATEGIES FUND INC - Form N-CSRS

For the Six Months Ended April 30, 2004

Investment Income

Interest (including \$39,316 from affiliates)
 Dividends
 Total income

Expenses

| | |
|--|------------|
| Investment advisory fees | \$ 4,628,4 |
| Commission fees | 685,6 |
| Accounting services | 224,7 |
| Transfer agent fees | 54,3 |
| Professional fees | 46,5 |
| Directors' fees and expenses | 46,1 |
| Custodian fees | 44,6 |
| Printing and shareholder reports | 29,6 |
| Listing fees | 15,5 |
| Pricing fees | 5,2 |
| Other | 23,5 |
| <hr/> | |
| Total expenses | |
| Investment income--net | |

Realized & Unrealized Gain (Loss) on Investments--Net

Realized loss on investments--net
 Change in unrealized appreciation/depreciation on
 investments--net
 Total realized and unrealized loss on investments--net

Dividends & Distributions to Preferred Stock Shareholders

Investment income--net
 Realized gain on investments--net
 Total dividends and distributions to Preferred Stock
 shareholders
 Net Increase in Net Assets Resulting from Operations

See Notes to Financial Statements

PREFERRED INCOME STRATEGIES FUND, INC.

APRIL 30, 2004

13

[LOGO] Merrill Lynch Investment Managers

Statements of Changes in Net Assets

Edgar Filing: PREFERRED INCOME STRATEGIES FUND INC - Form N-CSRS

| | For the Six Months End April 30, 2004 |
|---|--|
| Increase (Decrease) in Net Assets: | |
| ===== | |
| Operations | |
| ----- | |
| Investment income--net | \$ 43,371,3 |
| Realized gain (loss) on investments--net | (36,423,9 |
| Change in unrealized appreciation/depreciation on investments--net | 20,589,0 |
| Dividends and distributions to Preferred Stock shareholders | (3,179,4 |
| Net increase in net assets resulting from operations | 24,357,0 |
| ----- | |
| Dividends and Distributions to Common Stock Shareholders | |
| ----- | |
| Investment income--net | (45,747,3 |
| Realized gain on investments--net | (3,830,6 |
| Net decrease in net assets resulting from dividends and distributions to Common Stock shareholders | (49,578,0 |
| ----- | |
| Stock Transactions | |
| ----- | |
| Net proceeds from issuance of Common Stock | |
| Value of shares issued to Common Stock shareholders in reinvestment to dividends | |
| Offering costs resulting from the issuance of Common Stock . | |
| Offering and underwriting costs resulting from the issuance of Preferred Stock | |
| Net increase in net assets derived from stock transactions . | |
| ----- | |
| Net Assets Applicable to Common Stock | |
| ----- | |
| Total increase (decrease) in net assets applicable to Common Stock | (25,221,0 |
| Beginning of period | 995,722,2 |
| End of period* | \$970,501,2 |
| * Undistributed investment income--net | \$ 3,049,6 |
| ===== | |

+ Commencement of operations.

See Notes to Financial Statements.

Edgar Filing: PREFERRED INCOME STRATEGIES FUND INC - Form N-CSRS

The following per share data and ratios have been derived from information provided in the financial statements.

For the Six Months Ended April 30, 2004

Increase (Decrease) in Net Asset Value:

Per Share Operating Performance

| | | |
|--|----|-------|
| Net asset value, beginning of period | \$ | 24. |
| Investment income--net | | 1. |
| Realized and unrealized gain (loss) on investments--net | | (.) |
| Dividends and distributions to Preferred Stock shareholders from: | | |
| Investment income--net | | (.) |
| Realized gain on investments--net | | (.) |
| Total from investment operations | | . |
| Dividends and distributions to Common Stock shareholders from: | | |
| Investment income--net | | (1.) |
| Realized gain on investments--net | | (.) |
| Dividends and distributions to Common Stock shareholders ... | | (1.) |
| Capital charge resulting from the issuance of Common Stock . | | |
| Capital charge and underwriting costs resulting from the issuance of Preferred Stock | | |
| Net asset value, end of period | \$ | 23. |
| Market price per share, end of period | \$ | 21. |

Total Investment Return**

| | |
|--|-------|
| Based on market price per share | (2.) |
| Based on net asset value per share | 2.) |

Ratios Based on Average Net Assets of Common Stock

| | |
|--|------|
| Total expenses, net of waiver*** | 1.) |
| Total expenses*** | 1.) |
| Total investment income--net*** | 8.) |
| Amount of dividends to Preferred Stock shareholders | . |
| Investment income--net, to Common Stock shareholders | 8.) |

Ratios Based on Average Net Assets of Common & Preferred Stock***

| | |
|-------------------------------------|---|
| Total expenses, net of waiver | . |
|-------------------------------------|---|

Edgar Filing: PREFERRED INCOME STRATEGIES FUND INC - Form N-CSRS

| | | |
|------------------------------------|-------|----|
| Total expenses | ===== | . |
| Total investment income--net | ===== | 5. |

=====
Ratios Based on Average Net Assets of Preferred Stock

| | | |
|---|-------|----|
| Dividends to Preferred Stock shareholders | ===== | 1. |
|---|-------|----|

PREFERRED INCOME STRATEGIES FUND, INC. APRIL 30, 2004 15

[LOGO] Merrill Lynch Investment Managers

Financial Highlights (concluded)

The following per share data and ratios have been derived from information provided in the financial statements. For the Per
For the
Months E
April 3
2004

=====
Supplemental Data

| | | |
|--|----|-------|
| Net assets applicable to Common Stock, end of period (in thousands) | \$ | 970,5 |
| Preferred Stock outstanding, end of period (in thousands) .. | \$ | 550,0 |
| Portfolio turnover | | 13. |

=====
Leverage

| | | |
|----------------------------------|----|-----|
| Asset coverage per \$1,000 | \$ | 2,7 |
|----------------------------------|----|-----|

=====
Dividends Per Share on Preferred Stock Outstanding++

| | | |
|---|----|---|
| Series M7--Investment income--net | \$ | 1 |
| Series T7--Investment income--net | \$ | 1 |
| Series W7--Investment income--net | \$ | 1 |
| Series TH7--Investment income--net | \$ | 1 |
| Series F7--Investment income--net | \$ | 1 |
| Series W28--Investment income--net | \$ | 1 |
| Series TH28--Investment income--net | \$ | 1 |

Edgar Filing: PREFERRED INCOME STRATEGIES FUND INC - Form N-CSRS

- * Annualized.
- ** Total investment returns based on market value, which can be significantly greater or lesser than the net asset value, may result in substantially different returns. Total investment returns exclude the effects of sales charges. The Fund's Investment Adviser waived a portion of its management fee. Without such waiver, the Fund's performance would have been lower.
- *** Do not reflect the effect of dividends to Preferred Stock shareholders.
- + Commencement of operations.
- ++ The Fund's Preferred Stock was issued on May 16, 2003.
- @ Aggregate total investment return.
- @@ Based on average shares outstanding.

See Notes to Financial Statements.

16 PREFERRED INCOME STRATEGIES FUND, INC. APRIL 30, 2004

Notes to Financial Statements

1. Significant Accounting Policies:

Preferred Income Strategies Fund, Inc. (the "Fund") is registered under the Investment Company Act of 1940, as amended, as a diversified, closed-end management investment company. The Fund's financial statements are prepared in conformity with accounting principles generally accepted in the United States of America, which may require the use of management accruals and estimates. Actual results may differ from these estimates. These unaudited financial statements reflect all adjustments, which are, in the opinion of management, necessary to a fair statement of the results for the interim period presented. All such adjustments are of a normal, recurring nature. The Fund's Common Stock is listed on the New York Stock Exchange ("NYSE") under the symbol PSY. The following is a summary of significant accounting policies followed by the Fund.

(a) Valuation of investments -- Equity securities that are held by the Fund that are traded on stock exchanges or the Nasdaq National Market are valued at the last sale price or official close price on the exchange, as of the close of business on the day the securities are being valued or, lacking any sales, at the last available bid price for long positions, and at the last available ask price for short positions. In cases where equity securities are traded on more than one exchange, the securities are valued on the exchange designated as the primary market by or under the authority of the Board of Directors of the Fund. Long positions traded in the over-the-counter ("OTC") market, Nasdaq Small Cap or Bulletin Board are valued at the last available bid price or yield equivalent obtained from one or more dealers or pricing services approved by the Board of Directors of the Fund. Short positions traded in the OTC market are valued at the last available ask price. Portfolio securities that are traded both in the OTC market and on a stock exchange are valued according to the broadest and most representative market.

Options written are valued at the last sale price in the case of exchange-traded options or, in the case of options traded in the OTC market, the last ask price. Options purchased are valued at their last sale price in the case of exchange-traded options or, in the case of options traded in the OTC market, the last bid price. Swap agreements are valued daily based upon quotations from market makers. Financial futures contracts and options thereon, which are traded on exchanges, are valued at their last sale price as of the close of such exchanges. Obligations with remaining maturities of 60 days or less are valued at amortized cost unless the Investment Adviser believes that this method no longer produces fair valuations.

Repurchase agreements are valued at cost plus accrued interest. The Fund employs

Edgar Filing: PREFERRED INCOME STRATEGIES FUND INC - Form N-CSRS

pricing services to provide certain securities prices for the Fund. Securities and assets for which market quotations are not readily available are valued at fair value as determined in good faith by or under the direction of the Board of Directors of the Fund, including valuations furnished by the pricing services retained by the Fund, which may use a matrix system for valuations. The procedures of a pricing service and its valuations are reviewed by the officers of the Fund under the general supervision of the Fund's Board of Directors. Such valuations and procedures will be reviewed periodically by the Board of Directors of the Fund.

Generally, trading in foreign securities, as well as U.S. government securities and money market instruments, is substantially completed each day at various times prior to the close of business on the NYSE. The values of such securities used in computing the net asset value of the Fund's shares are determined as of such times. Foreign currency exchange rates also are generally determined prior to the close of business on the NYSE. Occasionally, events affecting the values of such securities and such exchange rates may occur between the times at which they are determined and the close of business on the NYSE that may not be reflected in the computation of the Fund's net asset value. If events (for example, a company announcement, market volatility or a natural disaster) occur during such periods that are expected to materially affect the value of such securities, those securities may be valued at their fair value as determined in good faith by the Fund's Board of Directors or by the Investment Adviser using a pricing service and/or procedures approved by the Fund's Board of Directors.

(b) Derivative financial instruments -- The Fund may engage in various portfolio investment strategies both to increase the return of the Fund and to hedge, or protect, its exposure to interest rate movements and movements in the securities markets. Losses may arise due to changes in the value of the contract or if the counterparty does not perform under the contract.

o Options -- The Fund may write and purchase call and put options. When the Fund writes an option, an amount equal to the premium received by the Fund is reflected as an asset and an equivalent liability. The amount of the liability is subsequently marked to market to reflect the

PREFERRED INCOME STRATEGIES FUND, INC.

APRIL 30, 2004

17

[LOGO] Merrill Lynch Investment Managers

Notes to Financial Statements (continued)

current market value of the option written. When a security is purchased or sold through an exercise of an option, the related premium paid (or received) is added to (or deducted from) the basis of the security acquired or deducted from (or added to) the proceeds of the security sold. When an option expires (or the Fund enters into a closing transaction), the Fund realizes a gain or loss on the option to the extent of the premiums received or paid (or gain or loss to the extent the cost of the closing transaction exceeds the premium paid or received).

Written and purchased options are non-income producing investments.

o Financial futures contracts -- The Fund may purchase or sell financial futures contracts and options on such futures contracts. Futures contracts are contracts for delayed delivery of securities at a specific future date and at a specific price or yield. Upon entering into a contract, the Fund deposits and maintains as collateral such initial margin as required by the exchange on which the transaction is effected. Pursuant to the contract, the Fund agrees to receive from or pay to the broker an amount

Edgar Filing: PREFERRED INCOME STRATEGIES FUND INC - Form N-CSRS

of cash equal to the daily fluctuation in value of the contract. Such receipts or payments are known as variation margin and are recorded by the Fund as unrealized gains or losses. When the contract is closed, the Fund records a realized gain or loss equal to the difference between the value of the contract at the time it was opened and the value at the time it was closed.

- o Swaps -- The Fund may enter into swap agreements, which are over-the-counter contracts in which the Fund and a counterparty agree to make periodic net payments on a specified notional amount. The net payments can be made for a set period of time or may be triggered by a predetermined credit event. The net periodic payments may be based on a fixed or variable interest rate; the change in market value of a specified security, basket of securities, or index; or the return generated by a security.

(c) Income taxes -- It is the Fund's policy to comply with the requirements of the Internal Revenue Code applicable to regulated investment companies and to distribute substantially all of its taxable income to its shareholders. Therefore, no Federal income tax provision is required.

(d) Security transactions and investment income -- Security transactions are recorded on the dates the transactions are entered into (the trade dates). Realized gains and losses on security transactions are determined on the identified cost basis. Dividend income is recorded on the ex-dividend dates. Interest income is recognized on the accrual basis. The Fund amortizes all premiums and discounts on debt securities.

(e) Offering expenses -- Direct expenses relating to the public offering of the Fund's Common Stock were charged to capital at the time of issuance of the shares.

(f) Dividends and distributions -- Dividends from net investment income are declared and paid monthly. Distributions of capital gains are recorded on the ex-dividend dates.

2. Investment Advisory Agreement and Transactions with Affiliates:

The Fund has entered into an Investment Advisory Agreement with Fund Asset Management, L.P. ("FAM"). The general partner of FAM is Princeton Services, Inc. ("PSI"), an indirect, wholly-owned subsidiary of Merrill Lynch & Co., Inc. ("ML & Co."), which is the limited partner.

FAM is responsible for the management of the Fund's portfolio and provides the necessary personnel, facilities, equipment and certain other services necessary to the operations of the Fund. For such services, the Fund pays a monthly fee at an annual rate of .60% of the Fund's average weekly net assets including proceeds from the issuance of Preferred Stock, plus the proceeds of any outstanding borrowings used for leverage.

For the six months ended April 30, 2004, the Fund reimbursed FAM \$31,150 for certain accounting services.

Certain officers and/or directors of the Fund are officers and/or directors of FAM, PSI, and/or ML & Co.

Edgar Filing: PREFERRED INCOME STRATEGIES FUND INC - Form N-CSRS

3. Investments:

Purchases and sales of investments, excluding short-term securities, for the six months ended April 30, 2004 were \$213,781,363 and \$248,407,970, respectively.

Net realized gains (losses) for the six months ended April 30, 2004 and net unrealized appreciation (depreciation) as of April 30, 2004 were as follows:

| | Realized Gains (Losses) | Unrealized Appreciation (Depreciation) |
|-----------------------------------|----------------------------|--|
| Long-term investments | \$ (1,664,074) | \$ 24,808,615 |
| Options purchased | (20,190,753) | (630,419) |
| Options written | 563,750 | 2,601,094 |
| Swaps | (483,750) | 499,116 |
| Financial futures contracts | (14,649,162) | -- |
| Total | \$ (36,423,989) | \$ 27,278,406 |

As of April 30, 2004, net unrealized appreciation for Federal income tax purposes aggregated \$23,848,746, of which \$50,984,660 related to appreciated securities and \$27,135,914 related to depreciated securities. The aggregate cost of investments, including options at April 30, 2004 for Federal income tax purposes was \$1,481,317,160.

Transactions in options written for the six months ended April 30, 2004 were as follows:

| | Number of Contracts | Premiums Received |
|---|------------------------|----------------------|
| Put Options Written | | |
| Outstanding put options written, beginning of period | 675 | \$ 10,528,750 |
| Options written | 1,250 | 815,625 |
| Options expired | (500) | (216,875) |
| Outstanding put options written, end of period | 1,425 | \$ 11,127,500 |

| | Number of Contracts | Premiums Received |
|--|------------------------|----------------------|
| Call Options Written | | |
| Outstanding call options written, beginning of period | -- | -- |
| Options written | 1,250 | \$ 346,875 |
| Options expired | (1,250) | (346,875) |
| Outstanding call options written, end of period | -- | \$ -- |

4. Stock Transactions:

The Fund is authorized to issue 200,000,000 shares of stock, including Preferred Stock, par value \$.10 per share, all of which were initially classified as Common Stock. The Board of Directors is authorized, however, to reclassify any

Edgar Filing: PREFERRED INCOME STRATEGIES FUND INC - Form N-CSRS

unissued shares of stock without approval of holders of Common Stock.

Common Stock

Shares issued and outstanding during the six months ended April 30, 2004 remained constant and during the period March 28, 2003 to October 31, 2003 increased by 40,550,000 from shares sold and 38,881 from reinvestments.

Preferred Stock

Auction Market Preferred Stock are redeemable shares of Preferred Stock of the Fund, with a par value of \$.10 per share and liquidation preference of \$25,000 per share, plus accrued and unpaid dividends, that entitle their holders to receive cash dividends at an annual rate that may vary for the successive dividend periods. The yields in effect at April 30, 2004 were as follows: Series M7, 1.08%; Series T7, 1.08%; Series W7, 1.08%; Series TH7, 1.10%; Series F7, 1.09%; Series W28, 1.08% and Series TH28, 1.07%.

Shares issued and outstanding during the six months ended April 30, 2004 remained constant and during the period May 16, 2003 to October 31, 2003 increased by 22,000 from issuance of Preferred Stock.

The Fund pays commissions to certain broker-dealers at the end of each auction at an annual rate ranging from .25% to .375%, calculated on the proceeds of each auction. For the six months ended April 30, 2004, Merrill Lynch, Pierce, Fenner & Smith Incorporated, an affiliate of FAM, earned \$286,886 as commissions.

5. Subsequent Event:

The Fund paid an ordinary income dividend to holders of Common Stock in the amount of \$.166667 per share on May 28, 2004 to shareholders of record on May 14, 2004.

PREFERRED INCOME STRATEGIES FUND, INC.

APRIL 30, 2004

19

[LOGO] Merrill Lynch Investment Managers

www.mlim.ml.com

Preferred Income Strategies Fund, Inc. seeks to provide shareholders with current income. The secondary objective of the Fund is to seek to provide shareholders with capital appreciation. The Fund seeks to achieve its objectives by investing primarily in a portfolio of preferred securities, including convertible preferred securities that may be converted into common stock or other securities of the same or a different issuer.

This report, including the financial information herein, is transmitted to shareholders of Preferred Income Strategies Fund, Inc. for their information. It is not a prospectus. The Fund leverages its Common Stock to provide Common Stock shareholders with a potentially higher rate of return. Leverage creates risk for Common Stock shareholders, including the likelihood of greater volatility of net asset value and market price of Common Stock shares, and the risk that fluctuations in short-term interest rates may reduce the Common Stock's yield. Past performance results shown in this report should not be considered a representation of future performance. Statements and other information herein are as dated and are subject to change.

A description of the policies and procedures that the Fund uses to determine how to vote proxies relating to portfolio securities is available (1) without charge, upon request, by calling toll-free 1-800-MER-FUND (1-800-637-3863); (2) on www.mutualfunds.ml.com; and (3) on the Securities and Exchange Commission's website at <http://www.sec.gov>.

Edgar Filing: PREFERRED INCOME STRATEGIES FUND INC - Form N-CSRS

Preferred Income Strategies Fund, Inc.
Box 9011
Princeton, NJ
08543-9011

#PIS -- 4/04

- Item 2 - Code of Ethics - Not Applicable to this semi-annual report
- Item 3 - Audit Committee Financial Expert - Not Applicable to this semi-annual report
- Item 4 - Principal Accountant Fees and Services - Not Applicable to this semi-annual report
- Item 5 - Audit Committee of Listed Registrants - Not Applicable to this semi-annual report
- Item 6 - Schedule of Investments - Not Applicable
- Item 7 - Disclosure of Proxy Voting Policies and Procedures for Closed-End Management Investment Companies - Not Applicable to this semi-annual report
- Item 8 - Purchases of Equity Securities by Closed-End Management Investment Company and Affiliated Purchasers - Not Applicable
- Item 9 - Submission of Matters to a Vote of Security Holders - Not Applicable
- Item 10 - Controls and Procedures
 - 10(a) - The registrant's certifying officers have reasonably designed such disclosure controls and procedures to ensure material information relating to the registrant is made known to us by others particularly during the period in which this report is being prepared. The registrant's certifying officers have determined that the registrant's disclosure controls and procedures are effective based on our evaluation of these controls and procedures as of a date within 90 days prior to the filing date of this report.
 - 10(b) - There were no changes in the registrant's internal control over financial reporting (as defined in Rule 30a-3(d) under the Act (17 CFR 270.30a-3(d)) that occurred during the last fiscal half-year of the period covered by this report that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.
- Item 11 - Exhibits attached hereto
 - 11(a)(1) - Code of Ethics - Not Applicable to this semi-annual report
 - 11(a)(2) - Certifications - Attached hereto
 - 11(a)(3) - Not Applicable
 - 11(b) - Certifications - Attached hereto

Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly

Edgar Filing: PREFERRED INCOME STRATEGIES FUND INC - Form N-CSRS

authorized.

Preferred Income Strategies Fund, Inc.

By: /s/ Terry K. Glenn

Terry K. Glenn,
President of
Preferred Income Strategies Fund, Inc.

Date: June 18, 2004

Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

By: /s/ Terry K. Glenn

Terry K. Glenn,
President of
Preferred Income Strategies Fund, Inc.

Date: June 18, 2004

By: /s/ Donald C. Burke

Donald C. Burke,
Chief Financial Officer of
Preferred Income Strategies Fund, Inc.

Date: June 18, 2004