

NUVEEN PREFERRED CONVERTIBLE INCOME FUND 2
Form N-CSR
March 09, 2007

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

FORM N-CSR

CERTIFIED SHAREHOLDER REPORT OF REGISTERED MANAGEMENT INVESTMENT COMPANIES

Investment Company Act file number 811-21333

Nuveen Preferred and Convertible Income Fund 2

(Exact name of registrant as specified in charter)

Nuveen Investments
333 West Wacker Drive
Chicago, IL 60606

(Address of principal executive offices) (Zip code)

Jessica R. Droeger
Nuveen Investments
333 West Wacker Drive
Chicago, IL 60606

(Name and address of agent for service)

Registrant's telephone number, including area code: (312) 917-7700

Date of fiscal year end: December 31

Date of reporting period: December 31, 2006

Form N-CSR is to be used by management investment companies to file reports with the Commission not later than 10 days after the transmission to stockholders of any report that is required to be transmitted to stockholders under Rule 30e-1 under the Investment Company Act of 1940 (17 CFR 270.30e-1). The Commission may use the information provided on Form N-CSR in its regulatory, disclosure review, inspection, and policymaking roles.

A registrant is required to disclose the information specified by Form N-CSR, and the Commission will make this information public. A registrant is not required to respond to the collection of information contained in Form N-CSR 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 Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. The OMB has reviewed this collection of information under the clearance requirements of 44 U.S.C. ss. 3507.

ITEM 1. REPORTS TO STOCKHOLDERS.

ANNUAL REPORT DECEMBER 31, 2006

NUVEEN INVESTMENTS
CLOSED-END
FUNDS

NUVEEN PREFERRED
AND CONVERTIBLE
INCOME FUND
JPC

NUVEEN PREFERRED
AND CONVERTIBLE
INCOME FUND 2
JQC

ATTRACTIVE MONTHLY DISTRIBUTIONS
FROM A PORTFOLIO OF
PREFERRED AND CONVERTIBLE
SECURITIES, DOMESTIC AND FOREIGN
EQUITIES, AND DEBT INSTRUMENTS

NUVEEN LOGO

COVER PHOTO

INSIDE COVER PHOTO

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NUVEEN LOGO

(TIMOTHY SCHWERTFEGER PHOTO)
Timothy R. Schwertfeger
Chairman of the Board

CHAIRMAN'S
LETTER TO SHAREHOLDERS

Dear Shareholder,

I am very pleased to report that over the twelve-month period covered by this report, your Fund continued to provide you with attractive monthly distributions from a diversified portfolio of quality preferred securities, convertible securities, high yield debt and equities. For more information on your Fund's performance, please read the Portfolio Managers' Comments, the Distribution and Share Price Information, and the Performance Overview sections of this report.

During 2006, the Board of Trustees' of each Fund authorized a series of changes to the Funds' investment and distribution policies. These changes were designed to enhance the Funds' ability to meet their investment objectives by providing for increased portfolio management flexibility, greater diversification, and increased capital appreciation potential over time through direct equity exposure. I urge you to review the Investment Strategy and Management Update section of this report for more detailed information. Some of these changes will require shareholder approval and you will receive proxy materials in the mail soon. I encourage you to read the complete proxy statement and vote.

As you look through this report, be sure to review the inside front cover. This contains information on how you can receive future Fund reports and other Fund information faster by using e-mails and the Internet. Sign up is quick and easy - just follow the step-by-step instructions.

At Nuveen Investments, our mission continues to be to assist you and your financial advisor by offering investment services and products that can help you to secure your financial objectives. We are grateful that you have chosen us as a partner as you pursue your financial goals, and we look forward to continuing to earn your trust in the months and years ahead.

Sincerely,

(TIMOTHY SCHWERTFEGER SIG)
Timothy R. Schwertfeger
Chairman of the Board

February 15, 2007

Nuveen Investments Closed-End Funds (JPC and JQC)

INVESTMENT STRATEGY AND MANAGEMENT
UPDATE

ON NOVEMBER 22, 2006, the Funds' Board of Trustees approved certain investment policy changes designed to provide both Funds with greater flexibility to pursue their investment objectives of high current income and total return. The following changes were approved for each Fund:

- Eliminating the requirement to invest a minimum of each Fund's managed assets in preferred and/or convertible securities

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- Expanding the Funds' direct equity investment types to include both domestic and international equities
- Increasing the percentage of the Funds' managed assets that may be invested directly in equity securities
- Adding Tradewinds NWQ Global Investors, LLC, as a sub-adviser to manage a portion of each Fund's direct equity investments, subject to shareholder approval

Reflecting these enhancements, the Funds also plan to change their names to the Nuveen Multi-Strategy Income and Growth Fund (JPC) and Nuveen Multi-Strategy Income and Growth Fund 2 (JQC). The anticipated implementation date for these changes is on or about April 11, 2007, assuming shareholder approval of Tradewinds NWQ Global Investors, LLC as one of the Fund's sub-advisers.

Shareholders will receive more information and proxy materials for the upcoming shareholder vote in the coming weeks.

ON APRIL 28, 2006, the Funds received authorization from their Board of Trustees to expand the range of permissible investments and implement a managed distribution policy. Symphony, which acts as sub-advisor for approximately 20% of each Fund's portfolio, was allowed to diversify its debt investments across high-yield bonds, senior loans and convertible securities, as well as invest up to 10% of each Fund's portfolio in equity securities. These changes were intended to better enable the Funds to meet their investment objectives and provide for increased capital appreciation potential over time.

The investment parameters for the Funds' other sub-advisors, Spectrum and Frole, Revy, did not change. Additionally, the Funds' new managed distribution policy gives each Fund the flexibility to draw upon net investment income as well as realized and unrealized portfolio gains and non-taxable returns of principal when making its monthly distributions to common shareholders. See the Distribution and Share Price Information section of this report immediately following the Portfolio Manager's Comments for more details about this managed distribution policy.

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Nuveen Investments Closed-End Funds (JPC and JQC)

PORTFOLIO MANAGERS' COMMENTS

In 2006, these Funds were subadvised by a team of specialists from Spectrum Asset Management, Inc., (Spectrum) Frole, Revy Investment Co., Inc. (Frole, Revy), and Symphony Asset Management LLC (Symphony), an affiliate of Nuveen Investments.

Spectrum, an affiliate of Principal Capital (SM), manages the preferred securities portion of each Fund's portfolio. Mark Lieb, Bernie Sussman and Phil Jacoby, who have more than 50 years of combined experience in the preferred securities markets, lead the team.

Frole, Revy, one of the oldest firms specializing in convertible securities, manages that portion of each Fund's portfolio. Their investment team is led by Andrea Revy O'Connell and Michael Revy, who each have more than 10 years experience in convertible securities investing.

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The Symphony team managing the high yield securities and other debt and equity instruments in both Funds is led by Igor Lotsvin.

Here representatives from Spectrum; Frole, Revy; and Symphony talk about their management strategies and the performance of both Funds for the 12-month period ended December 31, 2006.

WHAT WERE THE GENERAL ECONOMIC AND MARKET CONDITIONS YOU FACED DURING THIS ANNUAL REPORTING PERIOD ENDED DECEMBER 31, 2006?

In 2006, the U.S. economy benefited from increased flexibility stemming mainly from productivity advancements and globalization, which seems to be reducing the reliance on monetary policy actions to offset unexpected shocks. We began the year still in the midst of a Federal Reserve Bank (Fed) tightening cycle. Our departing Fed Chairman, Alan Greenspan warned, "History cautions that people experiencing long periods of relative stability are prone to excess. We must thus remain vigilant against complacency, especially since several important economic challenges confront policymakers in the years ahead." Chairman Greenspan's work was complete and Fed Chairman, Ben Bernanke, took the helm. By June and after two full years of rate tightening, the Fed finally paused with Fed Funds at 5.25%. The uncertainty of the Fed's actions throughout the year led to a fair amount of volatility in the long end of the bond market as the 30-year Treasury bond traded as high as 5.31% only to rally for the entire summer and close the year at 4.81%, just 27 basis points cheaper than where it started in January. The bond rally in the 2nd half of the year led to a U.S. Treasury yield curve inversion which is continuing for 7 months running now. In order to put a perspective on yield curve inversions, note that the U.S. has experienced 5 inversions since the 1970s with the average length of time being 12 months and the longest being 19 months. We do not think that this inversion will last too much longer because, according to the Fed, "economic growth has slowed over the course of the year, partly reflecting a substantial cooling of the housing market." Notably, the extended housing market was a concern of the Fed and its orderly cooling is indeed a policy victory. Nonetheless, Chairman Bernanke still has lingering concerns over inflation risks even though the

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pressures seem likely to moderate along with slowing aggregate demand around the globe.

There were some very good buying opportunities in the preferred sleeves of the Funds during the year. We were able to take advantage of several closed-end funds that were under-priced and confusion in the hybrid preferred market due to the National Association of Insurance Commissioners' (NAIC) classification of several preferred structures as common equity. As about 25% of the hybrid capital securities market was comprised of insurance company buyers traditionally, the IPO market for institutional deals took a timeout in April thanks to the NAIC, only to come back strong in May (continuing through December) as it became evident that the buyer base went significantly beyond insurance companies to newer buyers such as hedge funds and traditional corporate bond. Even the \$25 par preferred market has found new buyer breadth as equity income and balanced funds are the latest institutional buyers competing with retail. Overall, new issuance in hybrid-preferred securities set a record of over \$74 billion -- about 60% more than the issuance amount last year, which at the time was also a record year.

Convertibles ended 2006 with positive returns and kept close pace with the underlying equities. For 2006, the Merrill Lynch All Convertibles Index was up 12.8%, with the underlying equities up 14.7%. Mirroring the bond market, the Speculative Grade Index outperformed the Investment Grade Index, posting a 13.8% return for the year. Many of the fallen angels of 2005 ended up outperforming in

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2006, in particular automotives and airlines. Convertibles across all sectors performed well in 2006, with Materials (up 30.3%) the best performing sector.

High yield new issuance soared in 2006, helped by a large pickup in Leveraged Buyout (LBO) activity. Landmark deals during the year included HCA, which agreed to be acquired by a consortium of private equity investors for \$33 billion in July, and Freescale Semiconductor, which agreed to be purchased by private equity group for \$17.6 billion in September. The total new issue volume for the twelve-month period was \$114.8 billion, a \$33.6 billion increase from 2005 new issuance. While supply was large, there was plenty of demand in the market to absorb it, especially from hedge funds.

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WHAT WAS YOUR OVERALL MANAGEMENT STRATEGY FOR THE TWELVE-MONTH PERIOD ENDED DECEMBER 31, 2006?

In 2006, the Funds continued to allocate their assets in order to maintain a strategic asset mix of approximately 70% in income-oriented debt securities and 30% in equities and equity-like securities. (In response to market changes over time, Nuveen Asset Management, together with the funds' sub-advisers, will determine how best to allocate each fund's assets among the fund's sub-advisors, consistent with the fund's objectives and strategic asset allocation target.)

PLEASE SEE THE INVESTMENT STRATEGY AND MANAGEMENT UPDATE FROM NUVEEN FOR MORE INFORMATION REGARDING THE FUNDS' STRATEGY

HOW DID THE FUNDS PERFORM OVER THE TWELVE-MONTHS ENDED DECEMBER 31, 2006?

The performance of each Fund, as well as the performance of comparative benchmark is shown below:

TOTAL RETURN ON NET ASSET VALUE

For the 12-month period ended December 31, 2006

JPC	8.71%
-----	-------

JQC	8.73%
-----	-------

Comparative benchmark(1)	9.28%
--------------------------	-------

1 Comparative benchmark performance is a blended return consisting of: 1) 33% of the Merrill Lynch Preferred Stock Hybrid Securities Index, an unmanaged index of investment-grade, exchange traded preferred issues with outstanding market values of at least \$30 million and at least one year to maturity; 2) 27% of the Lehman Tier 1 Capital Securities Index, an unmanaged index that includes securities that can generally be viewed as hybrid fixed-income securities that either receive regulatory capital treatment or a degree of "equity credit" from a rating agency; 3) 30% of the Merrill Lynch All U.S. Convertibles Index, consisting of approximately 575 securities with par value greater than \$50 million that were issued by U.S. companies or non-U.S. based issuers that have a significant business presence in the U.S.; and 4) 10% of the CSFB High Yield Index, which includes approximately \$375 billion of \$US-denominated high yield debt with a minimum of \$75 million in par value and at least one rating below

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investment-grade. Index returns do not include the effects of any management fees or fund expenses. It is not possible to invest directly in an index.

Past performance does not guarantee future results. Current performance may be higher or lower than the data shown.

Returns do not reflect the deduction of taxes that a shareholder may have to pay on Fund distributions or upon the sale of Fund shares.

For more information, please see the individual Performance Overview pages in this report.

As indicated in the accompanying table, both Funds posted positive results for the twelve-month period.

In the Preferred Securities sleeves of the Funds, we generally maintained the 60/40 portfolio mix between the \$25 par preferred sector and the Capital Securities sector. Dividends Received Deduction (DRDs) Tax-Advantaged securities were sold as spreads tightened from the cheap positioning that took place in 2005. The sale proceeds were reinvested roughly equally in fully taxable \$25 par securities and in competitor closed-end funds (CEFs) that were priced at discounts to their Net Asset Value trading price.

We continued to opportunistically increase the Funds' concentration in DRDs due to the relative attractiveness of the sector that carried over from 2005 into the first quarter of 2006. As the year progressed and spreads tightened while other sectors widened, we took some profits with spreads as much as 85 basis points tighter in order to redeploy proceeds into CEFs and newer hybrid issues. We also switched from \$25 par paper and capital securities that were soon callable and into relatively cheap bullet capital securities and perpetual preferreds where structure paid us well. We benefited from the capital performance of the IPO market for floating rate DRD paper.

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In the convertibles sleeve of JPC and JQC the Financials, Media, Transportation and Utilities sectors benefited the portfolio relative to the index.

Financials represent the largest sector in the convertible universe at just under 20%. Over the period, our exposure to financials in the Funds increased. The fundamentals of the financial sector improved throughout the year and the higher credit quality of the financial sector also contributed to our market weight relative to the index. Relative to the ML All Convertibles Index, our financial sector holdings have significantly lower investment value premiums, making the sector very attractive.

Our superior convertible security selection in the Media sector also contributed significantly to performance. The portfolios benefited from the Interpublic Group floating rate issue as well as Walt Disney and Time Warner who were also strong contributors to performance due to company specific issues. Technology also benefited performance for the year. The portfolios had an equal weight relative to the index, but our security selection again contributed to performance. In addition, our overweight position in RF Micro Devices contributed to total performance. Convertibles issued by Metlife, Alleghany, and Merrill Lynch contributed to the portfolio's out-performance over the year.

In the high yield portion of the Funds, we continued to employ a value-oriented strategy, focusing on relatively higher quality credits with strong fundamental

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business models, more diversified revenue streams, strong asset coverage and relatively low earnings volatility. We stayed away from positions with escalating credit issues, limited upside potential, or significant downside risk with weak asset protection.

The Funds had several positions that constrained performance over this reporting period.

In the preferred sleeve of JPC and JQC while the added volatility in the "enhanced equity" hybrid and Tier 1 spaces provided some trading opportunities for the funds, it also slowed performance, as we were long the sector, as well. We also made a decision to stop selling the callable hybrid securities because it became unclear whether or not the issuers would have adequate incentive to call them. As a result, the portfolio duration was consciously lower than our benchmark and switches for lower yield and more duration became less attractive than holding for high income and low duration. This served the primary income objective very well, but the capital performance of the fund was a bit slower than it likely would have been otherwise when spreads tightened in the second half of the year.

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Very similar to the first half of 2006, Consumer Discretionary performance lagged ML All Convertibles Index due to an underweight in General Motors. In the Materials sector, the Funds did not own Titanium Metals. The security is nearly impossible to invest in; is highly illiquid and 65+% is held by the Chairman of the company. However, behind the largest issues in the index (GM and Ford), Titanium Metals added 30bps to the performance of the Index in 2006. Health Care and Energy also detracted from total performance. Specific names that led to the portfolio underperformance include Nabors Industries in the Energy sector and CV Therapeutics in the Health Care sector. Both issues had a larger position in the portfolio versus the index. In addition to the specific issues, the Health Care sector relative to the broader index suffered from slight underperformance.

Another factor that hindered the benchmark-relative performance of the portfolios' convertibles securities investments was the investment policies limiting investments in CCC-rated securities to no more than 5% of a Fund's net assets. The CCC-rated securities were up over 35% for the year in ML All Convertibles Index and the inability to more fully participate in this sector detracted from the overall performance of the Funds' allocation to convertible securities.

In the high yield sleeve, our strategy of investing in higher quality names allowed us to reduce the overall risk in the portfolio; however, it limited our exposure to some of the upside in the high yield market from lower rated credits which outperformed higher rated credits. Within the CS High Yield Index, distressed credits returned close to 40%, CCC/Split CCC rated credits returned close to 20%, B rated credits returned close to 11%, and BB rated credits returned 8%.

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DISTRIBUTION AND SHARE PRICE INFORMATION

DISTRIBUTION INFORMATION

Each of these Funds issues FundPreferred(TM) shares and uses financial leverage

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in an effort to enhance its distribution-paying capabilities. While this strategy adds volatility to a Fund's net asset value and share price, it generally enhances the amount of income the Fund has to distribute to its common shareholders. The extent of this benefit is tied in part to the short-term rates these Funds pay their FundPreferred shareholders. As short-term rates rose through this reporting period, the Funds paid higher dividends to their FundPreferred shareholders.

Effective with the distribution payable June 1, 2006, the Funds began implementing a Managed Distribution Policy. Under this policy, the Funds will make monthly distributions of a stated dollar amount per common share, comprised of net investment income, realized capital gains and/or, if necessary, non-taxable distributions (which generally are expected to represent unrealized capital appreciation).

Over this twelve month reporting period, both JPC and JQC announced increases in their monthly distribution to shareholders. JPC increased its monthly distribution to \$0.095 from \$0.085 a share. JQC increased its monthly distribution to \$0.095 from \$0.084 per share.

The goal of a managed distribution program is to provide shareholders relatively consistent and predictable cash flow by systematically converting its expected long-term return potential into regular monthly distributions. As a result, regular distributions throughout the year will likely include a portion of expected long-term gains (both realized and unrealized), along with net investment income.

Important points to understand about the managed distribution program are:

- Each Fund seeks to establish a relatively stable distribution rate that roughly corresponds to the projected total return from its investment strategy over an extended period of time. However, you should not draw any conclusions about the Fund's past or future investment performance from its current distribution rate.
- Actual returns will differ from projected long-term returns (and therefore the Fund's distribution rate), at least over shorter time periods. Over a specific timeframe, the difference between actual returns and total distributions will be reflected in an increasing (returns exceed distributions) or a decreasing (distributions exceed returns) fund net asset value.

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- Each month's distributions are expected to be paid from some or all of the following sources:
 - net investment income (regular interest and dividends),
 - realized capital gains, and
 - unrealized gains, or, in certain cases, a return of principal (non-taxable distributions)
- A non-taxable distribution is a payment of a portion of a Fund's capital. When a Fund's returns exceed distributions, it may represent portfolio gains generated, but not realized as a taxable capital gain. In periods when a Fund's return falls short of distributions, it will represent a portion of your original principal unless the shortfall is offset during other time periods over the life of your investment (previous or subsequent) when the fund's total return exceeds distributions.
- Because distribution source estimates are updated monthly during the year, based on a Fund's performance and forecast for its current fiscal year (which is the calendar year for each Fund), these estimates may differ from both the tax information reported to you in your Fund's 1099 statement provided at year end, as well as the ultimate economic sources of

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distributions over the life of your investment.

The following table provides information regarding each Fund's distributions and total return performance for the fiscal year ended December 31, 2006. The distribution information is presented on a tax basis rather than on a generally accepted accounting principles (GAAP) basis. This information is intended to help you better understand whether the Fund's returns for the specified time period was sufficient to meet each Fund's distributions. Information regarding such distributions in the future will likely vary based on the Fund's investment activities and portfolio investment value changes at that time.

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DISTRIBUTION AND SHARE PRICE INFORMATION (continued)

AS OF 12/31/2006	JPC	JQC
Inception date	3/26/03	6/25/03
Calendar Year:		
Per share distribution:		
From net investment income	\$0.87	\$0.93
From short-term capital gains	\$0.01	\$0.01
From long-term capital gains	\$0.07	\$0.08
From return of capital	\$0.15	\$0.08
Total per share distribution	\$1.10	\$1.10
Distribution rate on NAV	7.71%	7.70%
One-year total return on NAV	8.71%	8.73%
Annualized since inception total return on NAV	8.72%	7.95%

SHARE REPURCHASE AND SHARE PRICE INFORMATION

On February 3, 2006, the Funds' Board of Trustees approved an open market share repurchase program, as part of a broad, ongoing effort designed to support the market prices of the Funds' common shares. Under the terms of the program, each Fund may repurchase up to 10% of its outstanding common shares. As of December 31, 2006, JPC had repurchased 432,200 common shares and JQC had repurchased 511,200 common shares.

At the end of the reporting period, the Funds' share prices were trading relative to their NAVs as shown in the accompanying table:

	AS OF 12/31/06 PREMIUM DISCOUNT	12-MONTH AVERAGE DISCOUNT
JPC	0.21%	-8.91%
JQC	-1.26%	-9.62%

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Nuveen Preferred and Convertible Income Fund
JPC

PERFORMANCE

OVERVIEW As of December 31, 2006

(PORTFOLIO ALLOCATION PIE CHART)
(as a % of total investments)

\$25 Par (or similar) Preferred Securities	32.8%
Convertible Bonds	24.5%
Capital Preferred Securities	19.5%
Corporate Bonds	7.8%
Common Stocks	6.7%
Convertible Preferred Securities	5.8%
Variable Rate Senior Loan Interests	1.3%
Investment Companies	0.9%
Short-Term Investments	0.7%

(2006 MONTHLY DISTRIBUTIONS PER SHARE BAR CHART)

Jan	0.085
Feb	0.085
Mar	0.085
Apr	0.085
May	0.095
Jun	0.095
Jul	0.095
Aug	0.095
Sep	0.095
Oct	0.095
Nov	0.095
Dec	0.095

(SHARE PRICE PERFORMANCE CHART)

Past performances is not predictive of future results.

1/01/06

12.17

12.37
12.47
12.51
12.53
12.71
12.76
12.70
12.71
12.75
12.53
12.53
12.62
12.38
12.27
11.98
12.03
12.12
12.45
12.45
12.43
12.36
12.51
12.41
12.22
12.28
12.29
12.38
12.42
12.46
12.44
12.78
13.00
13.08
13.19
13.33
13.51
13.32
13.58
13.69
13.76
13.93
13.63
13.85
14.06
13.69
13.95
13.87
13.95
14.02
14.18
14.32
14.22
14.26
14.29
14.26

12/31/06

FUND SNAPSHOT

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Common Share Price	\$14.29
Common Share Net Asset Value	\$14.26
Premium/(Discount) to NAV	0.21%
Current Distribution Rate(1)	7.98%
Net Assets Applicable to Common Shares (\$000)	\$1,421,951

AVERAGE ANNUAL TOTAL RETURN
(Inception 3/26/03)

	ON SHARE PRICE	ON NAV
1-Year	29.81%	8.71%
Since Inception	8.07%	8.72%

INDUSTRIES
(as a % of total investments)

Commercial Banks	19.0%
Insurance	10.7%
Real Estate	10.4%
Capital Markets	7.2%
Media	5.5%
Diversified Financial Services	4.8%
Oil, Gas & Consumable Fuels	2.5%
Biotechnology	2.4%
Thriffs & Mortgage Finance	2.3%
Hotels, Restaurants & Leisure	2.1%
Energy Equipment & Services	1.8%
Aerospace & Defense	1.8%

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Pharmaceuticals	1.7%

Diversified Telecommunication Services	1.7%

Software	1.6%

Semiconductors & Equipment	1.5%

Computers & Peripherals	1.5%

Communications Equipment	1.4%

Health Care Equipment & Supplies	1.4%

Electric Utilities	1.3%

Health Care Providers & Services	1.3%

Automobiles	1.2%

Short-Term Investments	0.7%

Other	14.2%

TOP FIVE ISSUERS
(EXCLUDING SHORT-TERM INVESTMENTS)
(as a % of total investments)

Wachovia Corporation	2.0%

ING Group N.V.	1.7%

Morgan Stanley	1.6%

Union Planters Corporation	1.6%

Countrywide Financial Corporation	1.5%

1 Current Distribution Rate is based on the Fund's current annualized monthly distribution divided by the Fund's current market price. The Fund's monthly distributions to its shareholders may be comprised of ordinary income, net realized capital gains and, if at the end of the calendar year the Fund's cumulative net ordinary income and net realized gains are less than the amount of the Fund's distributions, a return of capital for tax purposes.

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PERFORMANCE

OVERVIEW As of December 31, 2006

(PORTFOLIO ALLOCATION PIE CHART)

(as a % of total investments)

\$25 Par (or similar) Preferred Securities	29.8%
Convertible Bonds	24.6%
Capital Preferred Securities	22.3%
Corporate Bonds	8.4%
Common Stocks	6.7%
Convertible Preferred Securities	5.9%
Variable Rate Senior Loan Interests	1.0%
Investment Companies	0.9%
Short-Term Investments	0.4%

(2006 MONTHLY DISTRIBUTIONS PER SHARE BAR CHART)

Jan	0.084
Feb	0.084
Mar	0.084
Apr	0.084
May	0.095
Jun	0.095
Jul	0.095
Aug	0.095
Sep	0.095
Oct	0.095
Nov	0.095
Dec	0.095

(SHARE PRICE PERFORMANCE CHART)

Past performance is not predictive of future results.

1/01/06	12.18
	12.43
	12.49
	12.50
	12.44
	12.49
	12.64
	12.55
	12.57
	12.58
	12.30
	12.38

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	12.43
	12.34
	12.26
	11.97
	12.02
	12.10
	12.38
	12.35
	12.32
	12.37
	12.52
	12.47
	12.27
	12.26
	12.28
	12.38
	12.44
	12.41
	12.49
	12.74
	13.02
	13.15
	13.22
	13.32
	13.46
	13.29
	13.54
	13.68
	13.69
	13.87
	13.64
	13.80
	13.90
	13.62
	13.91
	13.89
	13.93
	14.05
	14.27
	14.29
	14.22
	14.07
	14.11
12/31/06	14.29

FUND SNAPSHOT

Common Share Price	\$14.11

Common Share Net Asset Value	\$14.29

Premium/(Discount) to NAV	-1.26%

Current Distribution Rate(1)	8.08%

Net Assets Applicable to Common Shares (\$000)	\$2,008,154

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AVERAGE ANNUAL TOTAL RETURN
(Inception 6/25/03)

	ON SHARE PRICE	ON NAV
1-Year	26.71%	8.73%
Since Inception	6.81%	7.95%

INDUSTRIES
(as a % of total investments)

Commercial Banks	18.8%
Insurance	12.2%
Real Estate	8.6%
Capital Markets	6.8%
Media	6.6%
Diversified Financial Services	6.3%
Oil, Gas & Consumable Fuels	2.5%
Biotechnology	2.4%
Hotels, Restaurants & Leisure	2.1%
Diversified Telecommunication Services	1.9%
Energy Equipment & Services	1.8%
Aerospace & Defense	1.8%
Pharmaceuticals	1.7%
Computers & Peripherals	1.5%
Semiconductors & Equipment	1.5%
Software	1.5%
Communications Equipment	1.5%
Health Care Equipment & Supplies	1.4%

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Automobiles	1.2%
Thrifts & Mortgage Finance	1.2%
Health Care Providers & Services	1.2%
Short-Term Investments	0.4%
Other	15.1%

TOP FIVE ISSUERS
(EXCLUDING SHORT-TERM INVESTMENTS)
(as a % of total investments)

Wachovia Corporation	2.1%
JPMorgan Chase & Company	2.1%
Merrill Lynch and Company Inc.	2.0%
Citigroup Inc.	1.7%
Washington Mutual	1.6%

1 Current Distribution Rate is based on the Fund's current annualized monthly distribution divided by the Fund's current market price. The Fund's monthly distributions to its shareholders may be comprised of ordinary income, net realized capital gains and, if at the end of the calendar year the Fund's cumulative net ordinary income and net realized gains are less than the amount of the Fund's distributions, a return of capital for tax purposes.

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Report of
INDEPENDENT REGISTERED
PUBLIC ACCOUNTING FIRM

THE BOARD OF TRUSTEES AND SHAREHOLDERS
NUVEEN PREFERRED AND CONVERTIBLE INCOME FUND
NUVEEN PREFERRED AND CONVERTIBLE INCOME FUND 2

We have audited the accompanying statements of assets and liabilities, including the portfolios of investments, of Nuveen Preferred and Convertible Income Fund and Nuveen Preferred and Convertible Income Fund 2 (the "Funds") as of December 31, 2006, and the related statements of operations for the year then ended, the statements of changes in net assets for each of the two years in the period then ended, and the financial highlights for the periods indicated therein. These financial statements and financial highlights are the responsibility of the Funds' management. Our responsibility is to express an opinion on these

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financial statements and financial highlights based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and financial highlights are free of material misstatement. We were not engaged to perform an audit of the Funds' internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Funds' internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements and financial highlights, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our procedures included confirmation of securities owned as of December 31, 2006, by correspondence with the custodian, selling or agent banks and brokers or by other appropriate auditing procedures where replies from selling or agent banks were not received. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements and financial highlights referred to above present fairly, in all material respects, the financial positions of Nuveen Preferred and Convertible Income Fund and Nuveen Preferred and Convertible Income Fund 2 at December 31, 2006, the results of their operations for the year then ended, changes in their net assets for each of the two years in the period then ended, and the financial highlights for the periods indicated therein in conformity with U.S. generally accepted accounting principles.

(ERNST & YOUNG LLP LOGO)

Chicago, Illinois
February 20, 2007

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Nuveen Preferred and Convertible Income Fund (JPC)

Portfolio of
INVESTMENTS December 31, 2006

SHARES	DESCRIPTION (1)
	COMMON STOCKS - 10.0% (6.7% OF TOTAL INVESTMENTS)
	AEROSPACE & DEFENSE - 0.3%
18,710	Boeing Company
18,626	Lockheed Martin Corporation
11,060	Orbital Sciences Corporation, (2)
	Total Aerospace & Defense
	AIR FREIGHT & LOGISTICS - 0.2%
20,032	FedEx Corporation
11,840	Ryder System Inc.
	Total Air Freight & Logistics

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	BEVERAGES - 0.1%
25,300	Coca-Cola Company
8,306	Pepsi Bottling Group Inc.

	Total Beverages

	BIOTECHNOLOGY - 0.3%
14,790	Biogen Idec Inc., (2)
6,980	Cephalon, Inc., (2)
13,183	Genentech, Inc., (2)
21,878	Gilead Sciences, Inc., (2)

	Total Biotechnology

	CAPITAL MARKETS - 0.2%
52,780	JPMorgan Chase & Co.
11,620	Lehman Brothers Holdings Inc.

	Total Capital Markets

	CHEMICALS - 0.2%
12,710	Air Products & Chemicals Inc.
18,270	Airgas, Inc.
19,640	Ashland Inc.
7,740	Sparetech Corporation

	Total Chemicals

	COMMERCIAL BANKS - 0.5%
21,980	Bank of Hawaii Corporation
14,630	Colonial BancGroup Inc.
7,394	Greater Bay Bancorp
18,730	Mellon Financial Corporation
9,530	Northern Trust Corporation
31,300	PNC Financial Services Group, Inc.
8,175	Sterling Bancshares Inc.
4,760	Umpqua Holdings Corporation
19,067	Washington Mutual, Inc.

	Total Commercial Banks

	COMMERCIAL SERVICES & SUPPLIES - 0.6%
6,260	Administaff, Inc.
4,343	American Ecology Corporation
3,136	Consolidated Graphics Inc., (2)
27,420	Convergys Corporation, (2)
6,319	Corporate Executive Board Company
22,480	Corrections Corporation of America, (2)
27,909	Global Payments Inc.
9,930	ITT Educational Services, Inc., (2)
37,520	Republic Services, Inc.
31,520	SEI Investments Company

	Total Commercial Services & Supplies

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SHARES	DESCRIPTION (1)
	COMMUNICATIONS EQUIPMENT - 0.1%
83,360	Corning Incorporated, (2)
3,543	Harris Corporation
9,710	Polycom Inc., (2)
	Total Communications Equipment
	COMPUTERS & PERIPHERALS - 0.4%
18,441	Apple Computer, Inc., (2)
38,130	Hewlett-Packard Company
22,900	Lexmark International, Inc., (2)
36,563	Network Appliance Inc., (2)
	Total Computers & Peripherals
	CONSUMER FINANCE - 0.1%
13,130	Capital One Financial Corporation
	DIVERSIFIED CONSUMER SERVICES - 0.0%
10,419	Jackson Hewitt Tax Services Inc.
	DIVERSIFIED TELECOMMUNICATION SERVICES - 0.2%
13,290	Alltel Corporation
25,420	AT&T Inc.
4,780	Cbeyond Inc., (2)
5,920	CT Communications, Inc.
62,880	Sprint Nextel Corporation
	Total Diversified Telecommunication Services
	ELECTRIC UTILITIES - 0.3%
21,740	Great Plains Energy Incorporated
13,060	OGE Energy Corp.
34,950	PG&E Corporation
10,264	TXU Corporation
15,770	Xcel Energy, Inc.
	Total Electric Utilities
	ELECTRICAL EQUIPMENT - 0.2%
62,600	Emerson Electric Co.
4,244	Ormat Technologies Inc.
	Total Electrical Equipment
	ELECTRONIC EQUIPMENT & INSTRUMENTS - 0.3%
3,420	American Science & Engineering Inc., (2)
4,704	Itron Inc., (2)
53,460	MEMC Electronic Materials, (2)
9,308	Millipore Corporation, (2)
10,194	Plexus Corporation, (2)
10,387	Teledyne Technologies Inc., (2)
15,874	Waters Corporation, (2)
	Total Electronic Equipment & Instruments
	ENERGY EQUIPMENT & SERVICES - 0.0%
7,170	Matrix Service Company, (2)

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7,739	Unit Corporation, (2)

	Total Energy Equipment & Services

	FOOD & STAPLES RETAILING - 0.2%
36,880	Safeway Inc.
12,940	Whole Foods Market, Inc.

	Total Food & Staples Retailing

	FOOD PRODUCTS - 0.3%
33,750	Campbell Soup Company
80,670	ConAgra Foods, Inc.
14,290	H.J. Heinz Company
13,340	McCormick and Company Inc.

	Total Food Products

	GAS UTILITIES - 0.3%
77,410	Energen Corporation
11,940	Questar Corporation

	Total Gas Utilities

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Nuveen Preferred and Convertible Income Fund (JPC) (continued)

Portfolio of INVESTMENTS December 31, 2006

SHARES	DESCRIPTION (1)

	HEALTH CARE EQUIPMENT & SUPPLIES - 0.3%
11,976	American Medical Systems Holdings, Inc., (2)
30,410	Baxter International Inc.
16,290	Dade Behring Holdings Inc.
7,072	Express Scripts, Inc., (2)
8,470	Hillenbrand Industries
26,480	Hospira Inc., (2)
5,642	Surmodics Inc., (2)

	Total Health Care Equipment & Supplies

	HEALTH CARE PROVIDERS & SERVICES - 0.3%
5,490	Centene Corporation, (2)
10,206	Healthways Inc., (2)
3,980	Humana Inc., (2)
5,630	Mentor Corporation
6,830	Nighthawk Radiology Holdings Inc., (2)
22,160	Quest Diagnostics Incorporated
29,703	Wellcare Health Plans Inc., (2)

	Total Health Care Providers & Services

	HOTELS, RESTAURANTS & LEISURE - 0.1%

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30,756	Choice Hotels International, Inc.
11,334	Starbucks Corporation, (2)

	Total Hotels, Restaurants & Leisure

	HOUSEHOLD DURABLES - 0.1%
36,551	Newell Rubbermaid Inc.
11,780	Snap-on Incorporated

	Total Household Durables

	HOUSEHOLD PRODUCTS - 0.2%
37,900	Colgate-Palmolive Company
13,297	Kimberly-Clark Corporation

	Total Household Products

	INDEPENDENT POWER PRODUCERS & ENERGY TRADERS - 0.1%
17,550	NRG Energy Inc., (2)

	INDUSTRIAL CONGLOMERATES - 0.1%
21,130	General Electric Company
2,720	Teleflex Inc.

	Total Industrial Conglomerates

	INSURANCE - 0.6%
36,445	AFLAC Incorporated
34,663	HCC Insurance Holdings Inc.
45,317	Philadelphia Consolidated Holding Corporation, (2)
5,064	Tower Group Inc.
104,440	W.R. Berkley Corporation

	Total Insurance

	INTERNET & CATALOG RETAIL - 0.0%
2,806	Coldwater Creek Inc., (2)

	INTERNET SOFTWARE & SERVICES - 0.1%
5,630	F5 Networks, Inc., (2)
1,236	Google Inc., Class A, (2)

	Total Internet Software & Services

	IT SERVICES - 0.0%
11,022	Websense Inc., (2)

	LEISURE EQUIPMENT & PRODUCTS - 0.0%
15,710	Marvel Entertainment Inc., (2)

	LIFE SCIENCES TOOLS & SERVICES - 0.0%
2,500	Illumina Inc., (2)

	MACHINERY - 0.2%
5,440	Flow International Corporation, (2)
2,147	Freightcar America Inc.
9,883	Harsco Corporation
7,130	Joy Global Inc.

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SHARES	DESCRIPTION (1)
	MACHINERY (continued)
5,720	Paccar Inc.
10,857	Parker Hannifin Corporation
2,650	Robbins & Myers, Inc.
10,780	Terex Corporation, (2)
	Total Machinery
	MEDIA - 0.5%
9,484	Comcast Corporation, Class A, (2)
33,460	DIRECTV Group, Inc., (2)
19,277	John Wiley and Sons Inc., Class A
10,640	Liberty Global Inc., A Shares, (2)
10,640	Liberty Global Inc., Class C, (2)
5,731	Lodgenet Entertainment Corporation, (2)
43,840	McGraw-Hill Companies, Inc.
7,900	NetFlix.com Inc., (2)
57,760	Time Warner Inc.
	Total Media
	METALS & MINING - 0.0%
3,280	Compass Minerals International, Inc.
	MULTILINE RETAIL - 0.3%
21,400	Big Lots Inc., (2)
30,360	Dollar Tree Stores Inc., (2)
34,780	Kohl's Corporation, (2)
	Total Multiline Retail
	OIL, GAS & CONSUMABLE FUELS - 0.4%
4,640	Bill Barnett Corporation, (2)
8,320	Cabot Oil & Gas Corporation
24,520	EOG Resources, Inc.
5,920	Equitable Resources Inc.
4,490	Houston Exploration Company, (2)
7,436	Pioneer Drilling Company, (2)
6,450	St Mary Land and Exploration Company
20,405	Sunoco, Inc.
11,472	Valero Energy Corporation
36,172	W&T Offshore Inc.
	Total Oil, Gas & Consumable Fuels
	PAPER & FOREST PRODUCTS - 0.1%
18,590	Plum Creek Timber Company
	PERSONAL PRODUCTS - 0.2%
5,200	NBTY Inc., (2)
16,790	Nutri System Inc., (2)
	Total Personal Products
	PHARMACEUTICALS - 0.2%

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9,170	Abraxis Bioscience Inc., (2)
9,930	Allergan Inc.
7,530	Johnson & Johnson
10,550	Merck & Co. Inc.
5,150	New River Pharmaceuticals Inc., (2)
8,070	Pozen Inc., (2)

Total Pharmaceuticals

REAL ESTATE - 0.3%

5,110	American Home Mortgage Investment Corp.
9,950	Camden Property Trust
9,091	Equity Inns Inc.
8,200	Health Care Property Investors Inc.
6,286	LaSalle Hotel Properties
11,830	Northstar Realty Finance Corporation
8,196	Public Storage, Inc.
5,981	SL Green Realty Corporation
10,381	Tanger Factory Outlet Centers
1,903	Taubman Centers Inc.
9,703	United Dominion Realty Trust

Total Real Estate

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Nuveen Preferred and Convertible Income Fund (JPC) (continued)

Portfolio of INVESTMENTS December 31, 2006

SHARES DESCRIPTION (1)

SEMICONDUCTORS & EQUIPMENT - 0.2%

12,736	Advanced Micro Devices, Inc., (2)
125,820	Micron Technology, Inc., (2)
25,710	National Semiconductor Corporation
20,950	Trident Microsystems Inc., (2)

Total Semiconductors & Equipment

SOFTWARE - 0.5%

3,070	Ansys Inc., (2)
8,005	Aspen Technology Inc., (2)
33,919	Autodesk, Inc., (2)
10,908	Blackbaud, Inc.
66,940	BMC Software Inc., (2)
35,010	Intuit Inc., (2)
37,820	Salesforce.com, Inc., (2)

Total Software

SPECIALTY RETAIL - 0.3%

48,200	American Eagle Outfitters, Inc.
9,700	Ann Taylor Stores Corporation, (2)
5,196	Build-A-Bear-Workshop, Inc., (2)

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2,686 Childrens Place Retail Stores Inc., (2)
 4,700 Dick's Sporting Goods Inc., (2)
 4,730 Gymboree Corporation, (2)
 12,100 Office Depot, Inc., (2)
 8,750 PetSmart Inc.
 25,244 Staples, Inc.

 Total Specialty Retail

TEXTILES, APPAREL & LUXURY GOODS - 0.0%
 10,489 Guess Inc., (2)

 THRIFTS & MORTGAGE FINANCE - 0.0%
 14,350 Washington Federal Inc.

 TOBACCO - 0.1%
 34,750 UST Inc.

 TRADING COMPANIES & DISTRIBUTORS - 0.0%
 5,294 GATX Corporation

 TOTAL COMMON STOCKS (COST \$135,432,664)
 =====

SHARES	DESCRIPTION (1)	COUPON	RA
	CONVERTIBLE PREFERRED SECURITIES - 8.7% (5.8% OF TOTAL INVESTMENTS)		
	AUTOMOBILES - 1.8%		
287,000	Ford Motor Company Capital Trust II	6.500%	
468,700	General Motors Corporation	5.250%	
271,100	General Motors Corporation	6.250%	
	Total Automobiles		
	CAPITAL MARKETS - 0.6%		
9,500	Affiliated Managers Group Inc.	5.100%	
51,150	Affiliated Managers Group Inc.	5.100%	
102,200	E*Trade Financial Corporation	6.125%	
39,875	Lazard Limited	6.625%	
	Total Capital Markets		
	CHEMICALS - 0.1%		
36,215	Celanese Corporation	4.250%	
	COMMERCIAL BANKS - 0.7%		
6,475,000	Fortis Insurance NV, 144A	7.750%	
	COMMERCIAL SERVICES & SUPPLIES - 0.6%		
23,925	Allied Waste Industries Inc.	6.250%	
	CONSUMER FINANCE - 0.1%		
750,000	SLM Corporation	5.326%	

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SHARES	DESCRIPTION (1)	COUPON	RA
	ELECTRIC UTILITIES - 0.5%		
77,660	Entergy Corporation	7.625%	
56,800	PNM Resources Inc.	6.750%	
	Total Electric Utilities		
	FOOD PRODUCTS - 0.3%		
43,825	Bunge Limited	4.875%	
	GAS UTILITIES - 0.1%		
27,000	Southern Union Company	5.000%	
	INDEPENDENT POWER PRODUCERS & ENERGY TRADERS - 0.1%		
3,900	NRG Energy Inc.	5.750%	
	INSURANCE - 1.2%		
334,000	MetLife Inc.	6.375%	
272,390	Travelers Property Casualty Corporation	4.500%	
	Total Insurance		
	MEDIA - 0.5%		
190,000	Comcast Corporation	2.000%	
	METALS & MINING - 0.2%		
2,385	Freeport McMoran Copper & Gold, Inc.	5.500%	
	PHARMACEUTICALS - 0.7%		
180,055	Schering-Plough Corporation	6.000%	
	REAL ESTATE - 0.2%		
106,935	Annaly Mortgage Management Inc.	6.000%	
	U.S. AGENCY - 0.8%		
110	Fannie Mae	5.375%	
	WIRELESS TELECOMMUNICATION SERVICES - 0.2%		
55,050	Crown Castle International Corporation	6.250%	
	TOTAL CONVERTIBLE PREFERRED SECURITIES (COST \$113,067,554)		
	=====		
SHARES	DESCRIPTION (1)	COUPON	RA
	\$25 PAR (OR SIMILAR) PREFERRED SECURITIES - 48.7% (32.8% OF TOTAL INVESTMENTS)		
	CAPITAL MARKETS - 5.4%		
271,087	BNY Capital Trust V, Series F	5.950%	
148,300	Compass Capital Trust III	7.350%	
11,300	CSFB USA, Series 2002-10 (SATURNS)	7.000%	
41,500	First Union Institutional Capital II (CORTS)	8.200%	
5,900	Goldman Sachs Capital I, Series A (CORTS)	6.000%	
4,800	Goldman Sachs Group Inc., Series 2004-06 (SATURNS)	6.000%	
41,600	Goldman Sachs Group Inc., Series 2004-4 (CORTS)	6.000%	
7,000	Goldman Sachs Group Inc., Series GSC-3 (PPLUS)	6.000%	
4,400	Goldman Sachs Group Incorporated (SATURNS)	5.750%	

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527,188	Lehman Brothers Holdings Capital Trust III, Series K	6.375%
2,400	Lehman Brothers Holdings Capital Trust IV, Series L	6.375%
28,100	Merrill Lynch Capital Trust II	8.000%
153,700	Merrill Lynch Preferred Capital Trust III	7.000%
124,400	Merrill Lynch Preferred Capital Trust IV	7.120%
358,400	Merrill Lynch Preferred Capital Trust V	7.280%
71,100	Morgan Stanley Capital Trust II	7.250%
333,722	Morgan Stanley Capital Trust III	6.250%
626,759	Morgan Stanley Capital Trust IV	6.250%
285,641	Morgan Stanley Capital Trust VII	6.600%
2,600	Washington Mutual Capital Trust I, Series 2001-22, Class A-1 (CORTS)	7.650%

 Total Capital Markets

COMMERCIAL BANKS - 8.6%

173,100	Abbey National PLC, Series C	7.375%
83,300	ABN AMRO Capital Fund Trust V	5.900%
10,000	ABN AMRO Capital Trust Fund VII	6.080%
73,600	ASBC Capital I	7.625%
43,785	BAC Capital Trust I	7.000%
111,055	BAC Capital Trust II	7.000%
284,700	BAC Capital Trust III	7.000%
317,222	Banco Santander 144A	6.800%

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Nuveen Preferred and Convertible Income Fund (JPC) (continued)

Portfolio of INVESTMENTS December 31, 2006

SHARES	DESCRIPTION (1)	COUPON	RA
	COMMERCIAL BANKS (continued)		
45,182	Banco Santander, (6)	6.410%	
9,100	BancorpSouth Capital Trust I	8.150%	
231,600	Banesto Holdings, Series A, 144A	10.500%	
81,700	Bank One Capital Trust VI	7.200%	
35,700	BankNorth Capital Trust II	8.000%	
7,300	Capital One Capital II Corporation	7.500%	
62,300	Chittenden Capital Trust I	8.000%	
214,600	Citizens Funding Trust I	7.500%	
107,000	Cobank ABC, 144A, (6)	7.000%	
85,900	Comerica Capital Trust I	7.600%	
338,700	Fleet Capital Trust VIII	7.200%	
771,620	HSBC Finance Corporation	6.875%	
22,360	HSBC Holdings PLC, Series A	6.200%	
539,400	National City Capital Trust II	6.625%	
43,550	PNC Capital Trust	6.125%	
115,938	Royal Bank of Scotland Group PLC, Series L	5.750%	
91,395	Royal Bank of Scotland Group PLC, Series N	6.350%	
391,100	USB Capital Trust VI	5.750%	
36,050	USB Capital Trust XI	6.600%	
33,400	VNB Capital Trust I	7.750%	

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7,400	Wells Fargo Capital Trust IV	7.000%
80,735	Wells Fargo Capital Trust V	7.000%
127,369	Wells Fargo Capital Trust VII	5.850%
44,000	Wells Fargo Capital Trust IX	5.625%
80,700	Zions Capital Trust B	8.000%

	Total Commercial Banks	

	COMPUTERS & PERIPHERALS - 0.0%	
4,600	IBM Inc., Trust Certificates, Series 2001-2	7.100%

	CONSUMER FINANCE - 0.1%	
39,700	SLM Corporation	6.000%

	DIVERSIFIED FINANCIAL SERVICES - 3.6%	
63,130	BAC Capital Trust XII	6.875%
16,500	CIT Group Incorporated (CORTS)	7.750%
86,500	Citigroup Capital Trust VII	7.125%
241,654	Citigroup Capital Trust VIII	6.950%
68,255	Citigroup Capital XV	6.500%
13,400	Citigroup, Series CIT (CORTS)	6.750%
4,500	General Electric Capital Corporation (CORTS)	6.000%
33,100	General Electric Capital Corporation	6.625%
570,518	ING Group N.V.	7.200%
786,475	ING Group N.V.	7.050%
16,800	ING Group N.V.	6.200%
54,000	JPMorgan Chase & Company (PCARS)	7.125%
48,200	JPMorgan Chase Trust, Series 2002-6, Class A (SATURNS)	7.125%

	Total Diversified Financial Services	

	DIVERSIFIED TELECOMMUNICATION SERVICES - 0.4%	
21,900	BellSouth Capital Funding (CORTS)	7.100%
18,300	BellSouth Corporation (CORTS)	7.000%
34,300	BellSouth Corporation, Series 2001-3 (SATURNS)	7.125%
2,400	BellSouth Corporation, Series BLS (CORTS)	7.000%
12,300	BellSouth Corporation	7.125%
10,000	BellSouth Inc. (CORTS)	7.000%
18,300	BellSouth Telecommunications (PPLUS)	7.300%
17,500	Verizon Communications (CORTS)	7.625%
22,200	Verizon Communications (CORTS)	7.375%
4,700	Verizon Communications, Series 2004-1 (SATURNS)	6.125%
1,300	Verizon Global Funding Corporation Trust III, Series III (CORTS)	6.250%
13,900	Verizon New England Inc., Series B	7.000%
45,155	Verizon South Inc., Series F	7.000%

	Total Diversified Telecommunication Services	

	ELECTRIC UTILITIES - 0.8%	
10,000	Consolidated Edison, Inc.	7.250%
22,200	DTE Energy Trust I	7.800%
40,670	Entergy Louisiana LLC	7.600%
8,100	FPL Group Capital Inc.	6.600%
44,570	Georgia Power Capital Trust V	7.125%

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SHARES	DESCRIPTION (1)	COUPON	RA
	ELECTRIC UTILITIES (continued)		
153,100	Georgia Power Company	5.900%	
1,700	Georgia Power Company	5.750%	
1,100	National Rural Utilities Cooperative Finance Corporation	7.400%	
6,600	National Rural Utilities Cooperative Finance Corporation	6.100%	
4,900	National Rural Utilities Cooperative Finance Corporation	5.950%	
2,100	Southern Company Capital Trust I (CORTS)	7.375%	
2,800			