WESTERN ASSET MUNICIPAL HIGH INCOME FUND INC.
Form N-CSR
January 04, 2008

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 811-5497

Western Asset Municipal High Income Fund Inc.
(Exact name of registrant as specified in charter)

125 Broad Street, New York, NY	10004
(Address of principal executive offices)	(Zip code)

Robert I. Frenkel, Esq.
Legg Mason & Co., LLC
300 First Stamford Place, 4th Floor
Stamford, CT 06902
(Name and address of agent for service)

Registrant s telephone number, including area code: (800) 451-2010

Date of fiscal year end: October 31

Date of reporting period: October 31, 2007

ITEM 1. REPORT TO STOCKHOLDERS.

The Annual Report to Stockholders is filed herewith.

Western Asset Municipal
High Income Fund Inc.
(MHF)

ANNUAL REPORT

OCTOBER 31, 2007

Western Asset Municipal High Income Fund Inc.

Annual Report October 31, 2007

What s Inside

Fund Objective

The Fund s investment objective is high tax-exempt current income.

Letter from the Chairman

Dear Shareholder,

Despite continued weakness in the housing market and a credit crunch that began in the summer of 2007, the U.S. economy proved to be resilient during the 12-month reporting period ended October 31, 2007. After expanding 2.1% in the fourth quarter of 2006, U.S. gross domestic product (GDP[i]) growth was a tepid 0.6% in the first quarter of 2007, according to the U.S. Commerce Department. This was the lowest growth rate since the fourth quarter of 2002. The economy then rebounded, as second quarter 2007 GDP growth was a solid 3.8%. Given the modest increase earlier in the year, this higher growth rate was not unexpected. The preliminary estimate for third quarter GDP growth was 4.9%. A surge in inventory-building and robust exports supported the economy during the third calendar quarter.

R. JAY GERKEN, CFA

Chairman, President and Chief Executive Officer

Ongoing issues related to the housing and subprime mortgage markets and an abrupt tightening in the credit markets prompted the Federal Reserve Board (Fed[ii]) to take several actions during the reporting period. The Fed initially responded by lowering the discount rate the rate the Fed uses for loans it makes directly to banks from 6.25% to 5.75% in mid-August 2007. Then, at its meeting on September 18, the Fed reduced the federal funds rate[iii] from 5.25% to 4.75% and the discount rate to 5.25%. This marked the first reduction in the federal funds rate since June 2003. The Fed again lowered rates at the end of October, as it cut both the discount rate and federal funds rate another 0.25% to 5.00% and 4.50%, respectively. In its statement accompanying the October meeting, the Fed stated: Economic growth was solid in the third quarter, and strains in financial markets have eased somewhat on balance. However, the pace of economic expansion will likely slow in the near term, partly reflecting the intensification of the housing correction. The Fed went on to say: The

Committee judges that, after this action, the upside risks to inflation roughly balance the downside risks to growth.

During the 12-month reporting period, both short- and long-term Treasury yields experienced periods of significant volatility. Yields fluctuated early in the period, given mixed economic data and shifting expectations regarding the Fed s future monetary policy. After falling during the first three months of 2007, yields then moved steadily higher during much of the second quarter. This was due, in part, to inflationary fears, a solid job market and expectations that the Fed would not be cutting short-term rates in the foreseeable future. During the remainder of the reporting period, the U.S. fixed-income markets were extremely volatile, which negatively impacted market liquidity conditions. Initially, the concern on the part of market participants was limited to the subprime segment of the mortgage-backed market. These concerns broadened, however, to include a wide range of financial institutions and markets. As a result, other fixed-income instruments also experienced increased price volatility. This turmoil triggered a significant flight to quality, causing Treasury yields to move sharply lower (and their prices higher), while riskier segments of the market saw their yields move higher (and their prices lower). Overall, during the 12 months ended October 31, 2007, two-year Treasury yields fell from 4.71% to 3.94%. Over the same period, 10-year Treasury yields fell from 4.61% to 4.48%.

The municipal bond market lagged its taxable bond counterparts over the 12 months ended October 31, 2007. Over that period, the Lehman Brothers Municipal Bond Index[iv] and the Lehman Brothers U.S. Aggregate Index[v] returned 2.91% and 5.38%, respectively.

Please read on for a more detailed look at prevailing economic and market conditions during the Fund s fiscal year and to learn how those conditions have affected Fund performance.

Special Shareholder Notices

During the fiscal year, the Board of Directors of Western Asset Municipal High Income Fund Inc. approved certain changes to the Fund s non-fundamental investment policies recommended by Fund management. These changes, which are further described below, are intended to provide the portfolio managers with additional flexibility to meet the Fund s investment objectives and address developments in the market, although the Fund s portfolio managers do not currently anticipate that any dramatic change in the Fund s portfolio composition or investment approach will result.

On May 17, 2007, the Board of Directors approved, to be effective June 1, 2007, changes to the non-fundamental investment policies relating to the Fund s ability to invest in derivative instruments. The Fund may use a variety of derivative instruments for investment purposes, as well as for hedging or risk-management purposes. Previously, the Fund had been limited to the use of derivative instruments for hedging and risk-management purposes only. The use of derivative instruments is intended to provide Legg Mason Partners Fund Advisor, LLC (LMPFA), the Fund s investment manager, and Western Asset Management Company (Western Asset), the Fund s subadviser, greater flexibility in making investment decisions and opportunity to seek to achieve the Fund s investment objectives.

Derivatives are financial instruments the value of which depends upon, or is derived from, the value of something else, such as one or more underlying investments, indexes or currencies. Derivatives may be traded on organized exchanges or in individually negotiated transactions with other parties (these are known as over the counter derivatives). Investors should note that derivatives can be illiquid, may disproportionately increase losses and could have a potentially large impact on Fund performance.

Also, on November 19, 2007, the Board of Directors approved changes, to be effective December 19, 2007, to the non-fundamental investment policies relating to the types of securities and maturities in which the Fund may invest. The Fund may now, under normal market conditions, invest in non-publicly traded municipal securities, zero-coupon municipal obligations and non-appropriation or other municipal lease obligations. Previously, the Fund had the ability to invest up to 30% of its assets in non-publicly traded securities, up to 25% of its total assets in zero-coupon municipal obligations and no more than 10% of its assets in non-appropriation municipal lease obligations, although it could invest without limit in other municipal lease obligations.

Additionally, the Board of Directors approved a change to a non-fundamental investment policy that permits the Fund to invest in municipal obligations of any maturity. Previously, the Fund had indicated that it would generally invest in long-term municipal bonds and that it expected the weighted average maturity of its portfolio to exceed ten years.

Under the Fund s amended non-fundamental investment policies, the Fund may, under normal market conditions, invest in non-publicly traded municipal securities. The manager believes that non-publicly traded securities, which may be considered speculative, often provide attractive high yields. The sale of securities that are not traded publicly is typically restricted under the federal securities laws. As a result, the Fund may be forced to sell these securities at less than fair market value or may not be able to sell them at all when the manager believes it desirable to do so. Should the Fund desire to sell any of these securities when a ready buyer is not available at a price the Fund deems representative of their value, the value of the Fund s net assets could be adversely affected.

Under the Fund s amended non-fundamental investment policies, the Fund may, under normal market conditions, also invest in zero-coupon municipal obligations. Zero-coupon municipal obligations are debt obligations that do not entitle the holder to any periodic payments prior to maturity and are issued and traded at a discount from their face amounts. The discount varies depending on the time remaining until maturity, prevailing interest rates, liquidity of the security and perceived credit quality of the issuer. Zero-coupon municipal obligations may be created by investment banks under proprietary programs in which they strip the interest component from the principal component and sell both separately. The market prices of zero-coupon securities are generally more volatile than the market prices of securities that pay interest periodically and are likely to respond to changes in interest rates to a greater degree than do securities having similar maturities and credit quality that do pay periodic interest.

In addition, under the Fund s amended non-fundamental investment policies, the Fund may, under normal market conditions, invest in participations in lease obligations or installment purchase contract obligations of municipal authorities or entities that contain non-appropriation clauses (non-appropriation municipal lease obligations). Although lease obligations do not constitute general obligations of the municipality for which the municipality s taxing power is pledged, a lease obligation is ordinarily backed by the municipality s covenant to budget for, appropriate and make the payments due under the lease obligation. However, certain lease obligations contain non-appropriation clauses, which provide that the municipality has no obligation to make lease or installment purchase payments in future years unless money is appropriated for such purpose on a yearly basis. In addition to the non-appropriation risk, these securities represent a relatively new type of financing that has not yet developed the depth of marketability associated with more conventional securities. Although non-appropriation lease obligations are secured by the leased property, disposition of the property in the event of foreclosure might prove difficult. In addition, the tax treatment of such obligations in the event of non-appropriation is unclear.

Information About Your Fund

Important information with regard to recent regulatory developments that may affect the Fund is contained in the Notes to Financial Statements included in this report.

As always, thank you for your confidence in our stewardship of your assets. We look forward to helping you meet your financial goals.

Sincerely,

R. Jay Gerken, CFA
Chairman, President and Chief Executive Officer

November 30, 2007

All index performance reflects no deduction for fees, expenses or taxes. Please note that an investor cannot invest directly in an index.

i Gross domestic product (GDP) is the market value of all final goods and services produced within a country in a given period of time.

ii The Federal Reserve Board (Fed) is responsible for the formulation of policies designed to promote economic growth, full employment, stable prices, and a sustainable pattern of international trade and payments.

iii The federal funds rate is the rate charged by one depository institution on an overnight sale of immediately available funds (balances at the Federal Reserve) to another depository institution; the rate may vary from depository institution to depository institution and from day to day.

iv The Lehman Brothers Municipal Bond Index is a market value weighted index of investment grade municipal bonds with maturities of one year or more.

v The Lehman Brothers U.S. Aggregate Index is a broad-based bond index comprised of government, corporate, mortgage- and asset-backed issues, rated investment grade or higher, and having at least one year to maturity.

Fund Overview

Q. What were the overall market conditions during the Fund s reporting period?

A. During the fiscal year, the bond market experienced periods of increased volatility. Changing perceptions regarding the economy, inflation and future Federal Reserve Board (Fed)[i] monetary policy caused bond prices to fluctuate. Two- and 10-year Treasury yields began the reporting period at 4.71% and 4.61%, respectively. This inversion of the yield curve[ii], when shorter-term yields eclipse their longer-term counterparts, has often been a precursor to weaker economic growth. However, after tepid gross domestic product (GDP)[iii] growth in the first quarter of 2007, the economy rebounded, inflationary pressures increased and both short- and long-term Treasury yields moved sharply higher. By mid-June, two- and 10-year Treasurys were yielding 5.10% and 5.26%, respectively, and market sentiment was that the Fed s next move would be to raise interest rates.

After their June 2007 peaks, Treasury yields then moved sharply lower, as concerns regarding the subprime mortgage market and a severe credit crunch triggered a massive flight to quality. During this time, investors were drawn to the relative safety of Treasurys, causing their prices to rise. At the same time, increased risk aversion caused other segments of the bond market to falter. As conditions in the credit market worsened in August 2007, central banks around the world took action by injecting approximately $500 billion of liquidity into the financial system. Additionally, the Fed aggressively lowered the discount rate[iv] and then the federal funds rate[v] toward the end of the reporting period. These actions appeared to lessen the credit crunch and supported the overall bond market. By October 2007, the volatility in the bond market was less extreme and, at the end of the fiscal year, two- and 10-year Treasury yields were 3.94% and 4.48%, respectively.

The municipal bond market also experienced periods of volatility and lagged its taxable bond counterparts during the fiscal year. All told, the overall municipal market, as measured by the Lehman Brothers Municipal Bond Index[vi], returned 2.91% during the one-year period ended October 31, 2007. In contrast, over the same period, the overall taxable bond market, as measured by the Lehman Brothers U.S. Aggregate Index[vii], returned 5.38%.

Performance Review

For the 12 months ended October 31, 2007, Western Asset Municipal High Income Fund Inc. returned 5.40% based on its net asset value (NAV)[viii] and 4.06% based on its New York Stock Exchange (NYSE) market price per share. In comparison, the Fund s unmanaged benchmark, the Lehman Brothers Municipal Bond Index, returned 2.91% and its Lipper High Yield Municipal Debt Closed-End Funds Category Average[ix] increased 1.44% over the same time frame. Please note that Lipper performance returns are based on each fund s NAV.

Certain investors may be subject to the federal alternative minimum tax, and state and local taxes will apply. Capital gains, if any, are fully taxable. Please consult your personal tax or legal adviser.

During the 12-month period, the Fund made distributions to shareholders totaling $0.408 per share. The performance table shows the Fund s 12-month total return based on its NAV and market price as of October 31, 2007. **Past performance is no guarantee of future results.**

Performance Snapshot as of October 31, 2007 (unaudited)

Price Per Share	**12-Month Total Return**
$8.23 (NAV)	5.40%
$7.75 (Market Price)	4.06%

All figures represent past performance and are not a guarantee of future results.

Total returns are based on changes in NAV or market price, respectively. Total returns assume the reinvestment of all distributions in additional shares.

Q. What were the most significant factors affecting Fund performance?

What were the leading contributors to performance?

A. The Fund s duration[x] was managed tactically during the reporting period and was adjusted given changing market conditions. Overall, this contributed to performance, especially in the spring of 2007 when interest rates were on the rise.

At the start of the reporting period, the Fund s duration was 5.8 years. We then moved to a more defensive position by lowering its duration to 4.2 years during the second quarter of 2007. The Fund s duration was again adjusted given changing market conditions, and it ended the fiscal year at 5.6 years. It is important to note that, at the end of the period, the Fund s duration was significantly shorter than its benchmark and peer group. While the adjustments to the Fund s duration were not always optimal, they were, on balance, additive to performance.

To provide further insight regarding the changes to the Fund s duration, our view had been that U.S. economic growth would moderate and experience a soft landing. This led us to believe that the yield on 10-year Treasury bonds would range roughly between 4.25% and 4.75%, as data indicating progress toward the soft landing emerged. When yields were near the top of this range, we generally preferred to have a longer duration, as we felt that rates were likely to decline from that level. In contrast, when yields were at the low end of the range, our preference was to shorten duration, as we felt that yields were more likely to rise. Our view regarding yields was also impacted by the relationship between the yields of municipal securities and their Treasury counterparts.

However, as the issues related to the subprime mortgage crisis emerged in the summer of 2007, Treasury yields were primarily driven by an investor flight to quality rather than economic fundamentals. As such, our trading range scenario became largely irrelevant. During the flight to quality, the Fund s use of hedging activities was less important and our overweight to pre-refunded[xi] and high-quality issues became the dominant contributor to performance.

Overall, active management of the Fund s duration was more important in the first half of the fiscal year, while our overweight to high-quality securities was, on balance, more important in the second half of the reporting period.

What were the leading detractors from performance?

A. During the first half of the fiscal year, the Fund s underweight, relative to its benchmark, to lower-quality securities was a slight detractor from performance. In addition, during the first half of the reporting period, the Fund s short duration position subtracted somewhat from results.

Q. Were there any significant changes to the Fund during the reporting period?

A. Although there were no significant changes to the Fund s positioning over the period, there were changes to the non-fundamental investment policies as described in the Letter from the Chairman. These changes, noted under the Special Shareholder Notices, are intended to provide the portfolio managers with additional flexibility to meet the Fund s objectives. The request for authority to use derivatives was intended to give the manager another tool to transact in the most efficient manner available. To date, the manager has not exercised this authority.

Looking for Additional Information?

The Fund is traded under the symbol MHF and its closing market price is available in most newspapers under the NYSE listings. The daily NAV is available on-line under the symbol XMHFX on most financial websites. *Barron s* and *The Wall Street Journal s* Monday edition both carry closed-end fund tables that provide additional information. In addition, the Fund issues a quarterly press release that can be found on most major financial websites as well, as www.leggmason.com/individualinvestors.

In a continuing effort to provide information concerning the Fund, shareholders may call 1-888-777-0102 (toll free), Monday through Friday from 8:00 a.m. to 6:00 p.m. Eastern Time, for the Fund s current NAV, market price and other information.

Thank you for your investment in Western Asset Municipal High Income Fund Inc. As always, we appreciate that you have chosen us to manage your assets and we remain focused on achieving the Fund s investment goals.

Sincerely,

Western Asset Management Company

November 20, 2007

The information provided is not intended to be a forecast of future events, a guarantee of future results or investment advice. Views expressed may differ from those of the firm as a whole.

RISKS: The Fund may use derivatives, such as options and futures, which can be illiquid, may disproportionately increase losses, and have a potentially large impact on Fund performance. High-yield bonds involve greater credit and liquidity risks than investment grade bonds. As interest rates rise, bond prices fall, reducing the value of the Fund s share price. Certain investors may be subject to the federal alternative minimum tax (AMT), and state and local taxes will apply. Capital gains, if any, are fully taxable.

All index performance reflects no deduction for fees, expenses or taxes. Please note that an investor cannot invest directly in an index.

i The Federal Reserve Board (Fed) is responsible for the formulation of policies designed to promote economic growth, full employment, stable prices, and a sustainable pattern of international trade and payments.

ii The yield curve is the graphical depiction of the relationship between the yield on bonds of the same credit quality but different maturities.

iii Gross domestic product (GDP) is the market value of all final goods and services produced within a country in a given period of time.

iv The discount rate is the interest rate charged by the U.S. Federal Reserve Bank on short-term loans (usually overnight or weekend) to banks.

v The federal funds rate is the rate charged by one depository institution on an overnight sale of immediately available funds (balances at the Federal Reserve) to another depository institution; the rate may vary from depository institution to depository institution and from day to day.

vi The Lehman Brothers Municipal Bond Index is a market value weighted index of investment grade municipal bonds with maturities of one year or more.

vii The Lehman Brothers U.S. Aggregate Index is a broad-based bond index comprised of government, corporate, mortgage- and asset-backed issues, rated investment grade or higher, and having at least one year to maturity.

viii NAV is calculated by subtracting total liabilities and outstanding preferred stock(if any) from the closing value of all securities held by the Fund (plus all other assets) and dividing the result (total net assets) by the total number of the common shares outstanding. The NAV fluctuates with changes in the market prices of securities in which the Fund has invested. However, the price at which an investor may buy or sell shares of the Fund is at the Fund s market price as determined by supply of and demand for the Fund s shares.

ix Lipper, Inc. is a major independent mutual-fund tracking organization. Returns are based on the 12-month period ended October 31, 2007, including the reinvestment of all distributions, including returns of capital, if any, calculated among the 15 funds in the Fund s Lipper category.

x Duration is the measure of the price sensitivity of a fixed-income security to an interest rate change of 100 basis points. Calculation is based on the weighted average of the present values for all cash flows.

xi A refunded bond is a bond in which the original security has been replaced by an escrow, usually consisting of treasurys or agencies, which has been structured to pay principal, interest and any call premium, either to a call date (in the case of a pre-refunded bond), or to maturity (in the case of an escrowed to maturity bond). This is accomplished with the proceeds of a refunding issue. Once refunded, a bond takes on the credit quality of the securities held in the escrow. Bonds are commonly refunded to achieve savings when interest rates decline, though sometimes issuers refund a bond to relieve themselves of legal covenants in the refunded issue which they feel have become too restrictive.

Fund at a Glance (unaudited)

Investment Breakdown

As a Percent of Total Investments

Schedule of Investments (October 31, 2007)

WESTERN ASSET MUNICIPAL HIGH INCOME FUND INC.

Face Amount	Security	Value
MUNICIPAL BONDS 94.0%		
Alaska 0.6%		
$ 1,055,000	Alaska Industrial Development & Export Authority Revenue, Williams Lynxs Alaska Cargoport, 8.125% due 5/1/31 (a)	$ 1,136,847
Arizona 2.0%		
1,500,000	Casa Grande, AZ, IDA, Hospital Revenue, Casa Grande Regional Medical Center, 7.625% due 12/1/29	1,592,985
1,740,000	Phoenix, AZ, IDA, MFH Revenue, Ventana Palms Apartments Project, 8.000% due 10/1/34	1,918,002
	Total Arizona	3,510,987
Arkansas 1.0%		
	Arkansas State Development Financing Authority:	
1,000,000	Hospital Revenue, Washington Regional Medical Center, 7.375% due 2/1/29 (c)	1,080,870
600,000	Industrial Facilities Revenue, Potlatch Corp. Projects, 7.750% due 8/1/25 (a)	662,508
	Total Arkansas	1,743,378
California 7.0%		
1,500,000	Barona, CA, Band of Mission Indians, GO, 8.250% due 12/1/20 (d)	1,533,390
2,000,000	California Health Facilities Financing Authority Revenue, Refunding, Cedars-Sinai Medical Center, 5.000% due 11/15/27 (e)	2,023,700
2,500,000	California State, GO, Various Purpose, 5.000% due 9/1/35 (e)	2,535,450
	Golden State Tobacco Securitization Corp., California Tobacco Settlement Revenue:	
2,000,000	Asset Backed, 7.800% due 6/1/42 (c)(e)	2,418,360
1,000,000	Enhanced Asset Backed, 5.625% due 6/1/38 (c)	1,100,330
600,000	Redding, CA, Redevelopment Agency, Tax Allocation, Shastec Redevelopment Project, 5.000% due 9/1/29	602,022
1,865,000	Vallejo, CA, COP, Touro University, 7.375% due 6/1/29	1,926,918
	Total California	12,140,170
Colorado 3.0%		
500,000	Beacon Point Metropolitan District, GO, 6.250% due 12/1/35	507,560
	Colorado Educational & Cultural Facilities Authority Revenue:	
760,000	Charter School, Peak to Peak Project, 7.500% due 8/15/21 (c)	846,989
785,000	Elbert County Charter, 7.375% due 3/1/35	830,444
810,000	Unrefunded, University of Denver Project, FGIC, 5.250% due 3/1/23	875,667
500,000	High Plains, CO, Metropolitan District, GO, 6.250% due 12/1/35	457,580
1,000,000	Reata South Metropolitan District, CO, GO, 7.250% due 6/1/37	1,019,950
500,000	Southlands, CO, Metropolitan District No. 1, GO, 7.125% due 12/1/34 (c)	604,650
	Total Colorado	5,142,840

See Notes to Financial Statements.

Schedule of Investments (October 31, 2007) (continued)

Face Amount		Security		Value
District of Columbia 1.2%				
$	1,895,000	District of Columbia COP, District Public Safety & Emergency, AMBAC, 5.500% due 1/1/20 (e)	$	2,031,535
Florida 9.8%				
	955,000	Beacon Lakes, FL, Community Development District, Special Assessment, 6.900% due 5/1/35		1,003,409
	1,500,000	Bonnet Creek Resort Community Development District, Special Assessment, 7.500% due 5/1/34		1,592,400
	2,000,000	Capital Projects Finance Authority, FL, Continuing Care Retirement Glenridge on Palmer Ranch, 8.000% due 6/1/32 (c)(e)		2,378,120
	2,000,000	Capital Projects Finance Authority, FL, Student Housing Revenue, Capital Projects Loan Program, Florida University, 7.850% due 8/15/31 (c)(e)		2,283,860
	935,000	Century Parc Community Development District, Special Assessment, 7.000% due 11/1/31		960,254
	1,000,000	Highlands County, FL, Health Facilities Authority Revenue, Adventist Health Systems, 6.000% due 11/15/25 (c)		1,108,980
	2,000,000	Martin County, FL, IDA Revenue, Indiantown Cogeneration Project, 7.875% due 12/15/25 (a)		2,006,380
	1,000,000	Orange County, FL, Health Facilities Authority Revenue, First Mortgage, GF, Orlando Inc. Project, 9.000% due 7/1/31		1,104,470
	400,000	Palm Beach County, FL, Health Facilities Authority Revenue, John F. Kennedy Memorial Hospital Inc. Project, 9.500% due 8/1/13 (f)		470,048
	2,000,000	Reunion East Community Development District, Special Assessment, 7.375% due 5/1/33		2,137,820
	1,000,000	Santa Rosa, FL, Bay Bridge Authority Revenue, 6.250% due 7/1/28		979,470
	1,000,000	University of Central Florida, COP, FGIC, 5.000% due 10/1/25		1,034,260
		Total Florida		17,059,471
Georgia 3.5%				
		Atlanta, GA, Airport Revenue:		
	1,000,000	FGIC, 5.625% due 1/1/30 (a)		1,031,260
	1,000,000	FSA, 5.000% due 1/1/26		1,028,390
	2,500,000	Atlanta, GA, Tax Allocation, Atlantic Station Project, 7.900% due 12/1/24 (c)(e)		2,938,850
	1,000,000	Gainesville & Hall County, GA, Development Authority Revenue, Senior Living Facilities, Lanier Village Estates, 7.250% due 11/15/29		1,062,950
		Total Georgia		6,061,450
Illinois 1.8%				
	2,000,000			2,119,040

	Chicago, IL, GO, Neighborhoods Alive 21 Program, FGIC, 5.500% due 1/1/31 (c)(e)	
1,000,000	Illinois Finance Authority Revenue, Refunding, Chicago Charter School Project, 5.000% due 12/1/26	964,230
	Total Illinois	3,083,270

See Notes to Financial Statements.

Schedule of Investments (October 31, 2007) (continued)

	Face Amount	Security		Value
Indiana 0.5%				
		County of St Joseph, IN, EDR, Holy Cross Village Notre Dame Project:		
$	285,000	6.000% due 5/15/26	$	291,652
	550,000	6.000% due 5/15/38		559,867
		Total Indiana		851,519
Kansas 0.7%				
	1,150,000	Salina, KS, Hospital Revenue, Refunding & Improvement Salina Regional Health, 5.000% due 10/1/22		1,186,570
Kentucky 1.2%				
	2,000,000	Louisville & Jefferson County, KY, Metro Government Health System Revenue, Norton Healthcare Inc., 5.250% due 10/1/36		2,016,880
Louisiana 0.6%				
	1,000,000	Epps, LA, COP, 8.000% due 6/1/18		1,023,200
Maryland 1.5%				
	1,500,000	Maryland State Economic Development Corp. Revenue, Chesapeake Bay, 7.730% due 12/1/27 (c)		1,641,255
	1,000,000	Maryland State Health & Higher EFA Revenue, Refunding, Edenwald, 5.400% due 1/1/31		980,500
		Total Maryland		2,621,755
Massachusetts 3.2%				
	915,000	Boston, MA, Industrial Development Financing Authority Revenue, Roundhouse Hospitality LLC Project, 7.875% due 3/1/25 (a)		905,063
	1,000,000	Massachusetts State DFA Revenue, Briarwood, 8.250% due 12/1/30 (c)		1,145,220
	1,000,000	Massachusetts State HEFA Revenue, Caritas Christi Obligation, 6.750% due 7/1/16		1,089,300
	1,830,000	Massachusetts State IFA Revenue, Assisted Living Facilities, Marina Bay LLC Project, 7.500% due 12/1/27 (a)(c)		1,888,450
	355,000	Massachusetts State Port Authority Revenue, 13.000% due 7/1/13 (f)		457,414
		Total Massachusetts		5,485,447
Michigan 6.9%				
	2,130,000	Allen Academy, COP, 7.500% due 6/1/23 (e)		2,137,114
		Cesar Chavez Academy, COP:		
	1,000,000	6.500% due 2/1/33		1,032,270
	1,000,000	8.000% due 2/1/33		1,106,160
	1,000,000	Gaudior Academy, COP, 7.250% due 4/1/34		1,016,860
	1,750,000	Kalamazoo Advantage Academy, COP, 8.000% due 12/1/33		1,869,928
	3,000,000	Michigan State Hospital Finance Authority, Refunding Hospital, Sparrow Obligated, 5.000% due 11/15/31 (e)		2,991,630
	1,000,000	Star International Academy, COP, 7.000% due 3/1/33		1,006,680
	700,000	William C. Abney Academy, COP, 6.750% due 7/1/19		726,621
		Total Michigan		11,887,263

See Notes to Financial Statements.

Schedule of Investments (October 31, 2007) (continued)

Face Amount		Security		Value
Mississippi 0.9%				
$	1,480,000	Jackson, MS, Public School District, FSA, 5.000% due 10/1/20	$	1,561,370
Missouri 0.8%				
	1,300,000	Missouri State HEFA Revenue, Refunding, St Lukes Episcopal, 5.000% due 12/1/21		1,326,559
Montana 1.4%				
	2,450,000	Montana State Board of Investment, Resource Recovery Revenue, Yellowstone Energy LP Project, 7.000% due 12/31/19 (a)		2,456,370
New Hampshire 0.9%				
	1,600,000	New Hampshire HEFA Revenue, Covenant Health System, 5.500% due 7/1/34		1,653,856
New Jersey 10.5%				
	1,500,000	Casino Reinvestment Development Authority Revenue, MBIA, 5.250% due 6/1/20		1,620,390
	1,000,000	New Jersey EDA, Retirement Community Revenue, SeaBrook Village Inc., 8.250% due 11/15/30 (c)		1,143,390
	5,000,000	New Jersey EDA Revenue, Refunding, 6.875% due 1/1/37 (a)		5,278,050
		New Jersey Health Care Facilities Financing Authority Revenue, Trinitas Hospital Obligation Group:		
	5,000,000	5.250% due 7/1/30		4,838,850
	3,000,000	7.500% due 7/1/30 (c)		3,330,570
	1,750,000	Tobacco Settlement Financing Corp., 6.750% due 6/1/39 (c)		2,019,343
		Total New Jersey		18,230,593
New Mexico 1.3%				
	160,000	Albuquerque, NM, Hospital Revenue, Southwest Community Health Services, 10.000% due 8/1/12 (c)		167,552
	1,000,000	Otero County, NM, Jail Project Revenue, 7.500% due 12/1/24		1,079,830
	1,000,000	Sandoval County, NM, Incentive Payment Revenue, Refunding, 5.000% due 6/1/20		1,044,800
		Total New Mexico		2,292,182
New York 9.0%				
	700,000	Brookhaven, NY, IDA Civic Facilities Revenue, Memorial Hospital Medical Center Inc., 8.250% due 11/15/30 (c)		801,899
	2,000,000	Metropolitan Transportation Authority of New York, AMBAC, 5.000% due 7/1/30		2,061,800
	1,000,000	Monroe County, NY, IDA, Civic Facilities Revenue, Woodland Village Project, 8.550% due 11/15/32 (c)		1,164,710
		New York City, NY, IDA, Civic Facilities Revenue:		
	1,290,000	Community Residence for the Developmentally Disabled Project, 7.500% due 8/1/26		1,309,853
	860,000	Special Needs Facilities Pooled Program, 8.125% due 7/1/19 (c)		952,372
	1,000,000	New York City, NY, Municipal Water Finance Authority, Water & Sewer System Revenue, MBIA, 5.000% due 6/15/27		1,046,310
		New York State Dormitory Authority Revenue:		
	2,090,000	Cornell University, 5.000% due 7/1/21		2,217,971
	1,500,000			1,549,770

Mental Health Services Facilities Improvement, AMBAC, 5.000%
due 2/15/35

See Notes to Financial Statements.

Schedule of Investments (October 31, 2007) (continued)

Face Amount		Security		Value
New York 9.0% (continued)				
$	2,500,000	New York University Hospitals Center, 5.000% due 7/1/26	$	2,469,975
		Suffolk County, NY, IDA:		
		Civic Facilities Revenue, Eastern Long Island Hospital Association,		
	910,000	7.750% due 1/1/22 (c)		1,035,826
	1,000,000	Continuing Care Retirement Revenue, Refunding, Jeffersons Ferry Project,		
		5.000% due 11/1/28		941,750
		Total New York		15,552,236
North Carolina 0.6%				
	935,000	North Carolina Medical Care Community, Health Care Facilities Revenue,		
		First Mortgage, DePaul Community Facilities Project, 7.625% due 11/1/29 (c)		1,019,010
Ohio 3.4%				
		Cuyahoga County, OH, Hospital Facilities Revenue, Canton Inc. Project,		
	1,500,000	7.500% due 1/1/30		1,592,115
	1,500,000	Miami County, OH, Hospital Facilities Revenue, Refunding and Improvement		
		Upper Valley Medical Center, 5.250% due 5/15/21		1,523,670
	1,500,000	Ohio State, Air Quality Development Authority Revenue, Cleveland Pollution		
		Control, 6.000% due 12/1/13		1,517,460
		Riversouth Authority, OH, Revenue, Riversouth Area Redevelopment,		
	1,260,000	5.000% due 12/1/25		1,316,952
		Total Ohio		5,950,197
Oregon 0.6%				
		Salem, OR, Hospital Facility Authority Revenue, Salem Hospital Project,		
	1,000,000	5.000% due 8/15/36		1,014,830
Pennsylvania 4.7%				
	1,000,000	Cumberland County, PA, Municipal Authority Retirement Community Revenue,		
		Wesley Affiliate Services Inc. Project, 7.250% due 1/1/35 (c)		1,169,850
	1,000,000	Lebanon County, PA, Health Facilities Authority Revenue, Good Samaritan		
		Hospital Project, 6.000% due 11/15/35		1,027,400
		Monroe County, PA, Hospital Authority Revenue, Pocono Medical Center,		
	1,000,000	5.000% due 1/1/27		971,130
	2,640,000	Montgomery County, PA, Higher Education & Health Authority Revenue,		
		Temple Continuing Care Center, 6.625% due 7/1/19 (g)(h)		633,600
	965,000	Northumberland County, PA, IDA Facilities Revenue, NHS Youth Services Inc.		
		Project, 7.500% due 2/15/29		1,005,935
	1,000,000	Philadelphia, PA, Authority for IDR, Host Marriot LP Project,		
		Remarketed 10/31/95, 7.750% due 12/1/17 (a)		1,000,690
	2,000,000			2,273,480

		Westmoreland County, PA, IDA Revenue, Health Care Facilities, Redstone Highlands Health, 8.125% due 11/15/30 (c)	
		Total Pennsylvania	8,082,085
Puerto Rico 1.2%			
	2,000,000	Puerto Rico Sales Tax Financing, Corp. Sales Tax Revenue, 5.250% due 8/1/57	2,075,520

See Notes to Financial Statements.

Schedule of Investments (October 31, 2007) (continued)

Face Amount	Security	Value
South Carolina 0.1%		
$ 210,000	McCormick County, SC, COP, 9.750% due 7/1/09	$ 211,483
Tennessee 2.0%		
1,000,000	Clarksville, TN, Natural Gas Acquisition Corp. Gas Revenue, 5.000% due 12/15/21	996,940
2,500,000	Shelby County, TN, Health Educational & Housing Facilities Board Revenue, Trezevant Manor Project, 5.750% due 9/1/37	2,500,800
	Total Tennessee	3,497,740
Texas 10.0%		
550,000	Bexar County, TX, Housing Financial Corp., MFH Revenue, Continental Lady Ester, 6.875% due 6/1/29 (c)	588,115
1,000,000	Garza County Public Facility Corp., 5.500% due 10/1/18	1,045,000
2,000,000	Gulf Coast of Texas, IDA, Solid Waste Disposal Revenue, CITGO Petroleum Corp. Project, 7.500% due 10/1/12 (a)(e)(i)	2,199,400
2,750,000	Houston, TX, Airport Systems Revenue, Special Facilities, Continental Airlines Inc. Project, 6.125% due 7/15/27 (a)	2,751,292
1,000,000	Laredo, TX, ISD Public Facility Corp. Lease Revenue, AMBAC, 5.000% due 8/1/29	1,021,790
1,000,000	Midlothian, TX, Development Authority, Tax Increment Contract Revenue, 6.200% due 11/15/29	1,045,380
1,000,000	North Texas Tollway Authority, Dallas North Tollway Systems Revenue, FSA, 5.000% due 1/1/35	1,027,160
1,500,000	Texas State Public Finance Authority, Uplift Education, 5.750% due 12/1/27	1,521,675
1,865,000	West Texas Detention Facility Corp. Revenue, 8.000% due 2/1/25	1,890,327
	Willacy County, TX:	
2,000,000	Local Government Corp. Revenue, 6.875% due 9/1/28	2,111,220
	PFC Project Revenue:	
1,000,000	8.250% due 12/1/23	1,023,740
1,000,000	County Jail, 7.500% due 11/1/25	1,046,740
	Total Texas	17,271,839
Virginia 1.5%		
415,000	Alexandria, VA, Redevelopment & Housing Authority, MFH Revenue, Parkwood Court Apartments Project, 8.125% due 4/1/30	429,674
1,000,000	Broad Street CDA Revenue, 7.500% due 6/1/33	1,095,450
1,000,000	Fairfax County, VA, EDA Revenue, Retirement Community, Greenspring Village, Inc., 7.500% due 10/1/29 (c)	1,092,770
	Total Virginia	2,617,894
Wisconsin 0.6%		
1,000,000	Wisconsin State HEFA Revenue, Aurora Health Care, 6.400% due 4/15/33	1,050,430
	TOTAL INVESTMENTS 94.0% (Cost $157,310,510#)	**162,846,776**
	Other Assets in Excess of Liabilities 6.0%	10,396,240
	TOTAL NET ASSETS 100.0%	**$ 173,243,016**

See Notes to Financial Statements.

Schedule of Investments (October 31, 2007) (continued)

(a) Income from this issue is considered a preference item for purposes of calculating the alternative minimum tax (AMT).

(b) Security is exempt from registration under Rule 144A of the Securities Act of 1933. This security may be resold in transactions that are exempt from registration, normally to qualified institutional buyers. This security has been deemed liquid pursuant to guidelines approved by the Board of Directors, unless otherwise noted.

(c) Pre-Refunded bonds are escrowed with government obligations and/or government agency securities and are considered by the Manager to be triple-A rated even if issuer has not applied for new ratings.

(d) All or a portion of this security is held at the broker as collateral for open futures contracts.

(e) All or a portion of this security is segregated for open futures contracts.

(f) Bonds are escrowed to maturity by government securities and/or U.S. government agency securities and are considered by the manager to be triple-A rated even if issuer has not applied for new ratings.

(g) Security is currently in default.

(h) Security is valued in good faith at fair value by or under the direction of the Board of Directors (See Note 1).

(i) Variable rate security. Interest rate disclosed is that which is in effect at October 31, 2007.

Aggregate cost for federal income tax purposes is $157,233,145.

Abbreviations used in this schedule:

AMBAC	Ambac Assurance Corporation - Insured Bonds
CDA	Community Development Authority
COP	Certificate of Participation
DFA	Development Finance Agency
EDA	Economic Development Authority
EDR	Economic Development Revenue
EFA	Educational Facilities Authority
FGIC	Financial Guaranty Insurance Company - Insured Bonds
FSA	Financial Security Assurance - Insured Bonds
GO	General Obligation
HEFA	Health & Educational Facilities Authority
IDA	Industrial Development Authority
IDR	Industrial Development Revenue
IFA	Industrial Finance Agency
ISD	Independent School District
MBIA	Municipal Bond Investors Assurance Corporation - Insured Bonds
MFH	Multi-Family Housing
PFC	Public Facilities Corporation

Summary of Investments by Industry*

Pre-Refunded/Escrowed to Maturity	24.1%
Hospitals	23.9
Leasing	14.8
Industrial Development	9.2
Special Tax	7.3
Local General Obligations	4.0
Transportation	3.8
Resource Recovery	2.9
Education	2.5
Other Revenue	2.1
Electric	1.8
State General Obligations	1.6
Housing	1.4
Water & Sewer	0.6
	100.0%

* As a percentage of total investments. Please note that Fund holdings are as of October 31, 2007 and are subject to change.

See Notes to Financial Statements.

Schedule of Investments (October 31, 2007) (continued)

Ratings Table (unaudited)

S&P/Moody s/Fitch	
AAA/Aaa	22.2%
AA/Aa	3.2
A	13.2
BBB/Baa	15.9
BB/Ba	3.9
B/B	2.3
NR	39.3
	100.0%

As a percentage of total investments.

S&P primary rating; Moody s secondary, then Fitch.

See pages 14 and 15 for definitions of ratings.

See Notes to Financial Statements.

Bond Ratings (unaudited)

The definitions of the applicable rating symbols are set forth below:

Standard & Poor s Ratings Service (Standard & Poor s) Ratings from AA to CCC may be modified by the addition of a plus (+) or minus ( ) sign to show relative standings within the major rating categories.

AAA	Bonds rated AAA have the highest rating assigned by Standard & Poor s. Capacity to pay interest and repay principal is extremely strong.
AA	Bonds rated AA have a very strong capacity to pay interest and repay principal and differ from the highest rated issues only in a small degree.
A	Bonds rated A have a strong capacity to pay interest and repay principal although they are somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than debt in higher rated categories.
BBB	Bonds rated BBB are regarded as having an adequate capacity to pay interest and repay principal. Whereas they normally exhibit adequate protection parameters, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity to pay interest and repay principal for bonds in this category than in higher rated categories.
BB, B, CCC, CC and C	Bonds rated BB , B , CCC , CC and C are regarded, on balance, as predominantly specula with respect to capacity to pay interest and repay principal in accordance with the terms of the obligation. BB represents the lowest degree of speculation and C the highest degree of speculation. While such bonds will likely have some quality and protective characteristics, these are outweighed by large uncertainties or major risk exposures to adverse conditions.
D	Bonds rated D are in default and payment of interest and/or repayment of principal is in arrears.

Moody s Investors Service (Moody s) Numerical modifiers 1, 2 and 3 may be applied to each generic rating from Aa to Caa, where 1 is the highest and 3 the lowest ranking within its generic category.

Aaa	Bonds rated Aaa are judged to be of the best quality. They carry the smallest degree of investment risk and are generally referred to as gilt edge. Interest payments are protected by a large or by an exceptionally stable margin and principal is secure. While the various protective elements are likely to change, such changes can be visualized as most unlikely to impair the fundamentally strong position of such issues.
Aa	Bonds rated Aa are judged to be of high quality by all standards. Together with the Aaa group they comprise what are generally known as high grade bonds. They are rated lower than the best bonds because margins of protection may not be as large as in Aaa securities or fluctuation of protective elements may be of greater amplitude or there may be other elements present which make the long-term risks appear somewhat larger than in Aaa securities.
A	Bonds rated A possess many favorable investment attributes and are to be considered as upper medium grade obligations. Factors giving security to principal and interest are considered adequate but elements may be present which suggest a susceptibility to impairment some time in the future.
Baa	Bonds rated Baa are considered as medium grade obligations, i.e., they are neither highly protected nor poorly secured. Interest payments and principal security appear adequate for the present but certain protective elements may be lacking or may be characteristically unreliable over any great length of time. Such bonds lack outstanding investment characteristics and in fact have speculative characteristics as well.
Ba	

	Bonds rated Ba are judged to have speculative elements; their future cannot be considered as well assured. Often the protection of interest and principal payments may be very moderate and therefore not well safeguarded during both good and bad times over the future. Uncertainty of position characterizes bonds in this class.
B	Bonds rated B generally lack characteristics of desirable investments. Assurance of interest and principal payments or of maintenance of other terms of the contract over any long period of time may be small.
Caa	Bonds rated Caa are of poor standing. These may be in default, or present elements of danger may exist with respect to principal or interest.

Bond Ratings (unaudited) (continued)

Ca	Bonds rated Ca represent obligations which are speculative in a high degree. Such issues are often in default or have other marked short-comings.
C	Bonds rated C are the lowest class of bonds and issues so rated can be regarded as having extremely poor prospects of ever attaining any real investment standing.

Fitch Ratings Service (Fitch) Ratings from AA to CCC may be modified by the addition of a plus (+) or minus ( ) sign to show relative standings within the major rating categories.

AAA	Bonds rated AAA have the highest rating assigned by Fitch. Capacity to pay interest and repay principal is extremely strong.
AA	Bonds rated AA have a very strong capacity to pay interest and repay principal and differ from the highest rated issues only in a small degree.
A	Bonds rated A have a strong capacity to pay interest and repay principal although they are somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than debt in higher rated categories.
BBB	Bonds rated BBB are regarded as having an adequate capacity to pay interest and repay principal. Whereas they normally exhibit adequate protection parameters, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity to pay interest and repay principal for bonds in this category than in higher rated categories.
BB, B, CCC and CC	Bonds rated BB , B , CCC and CC are regarded, on balance, as predominantly speculative v respect to capacity to pay interest and repay principal in accordance with the terms of the obligation. BB represents a lower degree of speculation than B , and CC the highest degree of speculation. While such bonds will likely have some quality and protective characteristics, these are outweighed by large uncertainties or major risk exposures to adverse conditions.
NR	Indicates that the bond is not rated by Standard & Poor s, Moody s or Fitch.

Statement of Assets and Liabilities (October 31, 2007)

ASSETS:		
Investments, at value (Cost $157,310,510)	$	162,846,776
Cash		3,040,732
Receivable for securities sold		3,950,428
Interest receivable		3,477,978
Receivable from broker variation margin on open futures contracts		149,906
Prepaid expenses		6,724
Total Assets		**173,472,544**
LIABILITIES:		
Investment management fee payable		80,897
Directors fees payable		9,937
Distributions payable		246
Accrued expenses		138,448
Total Liabilities		**229,528**
Total Net Assets	**$**	**173,243,016**
NET ASSETS:		
Par value ($0.01 par value; 21,062,925 shares issued and outstanding; 500,000,000 shares authorized)	$	210,629
Paid-in capital in excess of par value		192,083,967
Undistributed net investment income		698,101
Accumulated net realized loss on investments and futures contracts		(25,233,589)
Net unrealized appreciation on investments and futures contracts		5,483,908
Total Net Assets	**$**	**173,243,016**
Shares Outstanding		**21,062,925**
Net Asset Value		**$ 8.23**

See Notes to Financial Statements.

Statement of Operations (For the year ended October 31, 2007)

INVESTMENT INCOME:	
Interest	**$ 10,247,438**
EXPENSES:	
Investment management fee (Note 2)	950,899
Directors fees	251,457
Legal fees	92,740
Shareholder reports	51,298
Audit and tax	43,331
Transfer agent fees	26,331
Stock exchange listing fees	21,305
Insurance	4,214
Custody fees	1,922
Miscellaneous expenses	12,739
Total Expenses	**1,456,236**
Less: Fee waivers and/or expense reimbursements (Note 2)	(95,677)
Net Expenses	**1,360,559**
Net Investment Income	**8,886,879**