

HYPERION STRATEGIC MORTGAGE INCOME FUND INC

Form N-CSRS

August 09, 2004

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 811-21102

THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.  
(Exact name of registrant as specified in charter)

ONE LIBERTY PLAZA, 165 BROADWAY, 36TH FLOOR  
NEW YORK, NEW YORK 10006-1404  
(Address of principal executive offices) (Zip code)

CLIFFORD E. LAI, PRESIDENT  
THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.  
ONE LIBERTY PLAZA, 165 BROADWAY, 36TH FLOOR  
NEW YORK, NEW YORK, 10006-1404  
(Name and address of agent for service)

Registrant's telephone number, including area code: 1 (800) Hyperion

Date of fiscal year end: November 30

Date of reporting period: May 31, 2004

Item 1. Reports to Shareholders.

[GRAPHIC OMITTED]

May 31, 2004

[GRAPHIC OMITTED]

-----  
THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.  
Report of the Investment Advisor  
For the Six Months Ended May 31, 2004  
-----

Dear Shareholder:

We welcome this opportunity to provide you with information about The Hyperion Strategic Mortgage Income Fund, Inc. (the "Fund"), for the semi-annual period ended May 31, 2004. The Fund is a closed-end bond fund whose shares are traded on the New York Stock Exchange ("NYSE") under the symbol "HSM."

#### Description of the Fund

The Fund is a diversified closed-end management investment company. The Fund's primary investment objective is to provide a high level of current income by investing primarily in mortgage-backed securities that offer an attractive combination of credit quality, yield and maturity. The Fund's secondary investment objective is to provide capital appreciation. Under normal market conditions, the Fund will invest at least 80% of its total assets in investment-grade Mortgage-Backed Securities ("MBS") including Agency MBS, Non-Agency Residential MBS ("RMBS"), Asset-Backed Securities ("ABS"), and Commercial MBS ("CMBS"), and may invest up to 20% of its total assets in U.S. Government securities, cash or other short-term instruments.

#### Performance

With the Federal Reserve Board's recent decisive change in posture regarding interest rates, the market prices of most fixed income bond funds dropped. Over the past six months, despite keeping the duration of the portfolio at the shorter end of its target, the Fund's return, based on market price, was (5.25)% for the six-month period ended May 31, 2004. The Fund's negative return, based on market price, resulted from the elimination of the premium between the market price of the Fund's shares and the shares' net asset value and the subsequent opening of a discount between the shares' market price and net asset value. At the beginning of the period, the Fund's shares traded at a premium of 1.8% over net asset value and at the end of the period the Fund's shares traded at a discount of 7.3% below net asset value. Based on the NYSE closing price of \$13.28 on May 31, 2004, the Fund had a yield of 9.76%.

As of May 31, 2004, the Fund, inclusive of the effect of leverage, was managed with an average duration (duration measures a bond portfolio's price sensitivity to interest rate changes) of 3.9 years, as measured on a net asset basis.

#### Market Environment

The economy is clearly performing well, such that the market's consensus view has changed and most economists believe that the Federal Reserve Board will raise interest rates several times in 2004 in 25 or 50 bps increments. The catalyst for this change in monetary policy has been the strong rebound in the employment reports, which shows the pace of job growth increasing over the last several months.

Interestingly, while the fixed income market is anticipating a 2.0% increase in the federal funds rate within about a year, those same "forward" indicators view

## Edgar Filing: HYPERION STRATEGIC MORTGAGE INCOME FUND INC - Form N-CSRS

the yield on the 10-year Treasury as being only about 50 bps higher in the same time frame. So the consensus in the market is that rates will be higher in the future, and that interest rates will rise more on shorter maturity assets than longer maturity assets. We are in agreement with both of these outlooks.

But while the outlook is for higher interest rates, there are some headwinds that could slow and maybe even arrest the trend. Higher oil prices, a slowing Chinese economy, and the potential for domestic terrorism could act to dampen the pace of economic growth. Currently, we do not believe that these threats are significant enough to deter rising interest rates.

---

THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.  
Report of the Investment Advisor  
For the Six Months Ended May 31, 2004

---

### Portfolio Strategy

The yield spreads for mortgage-related issues narrowed during the period, particularly in the ABS sector. With the recent increase in interest rates, we look for this trend to continue as the supply of ABS and MBS diminishes.

The Fund's allocation changed modestly over the period. On balance, the paydowns were reinvested into RMBS and mortgage-related ABS, in such a way as to maintain those exposures from an asset allocation point of view. The CMBS portfolio declined slightly, mostly due to their market value changes as interest rates increased. On a relative-value basis, CMBS yield spreads relative to other securities in the market appear overvalued; therefore we are cautious in adding to this sector.

The Fund continues to be managed very conservatively from a credit risk point of view. The AAA-rated exposure increased from 51% to 54% of total assets, versus a longer-term target of 40% of total assets. With the credit environment improving along with the strengthening economy, we expect to increase the allocation to lower rated issues over the next few months.

We remain fully leveraged to take advantage of the steepness in the yield curve, with much of the leverage being offset by floating rate assets. The Fund's duration has been running between 3.5 to 4.0 years, and we expect to maintain this duration range until longer-term interest rates appear attractive.

### Conclusion

We remain committed to the Fund and its shareholders. As always, we will continue to actively seek out investment opportunities in the market and act on them in a timely fashion in an effort to achieve the Fund's objectives. We welcome your questions and comments, and encourage you to contact our Shareholder Services Representatives at 1-800-HYPERION.

We appreciate the opportunity to serve your investment needs.

Sincerely,

/s/ Clifford E. Lai

Edgar Filing: HYPERION STRATEGIC MORTGAGE INCOME FUND INC - Form N-CSRS

CLIFFORD E. LAI  
 President,  
 The Hyperion Strategic Mortgage Income Fund, Inc.  
 President and Chief Executive Officer,  
 Hyperion Capital Management, Inc.

/s/ John H. Dolan

JOHN H. DOLAN  
 Vice President,  
 The Hyperion Strategic Mortgage Income Fund, Inc.  
 Chief Investment Officer,  
 Hyperion Capital Management, Inc.

-----  
 THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.  
 Portfolio of Investments -- (Unaudited)  
 May 31, 2004

	Interest Rate	Maturity
-----		
U.S. GOVERNMENT & AGENCY OBLIGATIONS -- 59.1%		
U.S. Government Agency Pass -Through Certificates -- 59.1%		
Federal Home Loan Mortgage Corporation		
Pool C68878.....	7.00%	06/01/32 \$
Pool C69047.....	7.00	06/01/32
Pool G01466.....	9.50	12/01/22
Pool 555538.....	10.00	03/01/21
Federal National Mortgage Association		
Pool 694391.....	5.50	03/01/33
Pool 753914.....	5.50	12/01/33
Pool 761836.....	6.00	06/01/33
Pool 754355.....	6.00	12/01/33
Pool 763643.....	6.00	01/01/34
Pool 323982.....	6.50	10/01/06
Pool 641575.....	7.00	04/01/32
Pool 645399.....	7.00	05/01/32
Pool 645466.....	7.00	05/01/32
Pool 626299.....	7.00	06/01/32
Pool 635095.....	7.00	06/01/32
Pool 650131.....	7.00	07/01/32
Pool 636449.....	8.50	04/01/32
Pool 458132.....	9.71	03/15/31

Total U.S. Government Agency Pass -Through Certificates

Edgar Filing: HYPERION STRATEGIC MORTGAGE INCOME FUND INC - Form N-CSRS

(Cost-- \$86,446,356).....

Total U.S. Government & Agency Obligations

(Cost-- \$86,446,356).....

ASSET-BACKED SECURITIES -- 22.3%

Housing Related Asset-Backed Securities -- 22.3%

Argent Securities, Inc.

Series 2004-W3, Class M5\*(a)..... 3.40+ 02/25/34

Asset Backed Funding Corp.

Series 2003-OPT1, Class M4(a)..... 3.90+ 07/25/32

Equity One ABS, Inc.

Series 2003-4, Class B2..... 5.85+ 11/25/33

First Franklin Mortgage Loan Asset Backed Certificates

Series 2004-FFH2C, Class B1\*(a)..... 0.00+ 06/25/34

Series 2004-FF4, Class M2(a)..... 2.35+ 06/25/34

Series 2003-FF4, Class M4(a)..... 4.00+ 10/25/33

Series 2003-FF1, Class M4(a)..... 4.10+ 03/25/33

Series 2003-FFH1, Class M4(a)..... 4.60+ 09/25/33

Series 2004-FFH1, Class B\*(a)..... 4.60+ 03/25/34

Series 2004-FF2, Class B\*(a)..... 4.60+ 03/25/34

Green Tree Financial Corp.

Series 1997-6, Class B1..... 7.17 01/15/29

Long Beach Mortgage Loan Trust

Series 2002-5, Class M3(a)..... 4.35+ 11/25/32

Series 2004-1, Class M9(a)..... 4.60+ 02/25/34

-----

See notes to financial statements.

-----  
THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.

Portfolio of Investments -- (Unaudited)

May 31, 2004

	Interest Rate	Maturity
-----		
ASSET-BACKED SECURITIES (continued)		
Structured Asset Investment Loan Trust		
Series 2003-BC8, Class M2(a).....	2.85+%	08/25/33 \$
Series 2004-2, Class B*(a).....	4.10+	03/25/34
Total Housing Related Asset-Backed Securities		
(Cost-- \$32,041,251).....		
Total Asset-Backed Securities		
(Cost-- \$32,041,251).....		

Edgar Filing: HYPERION STRATEGIC MORTGAGE INCOME FUND INC - Form N-CSRS

COMMERCIAL MORTGAGE BACKED SECURITIES -- 26.7%

Bear Stearns Commercial Mortgage Securities

Series 1999-C1, Class G*	5.64	02/14/31
Series 1999-C1, Class D	6.53	02/14/31
Series 2000-WF1, Class E	8.14+	02/15/32

GE Capital Commercial Mortgage Corp.

Series 2002-2A, Class G*	6.04	08/11/36
Series 2000-1, Class G*	6.13	01/15/33
Series 2002-2A, Class H*	6.31	08/11/36
Series 2000-1, Class E	7.44+	01/15/33

Government Lease Trust

Series 1999-C1A, Class B3*	4.00	05/18/11
----------------------------	------	----------

JP Morgan Chase Commercial Mortgage Securities

Series 2003-LN1, Class G*	5.65+	10/15/37
---------------------------	-------	----------

JP Morgan Commercial Mortgage Finance Corp.

Series 1999-C7, Class F*	6.00	10/15/35
--------------------------	------	----------

Morgan Stanley Capital I

Series 1999-WF1, Class E	7.19+	11/15/31
Series 1999-FNV1, Class E	7.71+	03/15/31

Morgan Stanley Dean Witter Capital I

Series 2001-TOP1, Class A4	6.66	02/15/33
----------------------------	------	----------

Nationslink Funding Corp.

Series 1998-2, Class E	7.11	08/20/30
------------------------	------	----------

UBS 400 Atlantic Street Mortgage Trust

Series 2002-C1A, Class B3*	7.19	01/11/22
----------------------------	------	----------

Total Commercial Mortgage Backed Securities

(Cost-- \$38,769,806)

NON-AGENCY RESIDENTIAL MORTGAGE BACKED SECURITIES-- 42.8%

Subordinated Collateralized Mortgage Obligations-- 42.8%

ABN AMRO Mortgage Corp.

Series 2002-7, Class B2	6.20+	09/25/32
-------------------------	-------	----------

Banc of America Alternative Loan Trust

Series 2004-3, Class 30B4	5.50	04/25/34
Series 2004-3, Class 30B5	5.50	04/25/34

-----  
See notes to financial statements.

THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.

Portfolio of Investments -- (Unaudited)

May 31, 2004

Interest

Edgar Filing: HYPERION STRATEGIC MORTGAGE INCOME FUND INC - Form N-CSRS

	Rate	Maturity
-----		
NON-AGENCY RESIDENTIAL MORTGAGE BACKED SECURITIES (continued)		
Banc of America Mortgage Securities, Inc		
Series 2004-A, Class B4.....	3.96+%	02/25/34 \$
Series 2002-H, Class B4.....	4.70+	08/25/32
Series 2002-H, Class B5.....	4.70+	08/25/32
Series 2002-H, Class B6.....	4.70+	08/25/32
Series 2002-I, Class B4.....	4.74+	08/25/32
Series 2002-10, Class 1B3.....	6.00	11/25/32
Series 2002-8, Class 1B1.....	6.25	08/25/32
Series 2002-8, Class 1B4*.....	6.25	08/25/32
Series 2002-8, Class 1B5*.....	6.25	08/25/32
Series 2002-8, Class 1B6*.....	6.25	08/25/32
Series 2002-9, Class 1B3.....	6.25	10/25/32
Series 2002-9, Class 1B4.....	6.25	10/25/32
Banc of America Mortgage Securities, Inc.		
Series 2003-10, Class 1B4.....	5.50	01/25/34
Cendant Mortgage Corp.		
Series 2002-4, Class B1.....	6.50	07/25/32
Series 2002-4, Class B2.....	6.50	07/25/32
Series 2002-4, Class B3.....	6.50	07/25/32
Series 2002-4, Class B4.....	6.50	07/25/32
Series 2002-4, Class B5.....	6.50	07/25/32
Series 2002-4, Class B6*.....	6.50	07/25/32
Citicorp Mortgage Securities, Inc.		
Series 2002-8, Class B1.....	6.07+	07/25/32
Series 2002-8, Class B2.....	6.07+	07/25/32
Series 2002-8, Class B3.....	6.07+	07/25/32
G3 Mortgage Reinsurance Ltd.		
Series 1, Class E*.....	21.10+	05/25/08
Master Asset Securitization Trus		
Series 2002-3, Class B6.....	6.25+	07/25/32
Residential Finance Limited Partnership		
Series 2002-A, Class B5*.....	3.45+	10/10/34
Series 2002-A, Class B7.....	6.80+	10/10/34
Residential Funding Mortgage Securities I, Inc.		
Series 2004-S1, Class B2.....	5.25	02/25/34
Series 2003-S7, Class B3.....	5.50	05/25/33
Series 2003-S7, Class B2.....	5.50	05/25/33
Series 2002-S10, Class B1*.....	6.50	07/25/32
Series 2002-S10, Class B2*.....	6.50	07/25/32
Series 2002-S10, Class B3*.....	6.50	07/25/32
Resix Finance Limited Credit-Linked Note		
Series 2004-B, Class B8*.....	5.85+	02/10/36
Series 2004-B, Class B9*.....	9.35+	02/10/36
Series 2004-A, Class B10*.....	12.60+	02/10/36

-----  
See notes to financial statements.

Edgar Filing: HYPERION STRATEGIC MORTGAGE INCOME FUND INC - Form N-CSRS

-----  
 THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.  
 Portfolio of Investments -- (Unaudited)  
 May 31, 2004

	Interest Rate	Maturity
-----		
NON-AGENCY RESIDENTIAL MORTGAGE BACKED SECURITIES (continued)		
Structured Asset Mortgage Investments, Inc.		
Series 2002-AR1, Class B4.....	4.29+%	03/25/32 \$
Washington Mutual Mortgage Securities Corp.		
Series 2002-AR12, Class B4.....	4.72+	10/25/32
Series 2002-AR12, Class B5.....	4.72+	10/25/32
Series 2002-AR12, Class B6.....	4.72+	10/25/32
Series 2002-AR10, Class B4*.....	5.01+	10/25/32
Series 2002-AR10, Class B5*.....	5.01+	10/25/32
Series 2002-AR10, Class B6*.....	5.01+	10/25/32
Series 2002-AR11, Class B5.....	5.16+	10/25/32
Series 2002-AR11, Class B6.....	5.16+	10/25/32

Wells Fargo Mortgage Backed Securities Trust

Series 2002, Class B5.....	6.00	06/25/32
Series 2002-15, Class B1.....	6.50	08/25/32
Series 2002-15, Class B4.....	6.50	08/25/32
Series 2002-15, Class B5.....	6.50	08/25/32
Series 2002-15, Class B6.....	6.50	08/25/32

Total Subordinated Collateralized Mortgage Obligations

(Cost-- \$59,228,734).....

Total Non-Agency Residential Mortgage Backed Securities

(Cost-- \$59,228,734).....

-----  
 SHORT TERM INVESTMENTS -- 0.7%

Short Term Investments -- 0.7%

Federal National Mortgage Association Discount Notes(b)

(Cost-- \$1,000,000).....	0.84	06/01/04
---------------------------	------	----------

Total Investments -- 151.6%

(Cost-- \$217,486,147).....

Liabilities in Excess of Other Assets-- (51.6)%.....

NET ASSETS-- 100.0%.....

SECURITIES SOLD SHORT

U.S. Government Agency Pass -Through Certificates

Federal National Mortgage Association TBA



Edgar Filing: HYPERION STRATEGIC MORTGAGE INCOME FUND INC - Form N-CSRS

(Proceeds-- \$4,967,641)..... 6.00 TBA

- @ -- Portion or entire principal amount delivered as collateral for reverse repurchase agreement
- + -- Variable Rate Security: Interest rate is the rate in effect May 31, 2004.
- \* -- Security exempt from registration under Rule 144A of the Securities Act of 1933. These securities may be resold in transactions exempt from registration, normally to qualified institutional investors.
- # -- Portion or entire principal amount is held as collateral for open futures contracts (N/A)
- (a) -- Security is a "step up" bond where coupon increases or steps up at a predetermined date. The coupons increase to LIBOR plus a predetermined margin.
- (b) -- Zero Coupon Note-- Interest rate represents current yield to maturity.
- TBA -- Settlement is on a delayed delivery or when-issued basis with a final maturity to be announced (TBA) in the future.

-----  
See notes to financial statements.

-----  
THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.  
Statement of Assets and Liabilities -- (Unaudited)  
May 31, 2004  
-----

Assets:

Investments in securities, at market (cost \$217,486,147) (Note 2).....  
Cash.....  
Receivable for investments sold.....  
Interest receivable.....  
Principal paydowns receivable.....  
Unrealized appreciation on swap contracts (Note 7).....  
Receivable for variation margin.....  
Prepaid expenses and other assets.....  
  
Total assets.....

Liabilities:

Reverse repurchase agreements (Note 5).....  
Interest payable for reverse repurchase agreements (Note 5).....  
Payable for investments purchased.....  
Securities sold short, at value (proceeds \$4,967,641) (Note 2).....  
Interest payable for securities sold short.....  
Investment advisory fee payable (Note 3).....  
Administration fee payable (Note 3).....  
Directors' fees payable.....  
Accrued expenses and other liabilities.....  
  
Total liabilities.....

Net Assets (equivalent to \$14.32 per share based on 10,142,600 shares issued and outstanding)...

Composition of Net Assets:

Capital stock, at par value (\$.01) (Note 6).....

Edgar Filing: HYPERION STRATEGIC MORTGAGE INCOME FUND INC - Form N-CSRS

Additional paid-in capital (Note 6).....  
Accumulated undistributed net investment income.....  
Accumulated net realized loss.....  
Net unrealized appreciation.....  
  
Net assets applicable to capital stock outstanding.....

-----  
See notes to financial statements.

-----  
THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.  
Statement of Operations -- (Unaudited)  
For the Six Months Ended May 31, 2004  
-----

Investment Income (Note 2):

Interest.....

Expenses:

Investment advisory fee (Note 3).....  
Administration fee (Note 3).....  
Insurance.....  
Auditing and tax services.....  
Reports to shareholders.....  
Custodian.....  
Directors' fees.....  
Legal.....  
Registration fees.....  
Transfer agency.....  
Miscellaneous.....

Total operating expenses.....

Interest expense on reverse repurchase agreements (Note 5).....

Total expenses.....

Net investment income.....

Realized and Unrealized Gain (Loss) on Investments (Notes 2 and 7):

Net realized gain (loss) on:

Investment transactions.....  
Short sales.....  
Futures transactions.....  
Swap contracts (loss).....

Net realized gain on investment transactions, short sales, futures transactions  
and swap contracts 434,640 Net change in unrealized appreciation/depreciation  
on:

Investments.....

Edgar Filing: HYPERION STRATEGIC MORTGAGE INCOME FUND INC - Form N-CSRS

Short sales.....	
Futures.....	
Swap contracts.....	
Net change in unrealized appreciation/depreciation on investments, short sales, futures and swap ..contracts.....	
Net realized and unrealized loss on investments, short sales, futures and swap contracts.....	
Net increase in net assets resulting from operations.....	

-----  
See notes to financial statements.

-----  
THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.  
Statements of Changes in Net Assets

	For the Six Months Ended May 31, 2004 (Unaudited)
Increase (Decrease) in Net Assets Resulting from Operations:	
Net investment income.....	\$ 5,800,283
Net realized gain(loss) on investment transactions, short sales, futures....	434,640
Net change in unrealized appreciation/depreciation on investments, short....	(622,775)
Net increase in net assets resulting from operations.....	5,612,148
Dividends to Shareholders (Note 2):	
Net investment income.....	(6,571,961)
Capital Stock Transactions (Note 6):	
Net asset value of shares issued through dividend reinvestment (1,380 and....	20,259
Net increase from capital stock transactions.....	20,259
Total increase (decrease) in net assets.....	(939,554)
Net Assets:	
Beginning of period.....	146,179,845

Edgar Filing: HYPERION STRATEGIC MORTGAGE INCOME FUND INC - Form N-CSRS

End of period (including undistributed net investment income of \$799,405 \$ 145,240,291  
 =====

-----

\* Certain amounts have been reclassified to conform to current year presentation. See Note 2--

-----

See notes to financial statements.

-----  
 THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.  
 Statement of Cash Flows -- (Unaudited)  
 For the Six Months Ended May 31, 2004  
 -----

Increase (Decrease) in Cash:		
Cash flows provided by (used for) operating activities:		
Interest received (including net accretion of \$158,119)	.....	\$
Interest expense paid	.....	
Operating expenses paid	.....	
Sales of short-term portfolio investments, net	.....	
Purchases of long-term portfolio investments	.....	
Proceeds from disposition of long-term portfolio investments and principal paydowns	....	
Proceeds from securities sold short	.....	
Net cash provided by futures transactions	.....	
Net cash used for operating activities	.....	---
Cash flows provided by (used for) financing activities:		
Net cash provided by reverse repurchase agreements	.....	
Cash dividends paid	.....	
Net cash provided by financing activities	.....	---
Net increase in cash	.....	
Cash at beginning of period	.....	
Cash at end of period	.....	\$ ===

## Edgar Filing: HYPERION STRATEGIC MORTGAGE INCOME FUND INC - Form N-CSRS

Reconciliation of Net Increase in Net Assets Resulting from Operations to Net Cash Provided by Operating Activities:

Net increase in net assets resulting from operations.....	\$	
Increase in investments, at cost.....		----
Net realized gain on investments.....		
Net accretion on investments.....		
Decrease in net unrealized appreciation/depreciation on investments and swaps.....		
Increase in interest receivable.....		
Increase in variation margin receivable.....		
Increase in other assets.....		
Decrease in payables and other liabilities.....		----
Total adjustments.....		----
Net cash used for operating activities.....	\$	====

Noncash financing activities not included herein consist of reinvestment of dividends and distrib

-----  
See notes to financial statements.

-----  
THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.  
Financial Highlights

	For the Six Months Ended May 31, 2004* (Unaudited)	For the Year Ended November 30, 2003*
-----		
Per Share Operating Performance:		
Net asset value, beginning of period.....	\$ 14.41	\$ 14.10
Net investment income.....	0.57	1.22
Net realized and unrealized gain (loss) on investments, short sales, futures transactions and swap contracts....	(0.01)	0.39
Net increase in net asset value resulting from operations.	0.56	1.61
Dividends from net investment income.....	(0.65)	(1.30)
Offering costs charged to additional paid-in-capital.....	--	--
Net asset value, end of period.....	\$ 14.32	\$ 14.41
Market price, end of period.....	\$ 13.2800	\$ 14.6700
	=====	=====

Edgar Filing: HYPERION STRATEGIC MORTGAGE INCOME FUND INC - Form N-CSRS

Total Investment Return+.....		(5.25)%(1)		17.55%
Ratios to Average Net Assets/Supplementary Data:				
Net assets, end of period (000's).....	\$	145,240	\$	146,180
Operating expenses.....		1.26%(2)		1.28%
Interest expense.....		0.43%(2)		0.51%
Total expenses.....		1.69%(2)		1.79%
Net expenses.....		1.69%(2)		1.79%
Net investment income.....		7.85%(2)		8.54%
Portfolio turnover rate.....		38%(1)		78%

+ Total investment return is calculated assuming a purchase of common stock at the current first day and a sale at the current market price on the last day of the period reported November 30, 2002, total investment return is based on a beginning period price of \$15. Total investment return for subsequent periods is computed based upon the New York Stock Exchange closing price of the Fund's shares. Dividends and distributions, if any, are assumed for purposes of reinvested at the prices obtained under the Fund's dividend reinvestment plan. Total investment return does not reflect brokerage commissions and is not annualized.

(1) Not Annualized

(2) Annualized

@ Commenced operations on July 26, 2002

\* As a result of recent changes in generally accepted accounting principles, the Fund's periodic payments made under interest rate swap agreements, previously included within net investment income, to components of realized and unrealized gain (loss) in the statement of operations. This reclassification was to reduce the interest expense and total expense ratios and increase net investment income ratio by 0.08% and increase net investment income per share by \$0.01 on realized and unrealized gains (losses) on investments, short sales, futures transactions and swap contracts per share by \$0.01 for the six months ended May 31, 2002. For consistency, similar reclassifications have been made to prior year amounts, resulting in a reduction to the interest expense and total expense ratios and an increase to the net investment income ratio of 0.36% and an increase to net investment income per share and a decrease to net realized and unrealized gains (losses) on investments, short sales, futures transactions and swap contracts per share by \$0.05 for the fiscal year ended November 30, 2002. This reclassification resulted in a decrease to the interest expense, total and net expense ratios and an increase to the net investment income ratio of 0.10% and an increase to net investment income per share of \$0.01 and a decrease to net realized and unrealized gains (losses) on investments, short sales, futures transactions and swap contracts per share of \$0.01 for the period ended November 30, 2002.

\*\* Initial public offering of \$15.00 per share less underwriting discount of \$0.75 per share

See notes to financial statements.

-----  
 THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.  
 Notes to Financial Statements -- (Unaudited)  
 May 31, 2004  
 -----

1. The Fund

The Hyperion Strategic Mortgage Income Fund, Inc. (the "Fund"), which was incorporated under the laws of the State of Maryland on May 17, 2002, is registered under the Investment Company Act of 1940 (the "1940 Act") as a diversified, closed-end management investment company. The Fund commenced operations on July 26, 2002. Prior to July 26, 2002, the Fund had no operations other than the sale of 7,018 shares for \$100,000 to Hyperion Capital Management, Inc. (the "Advisor").

The Fund's investment objective is to provide a high level of current income by investing primarily in mortgage-backed securities. No assurance can be given that the Fund's investment objective will be achieved.

2. Significant Accounting Policies

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Valuation of Investments: Where market quotations are readily available, securities held by the Fund are valued based upon the current bid price, except preferred stocks, which are valued based upon the closing price. Securities may be valued by independent pricing services that have been approved by the Board of Directors. The prices provided by a pricing service take into account broker dealer market price quotations for institutional size trading in similar groups of securities, security quality, maturity, coupon and other security characteristics as well as any developments related to the specific securities. The Fund values mortgage-backed securities ("MBS") and other debt securities for which market quotations are not readily available (approximately 22% of the investments in securities held by the Fund at May 31, 2004) at their fair value as determined in good faith, utilizing procedures approved by the Board of Directors of the Fund, on the basis of information provided by dealers in such securities. Some of the general factors which may be considered in determining fair value include the fundamental analytic data relating to the investment and an evaluation of the forces which influence the market in which these securities are purchased and sold. Determination of fair value involves subjective judgment, as the actual market value of a particular security can be established only by negotiations between the parties in a sales transaction. Debt securities having a remaining maturity of sixty days or less when purchased and debt securities originally purchased with maturities in excess of sixty days but which currently have maturities of sixty days or less are valued at amortized cost.

The ability of issuers of debt securities held by the Fund to meet their obligations may be affected by economic developments in a specific industry or region. The values of MBS can be significantly affected by changes in interest rates or in the financial condition of an issuer or market.

Options Written or Purchased: The Fund may write or purchase options as a method of hedging potential declines in similar underlying securities. When the Fund writes or purchases an option, an amount equal to the premium received or paid by the Fund is recorded as a liability or an asset and is subsequently adjusted to the current market value of the option written or purchased. Premiums received or paid from writing or purchasing options which expire unexercised are treated by the Fund on the expiration date as realized gains or losses. The difference between the premium and the amount paid or received on effecting a closing purchase or sale transaction, including brokerage commissions, also is treated as a realized gain or loss. If an option is exercised, the premium paid or received is added to the proceeds from the sale or cost of the purchase in determining whether the Fund has realized a gain or a loss on the investment transaction.

## Edgar Filing: HYPERION STRATEGIC MORTGAGE INCOME FUND INC - Form N-CSRS

May 31, 2004

---

The Fund, as writer of an option, may have no control over whether the underlying securities may be sold (call) or purchased (put) and as a result bears the market risk of an unfavorable change in the price of the security underlying the written option.

The Fund purchases or writes options to hedge against adverse market movements or fluctuations in value caused by changes in interest rates. The Fund bears the risk in purchasing an option, to the extent of the premium paid, that it will expire without being exercised. If this occurs, the option expires worthless and the premium paid for the option is recognized as a realized loss. The risk associated with writing call options is that the Fund may forego the opportunity for a profit if the market value of the underlying position increases and the option is exercised. The Fund will only write call options on positions held in its portfolio. The risk in writing a put option is that the Fund may incur a loss if the market value of the underlying position decreases and the option is exercised. In addition, the Fund bears the risk of not being able to enter into a closing transaction for written options as a result of an illiquid market.

**Short Sales:** The Fund may make short sales of securities as a method of hedging potential declines in similar securities owned. The Fund may have to pay a fee to borrow the particular securities and may be obligated to pay to the lender an amount equal to any payments received on such borrowed securities. A gain, limited to the amount at which the Fund sold the security short, or a loss, unlimited as to dollar amount, will be realized upon the termination of a short sale if the market price is less or greater than the proceeds originally received.

**Financial Futures Contracts:** A futures contract is an agreement between two parties to buy and sell a financial instrument for a set price on a future date. Initial margin deposits are made upon entering into futures contracts and can be either cash or securities. During the period the futures contract is open, changes in the value of the contract are recognized as unrealized gains or losses by "marking-to-market" on a daily basis to reflect the market value of the contract at the end of each day's trading. Variation margin payments are made or received, depending upon whether unrealized gains or losses are incurred. When the contract is closed, the Fund records a realized gain or loss equal to the difference between the proceeds from (or cost of) the closing transaction and the Fund's basis in the contract.

The Fund invests in financial futures contracts to hedge against fluctuations in the value of portfolio securities caused by changes in prevailing market interest rates. Should interest rates move unexpectedly, the Fund may not achieve the anticipated benefits of the financial futures contracts and may realize a loss. The use of futures transactions involves the risk of imperfect correlation in movements in the price of futures contracts, interest rates and the underlying hedged assets. The Fund is at risk that it may not be able to close out a transaction because of an illiquid market.

**Swap agreements:** The Fund may enter into interest rate swap agreements to manage its exposure to interest rates. Interest rate swap agreements involve the exchange by the Fund with another party of their respective commitments to pay or receive interest, e.g., an exchange of floating rate payments for fixed rate payments with respect to a notional amount of principal. The Fund will usually enter into interest rate swaps on a net basis, i.e., the two payment streams are netted out, with the Fund receiving or paying, as the case may be, only the net amount of the two payments. Swaps are marked to market based upon quotations from market makers and the change, if any, along with an accrual for periodic payments due or owed is recorded as unrealized gain or loss in the Statement of Operations. Net payments of interest on interest rate swap agreements are



## Edgar Filing: HYPERION STRATEGIC MORTGAGE INCOME FUND INC - Form N-CSRS

included as part of realized gain/loss in the Statement of Operations. Entering into these agreements involves, to varying degrees, elements of credit and market risk in excess of the amounts recognized on the Statement of Assets and Liabilities. Such risks involve the possibility that there will be no liquid market for these agreements, that the counterparty to the agreements may default on its obligation to perform or that there may be unfavorable changes in the fluctuation of interest rates. See Note 7 for a summary of all open swap agreements as of May 31, 2004.

---

THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.  
Notes to Financial Statements -- (Unaudited)  
May 31, 2004

---

As a result of a recent FASB Emerging Issues Task Force consensus and subsequent related SEC staff guidance, the Fund has reclassified periodic payments made under interest rate swap agreements, previously included within net investment income, to components of realized and unrealized gain (loss) in the Statement of Operations. For consistency, similar reclassifications have been made to amounts appearing in the previous year's Statement of Changes in Net Assets and the per share amounts in prior year financial highlights. Prior year expense and net investment income ratios in the financial highlights have also been modified accordingly. This reclassification increased net investment income by \$112,592, increased net realized loss on swap contracts by \$53,965 and reduced net change in unrealized gain on swap contracts by \$58,627 for the six months ended May 31, 2004, and increased net investment income by \$522,260, increased net realized loss on swap contracts by \$154,861 and increased change in net unrealized loss on swap contracts by \$367,399 for the year ended November 30, 2003. Such reclassifications had no effect on the Fund's net asset value, either in total or per share, or its total increase in net assets from operations during any period.

**When-Issued Purchases and Forward Commitments:** The Fund may purchase securities on a "when-issued" basis and may purchase or sell securities on a "forward commitment" basis in order to hedge against anticipated changes in interest rates and prices and secure a favorable rate of return. When such transactions are negotiated, the price, which is generally expressed in yield terms, is fixed at the time the commitment is made, but delivery and payment for the securities take place at a later date, which can be a month or more after the date of the transaction. At the time the Fund makes the commitment to purchase securities on a when-issued or forward commitment basis it will record the transaction and thereafter reflect the value of such securities in determining its net asset value. At the time the Fund enters into a transaction on a when-issued or forward commitment basis, the Advisor will identify collateral consisting of cash or liquid securities equal to the value of the when-issued or forward commitment securities and will monitor the adequacy of such collateral on a daily basis. On the delivery date, the Fund will meet its obligations from securities that are then maturing or sales of the securities identified as collateral by the Advisor and/or from then available cash flow. When-issued securities and forward commitments may be sold prior to the settlement date. If the Fund disposes of the right to acquire a when-issued security prior to its acquisition or disposes of its right to deliver or receive against a forward commitment, it can incur a gain or loss due to market fluctuation. There is always a risk that the securities may not be delivered and that the Fund may incur a loss. Settlements in the ordinary course are not treated by the Fund as

## Edgar Filing: HYPERION STRATEGIC MORTGAGE INCOME FUND INC - Form N-CSRS

when-issued or forward commitment transactions and, accordingly, are not subject to the foregoing limitations even though some of the risks described above may be present in such transactions.

**Securities Transactions and Investment Income:** Securities transactions are recorded on the trade date. Realized gains and losses from securities transactions are calculated on the identified cost basis. Interest income is recorded on the accrual basis. Discounts and premiums on securities are accreted and amortized, respectively, using the effective yield to maturity method.

**Taxes:** It is the Fund's intention to continue to meet the requirements of the Internal Revenue Code applicable to regulated investment companies and to distribute substantially all of its taxable income to its shareholders. Therefore, no federal income or excise tax provision is required.

**Dividends and Distributions:** The Fund declares and pays dividends monthly from net investment income. Distributions of realized capital gains in excess of capital loss carryforwards are distributed at least annually. Dividends and distributions are recorded on the ex-dividend date. Dividends from net investment income and distributions from realized gains from investment transactions have been determined in accordance with Federal income tax regulations and may differ from net investment income and realized gains recorded by the Fund for financial reporting purposes. These differences, which could be temporary or permanent in nature, may result in reclassification of distributions; however, net investment income, net realized gains and net assets are not affected.

-----  
THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.  
Notes to Financial Statements -- (Unaudited)  
May 31, 2004  
-----

**Cash Flow Information:** The Fund invests in securities and distributes dividends and distributions which are paid in cash or are reinvested at the discretion of shareholders. These activities are reported in the Statement of Changes in Net Assets. Additional information on cash receipts and cash payments is presented in the Statement of Cash Flows. Cash, as used in the Statement of Cash Flows, is the amount reported as "Cash" in the Statement of Assets and Liabilities, and does not include short-term investments.

Accounting practices that do not affect reporting activities on a cash basis include carrying investments at value and accreting discounts and amortizing premiums on debt obligations.

**Repurchase Agreements:** The Fund, through its custodian, receives delivery of the underlying collateral, the market value of which at the time of purchase is required to be in an amount at least equal to the resale price, including accrued interest. The Advisor is responsible for determining that the value of these underlying securities is sufficient at all times. If the seller defaults and the value of the collateral declines or if bankruptcy proceedings commence with respect to the seller of the security, realization of the collateral by the Fund may be delayed or limited.

### 3. Investment Advisory Agreements and Affiliated Transactions

## Edgar Filing: HYPERION STRATEGIC MORTGAGE INCOME FUND INC - Form N-CSRS

The Fund has entered into an Investment Advisory Agreement with the Advisor. The Advisor is responsible for the management of the Fund's portfolio and provides the necessary personnel, facilities, equipment and certain other services necessary to the operations of the Fund. For such services, the Fund pays a monthly fee at an annual rate of 0.65% of the Fund's average weekly net assets. During the six months ended May 31, 2004, the Advisor earned \$480,214 in investment advisory fees.

The Advisor had entered into a Sub-Advisory Agreement with Lend Lease Hyperion Capital Advisors, LLC ("Lend Lease Hyperion"). Lend Lease Hyperion was owned equally by Lend Lease Real Estate Investments, Inc. ("LLREI") and the Advisor and was formed for the purpose of managing portfolios of commercial mortgage-backed securities ("CMBS"). On August 12, 2003, GMAC Commercial Mortgage Corporation purchased the assets of LLREI. As a result, the Sub-Advisory Agreement terminated automatically by its terms due to a change of control of Lend Lease Hyperion. In addition, Lend Lease Hyperion changed its name to Hyperion/GMAC Capital Advisors, LLC ("Hyperion/GMAC"). At a special meeting held on April 15, 2003, the Board of Directors, in anticipation of Lend Lease Hyperion's change of control and the resulting automatic termination of the Sub-Advisory Agreement, approved (1) an Interim Sub-Advisory Agreement (the "Interim Agreement") with Hyperion/GMAC effective when the Lend Lease Hyperion change of control was completed, and (2) a new Sub-Advisory Agreement (the "New Sub-Advisory Agreement") with Hyperion/GMAC. The Interim Agreement terminated on December 9, 2003, the date on which the Fund's stockholders approved the New Sub-Advisory Agreement. Under the terms of the New Sub-Advisory Agreement, Hyperion/GMAC is to assist in managing the Fund's investments in CMBS and to provide such investment research and advice regarding CMBS as may be necessary for the operation of the Fund. The same fee paid under the Sub-Advisory Agreement was paid by the Advisor, out of its advisory fee, to Hyperion/GMAC under the Interim Agreement and will continue to be paid by the Advisor under the new Sub-Advisory Agreement. The monthly fee is equally to a percentage of the portion of the Fund's average weekly net assets that are invested in CMBS. The fee is determined by the credit rating of the CMBS at the time of purchase, and ranges from 1.00% for unrated CMBS to 0.13% for AAA/Aaa rated CMBS.

The Fund has entered into an Administration Agreement with Hyperion Capital Management, Inc. (the "Administrator"). The Administrator entered into a sub-administration agreement with State Street Bank and Trust Company (the "Sub-Administrator"). The Administrator and Sub-Administrator perform administrative services necessary for the operation of the Fund, including maintaining certain books and records of the Fund and preparing reports and other documents required by federal, state, and other applicable laws and regulations, and providing the Fund with administrative office facilities. For these services, the Fund pays to the Administrator a monthly fee at an annual rate of 0.20% of the Fund's average weekly net assets. During the six months ended May 31, 2004 the

-----  
THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.  
Notes to Financial Statements -- (Unaudited)  
May 31, 2004  
-----

Administrator earned \$147,758 in administration fees. The Administrator is responsible for any fees due the Sub-Administrator.

Certain officers and/or directors of the Fund are officers and/or directors of the Advisor and /or Administrator.

# Edgar Filing: HYPERION STRATEGIC MORTGAGE INCOME FUND INC - Form N-CSRS

## 4. Purchases and Sales of Investments

Purchases and sales of investments, excluding short-term securities, U.S. Government securities and reverse repurchase agreements, for the six months ended May 31, 2004, were \$24,541,960 and \$14,255,628, respectively. Purchases and sales of U.S. Government securities, for the six months ended May 31, 2004, were \$70,649,813 and \$68,564,817, respectively. For purposes of this footnote, U.S. Government securities may include securities issued by the U.S. Treasury, Federal Home Loan Mortgage Corporation, and the Federal National Mortgage Association.

## 5. Borrowings

The Fund may enter into reverse repurchase agreements with the same parties with whom it may enter into repurchase agreements. Under a reverse repurchase agreement, the Fund sells securities and agrees to repurchase them at a mutually agreed upon date and price. Under the 1940 Act, reverse repurchase agreements will be regarded as a form of borrowing by the Fund unless, at the time it enters into a reverse repurchase agreement, it establishes and maintains a segregated account with its custodian containing securities from its portfolio having a value not less than the repurchase price (including accrued interest). The Fund has established and maintained such an account for each of its reverse repurchase agreements.

Reverse repurchase agreements involve the risk that the market value of the securities retained in lieu of sale by the Fund may decline below the price of the securities the Fund has sold but is obligated to repurchase. In the event the buyer of securities under a reverse repurchase agreement files for bankruptcy or becomes insolvent, such buyer or its trustee or receiver may receive an extension of time to determine whether to enforce the Fund's obligation to repurchase the securities, and the Fund's use of the proceeds of the reverse repurchase agreement may effectively be restricted pending such decision.

At May 31, 2004 the Fund had the following reverse repurchase agreements outstanding:

Face Value	Description
\$ 2,302,000	Merrill Lynch, 1.11%, dated 05/13/04, maturity date 06/23/04.....
1,678,000	Merrill Lynch, 1.11%, dated 05/13/04, maturity date 06/23/04.....
9,532,000	Merrill Lynch 1.11%, dated 05/13/04, maturity date 06/23/04.....
3,096,000	Lehman Brothers 1.12%, dated 05/27/04, maturity date 06/08/04.....
1,816,000	Lehman Brothers 1.12%, dated 05/27/04, maturity date 06/08/04.....
4,954,000	Lehman Brothers 1.10%, dated 05/28/04, maturity date 06/15/04.....
2,700,000	Morgan Stanley 1.08%, dated 05/21/04, maturity date 06/23/04.....
19,600,000	Morgan Stanley 1.12%, dated 05/27/04, maturity date 06/02/04.....
2,127,000	Morgan Stanley 1.09%, dated 05/27/04, maturity date 06/08/04.....
8,124,000	Goldman Sachs 1.10%, dated 05/12/04, maturity date 06/23/04.....
10,172,000	Goldman Sachs 1.10%, dated 05/12/04, maturity date 06/23/04.....
-----	
\$ 66,101,000	
=====	
	Maturity Amount, Including Interest Payable.....
	Market Value of Assets Sold Under Agreements.....
	Weighted Average Interest Rate.....

-----  
 THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.  
 Notes to Financial Statements -- (Unaudited)  
 May 31, 2004  
 -----

The average daily balance of reverse repurchase agreements outstanding during the six months ended May 31, 2004, was approximately \$57,502,781 at a weighted average interest rate of 1.09%. The maximum amount of reverse repurchase agreements outstanding at any time during the period was \$75,036,958 as of February 11, 2004, which was 33.62% of total assets.

6. Capital Stock

There are 50 million shares of \$0.01 par value common stock authorized. Of the 10,142,600 shares outstanding at May 31, 2004, the Advisor owned 7,018 shares.

In connection with the initial public offering of the Fund's Shares, the Advisor made an undertaking to pay any offering costs in excess of \$0.03 per common share. The Advisor has advised the Fund that such excess amounted to \$482,964.

7. Financial Instruments

The Fund regularly trades in financial instruments with off-balance sheet risk in the normal course of its investing activities to assist in managing exposure to various market risks. These financial instruments include written options, futures contracts and swap agreements and may involve, to a varying degree, elements of risk in excess of the amounts recognized for financial statement purposes. The notional or contractual amounts of these instruments represent the investment the Fund has in particular classes of financial instruments and does not necessarily represent the amounts potentially subject to risk. The measurement of the risks associated with these instruments is meaningful only when all related and offsetting transactions are considered. During the period, the Fund had segregated sufficient cash and/or securities to cover any commitments under these contracts.

There was no written option activity for the six months ended May 31, 2004.

As of May 31, 2004, the following swap agreements were outstanding:

Notional Amount	Expiration Date	Description
\$ 10,000,000	01/23/06	Agreement with Goldman Sachs Capital Markets, LP, dated 01/21/04 to pay semi-annually the notional amount multiplied by 2.005% and to receive quarterly the notional amount multiplied by 3 month USD-LIBOR-BBA.

Edgar Filing: HYPERION STRATEGIC MORTGAGE INCOME FUND INC - Form N-CSRS

As of May 31, 2004, the following futures contract was outstanding:

Short:

Notional Amount	Type	Expiration Date	Cost at Trade Date	Value at May 31, 2004
\$ 1,600,000	5 Yr. U.S. Treasury Note	June 2004	\$ 1,820,380	\$ 1,753,000

8. Federal Income Tax Information

Income and capital gain distributions are determined in accordance with federal income tax regulations from generally accepted accounting principles.

-----  
 THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.  
 Notes to Financial Statements -- (Unaudited)  
 May 31, 2004  
 -----

During the year ended November 30, 2003 the tax character of the \$13,140,962 of distributions paid was from ordinary income.

At May 31, 2004 the components of net assets (excluding paid-in-capital) on a tax basis were as follows:

Undistributed Tax ordinary income.....	\$	741,058
Accumulated capital loss.....	\$	(2,529,558)
Book basis unrealized appreciation/(depreciation).....	\$	2,807,957
Plus: Cumulative timing differences.....	\$	(9,033)
Unrealized appreciation/(depreciation).....	\$	2,798,924

The difference between book basis and tax basis undistributed income is due to the differing treatment of investments in swap contracts. The difference between book basis and tax basis unrealized appreciation/(depreciation) is due to the differing treatment of investments in swap contracts and the market-to-market of futures. The difference between book basis and tax basis accumulated gain/(loss) is due to the market-to-market of futures.

Edgar Filing: HYPERION STRATEGIC MORTGAGE INCOME FUND INC - Form N-CSRS

Federal Income Tax Basis: The federal income tax basis of the Fund's investments at May 31, 2004 was \$217,486,147. Net unrealized appreciation was \$2,708,904 (gross unrealized appreciation -- \$4,672,611; gross unrealized depreciation -- \$1,963,707). During the six months ended May 31, 2004, the Fund utilized available capital loss carryforwards amounting to \$168,218. At May 31, 2004, the Fund had a capital loss carryforward of \$2,529,558, which \$746,090 expires in 2010 and \$1,783,468 expires in 2011, available to offset any future gains, to the extent provided by regulations.

Capital Account Reclassification: For the six months ended May 31, 2004, the Fund's undistributed net investment income was increased by \$411,971 with an offsetting decrease in accumulated net realized loss. These adjustments were primarily the result of current year paydown reclassifications and the reclassifications of payments related to swaps.

9. Subsequent Events

Dividend: The Fund's Board of Directors declared the following regular monthly dividends:

Dividend Per Share	Record Date	Payable Date
\$ 0.1080	06/15/04	06/24/04

PROXY RESULTS (Unaudited)

During the six months ended May 31, 2004, The Hyperion Strategic Mortgage Income Fund, Inc. shareholders voted on the following proposals at shareholders' meetings on December 9, 2003 and April 13, 2004. The description of each proposal and number of shares voted are as follows:

December 9, 2003 Meeting:

	Shares Voted For	Shares Agai
1. Approval of New Investment Sub-Advisory Agreement:	9,528,731	108,

April 13, 2004 Meeting:

	Shares Voted For	Shares Agai
1. To elect to the Fund's Board of Directors Rodman L. Drake:	9,979,003	0

	Shares Voted For	Shares Agai
2. To elect to the Fund's Board of Directors	9,979,003	0

Edgar Filing: HYPERION STRATEGIC MORTGAGE INCOME FUND INC - Form N-CSRS

Harry E. Petersen:

		Shares Voted For	Shares Against
3.	To elect to the Fund's Board of Directors Clifford E. Lai:	9,979,003	0
4.	To select PricewaterhouseCoopers LLP as the independent auditors:	9,924,233	23,

THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.  
Information Concerning Directors and Officers (Unaudited)

The following tables provide information concerning the directors and officers of The Hyperion S Inc. (the "Fund").

Name, Address and Age	Position(s) Held with Fund and Term of Office and Length of Time Served	Principal Occupation(s) During Past 5 Years Other Directorships Held by Director
-----------------------	---	--

Disinterested Director

Class I to serve until 2006 Annual Meeting of Stockholders:

Robert F. Birch c/o One Liberty Plaza 36th Floor New York, NY 10006-1404	Director, Member of The Audit Committee, Member of Nominating and Compensation Committee and Member of Executive Committee	Director and/or Trustee of several investment companies advised by Hyperion Capital Management, Inc. (the "Advisor" (1989-Present)); Chairman and President, America High Income Fund (1992-Present); Chairman of the Board and Co-Founder, The Business Group, Inc. (1996-Present); Director of Brandywine Funds (3) (2001 to Present).
Age 68	Elected for Three-Year Term  Director since June 2002	

Disinterested Directors



Edgar Filing: HYPERION STRATEGIC MORTGAGE INCOME FUND INC - Form N-CSRS

Class II to serve until 2007 Annual Meeting of Stockholders:

<p>Rodman L. Drake c/o One Liberty Plaza 36th Floor New York, NY 10006-1404</p> <p>Age 61</p>	<p>Chairman Elected December 9, 2003</p> <p>Director, Member of the Audit Committee, Chairman of Nominating and Compensation Committee</p> <p>Elected for Three-Year Term</p> <p>Director since June 2002</p>	<p>Chairman (since 2003) and Director and/or Trustee of several investment companies (I advised by Hyperion Capital Management, I (the "Advisor") (1989- Present); Co-Found Baringo Capital LLC (2002- Present); Direct Animal Medical Center (2002-Present); Director, Hotelevision, Inc. (1999-Present) Director, Parsons Brinckerhoff, Inc. (1995-Present); Director, Absolute Qualit Inc.(2000-Present); Trustee of Excelsior Funds (33) (1994-Present); President, Continuation Investments Group Inc. (1997-2001).</p>
<p>Harry E. Petersen, Jr. c/o One Liberty Plaza 36th Floor New York, NY 10006-1404</p> <p>Age 79</p>	<p>Director, Member of the Audit Committee, Member of Nominating and Compensation Committee, Member of Executive Committee</p> <p>Elected for Three-Year Term</p> <p>Director since June 2002</p>	<p>Director and/or Trustee of several investme companies (3) advised by Hyperion Capita Management, Inc. (the "Advisor") (1992-Present); Senior Consultant to Cornerstone Equity Advisors, Inc. (1998-2001</p>

-----  
THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.  
Information Concerning Directors and Officers (Unaudited)  
-----

Name, Address and Age	Position(s) Held with Fund and Term of Office and Length of Time Served	Principal Occupation(s) During Past 5 Years Other Directorships Held by Director
--------------------------	--	---

-----

Disinterested Director  
-----

Class III to serve until 2005 Annual Meeting of Stockholders:

<p>Leo M. Walsh, Jr. c/o One Liberty Plaza 36th Floor New York, NY 10006-1404</p>	<p>Director, Chairman of the Audit Committee, Member of Nominating and Compensation Committee</p>	<p>Director and/or Trustee of several investm companies (3) advised by Hyperion Capi Management, Inc. (the "Advisor") (1989-Prese Financial Consultant for Medco Health Soluti (formerly, Merck-Medco Managed Care LLC) (1</p>
---	---	--

Edgar Filing: HYPERION STRATEGIC MORTGAGE INCOME FUND INC - Form N-CSRS

Age 71

Elected for Three-Year  
Term

Director since June  
2002

Interested Director

Class III to serve until 2005 Annual Meeting of Stockholders:

Clifford E. Lai(1)  
c/o One Liberty Plaza  
36th Floor  
New York, NY  
10006-1404

Director,  
Elected until 2005  
Since December 2003

President  
Elected Annually  
Since June 2002

President (November 1998-Present) and Chief  
Investment Officer (1993-2002) of Hyperion  
Capital Management, Inc. (the "Investment  
Advisor"); Co-Chairman (2003-Present)  
Board of Managers (1995-Present)  
Hyperion-GMAC Capital Advisors, LLC (former  
Lend Lease Hyperion Capital Advisors, LLC)  
President of several investment companies  
advised by the Advisor (1995-Present).

Age 51

-----

(1) Mr. Lai is an "interested person" as defined in the Investment Company Act of 1940, as amended, (the "1940 Act") because of affiliations with Hyperion Capital Management, Inc., the Fund's advisor. As a result of his service with the Advisor and certain affiliations with the Advisor as described below, the Fund considers Mr. Lai to be an "interested person" of the Fund within the meaning of Section 2(a)(19) of the 1940 Act.

-----  
THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.  
Information Concerning Directors and Officers (Unaudited)  
-----

Officers of the Fund

Name, Address and Age	Position(s) Held with Fund	Term of Office and Length of Time Served	Principal Occupation(s) During Past 5 Years
Clifford E. Lai c/o One Liberty Plaza 36th Floor	President	Elected Annually Since June 2002	Please see "Information

## Edgar Filing: HYPERION STRATEGIC MORTGAGE INCOME FUND INC - Form N-CSRS

New York, NY  
10006-1404

Age 51

John Dolan  
c/o One Liberty Plaza  
36th Floor  
New York, NY  
10006-1404  
New York, NY  
10006-1404

Vice President

Elected Annually  
Since June 2002

Chief Investment Str  
Investment Officer (M  
Management.

Age 50

Patricia A. Sloan  
c/o One Liberty Plaza  
36th Floor  
New York, NY  
10006-1404

Vice President

Elected Annually  
Since June 2002

Consultant of Ranieri &  
Secretary, Director a  
companies advised by  
(1989-2002).

Age 60

Thomas F. Doodian  
c/o One Liberty Plaza  
36th Floor  
New York, NY  
10006-1404

Treasurer

Elected Annually  
Since June 2002

Managing Director, Chief  
Present) and Director o  
Capital Management, Inc  
several investment co  
Capital Management, Inc

Age 45

Joseph Tropeano  
c/o One Liberty Plaza  
36th Floor  
New York, NY  
10006-1404

Secretary

Elected Annually  
Since June 2002

Director and Compli  
Management, Inc. (1993-P  
Officer of several  
Hyperion Capital Ma  
Secretary and Complian  
Advisors, LLC (1995-Pre

Age 42

The Fund's Statement of Additional Information includes additional information about the directors and is available, without charge, upon request by calling 1-800-497-3746.

---

DIVIDEND REINVESTMENT PLAN

-----

A Dividend Reinvestment Plan (the "Plan") is available to shareholders of the Fund pursuant to which they may elect to have all distributions of dividends and capital gains automatically reinvested by American Stock Transfer & Trust Company (the "Plan Agent") in additional Fund shares. Shareholders who do not participate in the Plan will receive all distributions in cash paid by check mailed directly to the shareholder of record (or if the shares are held in street or other nominee name, then to the nominee) by the Fund's Custodian, as Dividend Disbursing Agent.

The Plan Agent serves as agent for the shareholders in administering the Plan. After the Fund declares a dividend or determines to make a capital gain distribution, payable in cash, if (1) the market price is lower than net asset value, the participants in the Plan will receive the equivalent in Fund shares valued at the market price determined as of the time of purchase (generally, the payment date of the dividend or distribution); or if (2) the market price of the shares on the payment date of the dividend or distribution is equal to or exceeds their net asset value, participants will be issued Fund shares at the higher of net asset value or 95% of the market price. This discount reflects savings in underwriting and other costs that the Fund otherwise will be required to incur to raise additional capital. If net asset value exceeds the market price of the Fund shares on the payment date or the Fund declares a dividend or other distribution payable only in cash (i.e., if the Board of Directors precludes reinvestment in Fund shares for that purpose), the Plan Agent will, as agent for the participants, receive the cash payment and use it to buy Fund shares in the open market, on the New York Stock Exchange or elsewhere, for the participants' accounts. If, before the Plan Agent has completed its purchases, the market price exceeds the net asset value of the Fund's shares, the average per share purchase price paid by the Plan Agent may exceed the net asset value of the Fund's shares, resulting in the acquisition of fewer shares than if the dividend or distribution had been paid in shares issued by the Fund. The Fund will not issue shares under the Plan below net asset value.

Participants in the Plan may withdraw from the Plan upon written notice to the Plan Agent. When a participant withdraws from the Plan or upon termination of the Plan by the Fund, certificates for whole shares credited to his or her account under the Plan will be issued and a cash payment will be made for any fraction of a share credited to such account.

There is no charge to participants for reinvesting dividends or capital gain distributions, except for certain brokerage commissions, as described below. The Plan Agent's fees for handling the reinvestment of dividends and distributions are paid by the Fund. There are no brokerage commissions charged with respect to shares issued directly by the Fund. However, each participant will pay a pro rata share of brokerage commissions incurred with respect to the Plan Agent's open market purchases in connection with the reinvestment of dividends and distributions.

The automatic reinvestment of dividends and distributions will not relieve participants of any federal income tax that may be payable on such dividends or distributions.

A brochure describing the Plan is available from the Plan Agent, by calling 1-212-936-5100.

If you wish to participate in the Plan and your shares are held in your name, you may simply complete and mail the enrollment form in the brochure. If your shares are held in the name of your brokerage firm, bank or other nominee, you should ask them whether or how you can participate in the Plan. Shareholders whose shares are held in the name of a brokerage firm, bank or other nominee and

## Edgar Filing: HYPERION STRATEGIC MORTGAGE INCOME FUND INC - Form N-CSRS

are participating in the Plan may not be able to continue participating in the Plan if they transfer their shares to a different brokerage firm, bank or other nominee, since such shareholders may participate only if permitted by the brokerage firm, bank or other nominee to which their shares are transferred.

### INVESTMENT ADVISOR AND ADMINISTRATOR

HYPERION CAPITAL MANAGEMENT, INC.  
One Liberty Plaza  
165 Broadway, 36th Floor  
New York, New York 10006-1404  
For General Information about the Trust:  
(800) HYPERION

### SUB-ADVISOR

HYPERION GMAC CAPITAL ADVISORS, LLC  
One Liberty Plaza  
165 Broadway, 36th Floor  
New York, New York 10006-1404

### SUB-ADMINISTRATOR

STATE STREET BANK and TRUST COMPANY  
225 Franklin Street  
Boston, Massachusetts 02116

### CUSTODIAN AND FUND ACCOUNTING AGENT

STATE STREET BANK and TRUST COMPANY  
225 Franklin Street  
Boston, Massachusetts 02116

### TRANSFER AGENT

AMERICAN STOCK TRANSFER & TRUST  
COMPANY  
Investor Relations Department  
59 Maiden Lane  
New York, NY 10038  
For Shareholder Services:  
(800) 937-5449

### INDEPENDENT AUDITORS

PRICEWATERHOUSECOOPERS LLP  
1177 Avenue of the Americas  
New York, New York 10036

### LEGAL COUNSEL

SULLIVAN & WORCESTER LLP  
1666 K Street, N.W.  
Washington, D.C. 20006

Notice is hereby given in accordance with Section 23(c) of the Investment Company Act of 1940 that periodically the Fund may purchase its shares in the open market at prevailing market prices.

Quarterly Portfolio Schedule: No later than October 29, 2004, the Fund will file its complete schedule of portfolio holdings with the Securities and Exchange Commission for the third quarter of 2004 on Form N-Q. The Fund will thereafter file Form N-Q for the first and third quarters of each fiscal year on Form N-Q. The Fund's Forms N-Q will be available on the Securities and Exchange Commission's website at <http://www.sec.gov>. The Fund's Form N-Q may be reviewed and copied at the Securities and Exchange Commission's Public Reference Room in Washington, D.C. and information on the operation of the Public Reference Room may be obtained by calling 1-800-SEC-0330. Once filed, the most recent Form N-Q will be available without charge, upon request, by calling 1-800-HYPERION or on the Fund's website at <http://www.hyperioncapital.com>.

-----  
Officers & Directors  
-----

Rodman L. Drake\*  
Chairman

Robert F. Birch\*  
Director

Leo M. Walsh, Jr.\*  
Director

Harry E. Petersen, Jr.\*  
Director

Clifford E. Lai  
Director and President

Patricia A. Sloan  
Vice President

John Dolan  
Vice President

Thomas F. Doodian  
Treasurer

Joseph Tropeano  
Secretary

-----  
\* Audit Committee Members

-----  
[GRAPHIC OMITTED]

The financial information included herein is taken from records of the Fund without audit by the Fund's independent auditors, who do not express an opinion thereon.

This report is for shareholder information. This is not a prospectus intended for use in the purchase or sale of Fund shares.

The Hyperion Strategic Mortgage  
Income Fund, Inc.  
One Liberty Plaza  
165 Broadway, 36th Floor  
New York, NY 10006-1404

## Edgar Filing: HYPERION STRATEGIC MORTGAGE INCOME FUND INC - Form N-CSRS

### Item 2. Code of Ethics.

As of the end of the period covered by this report, the Registrant had adopted a Code of Ethics for Principal Executive and Principal Financial Officers (the "Code"). There were no amendments to or waivers from the Code during the period covered by this report. A copy of the Registrant's Code will be provided upon request to any person without charge by contacting Joseph Tropeano at 1-800-HYPERION or by writing to Mr. Tropeano at One Liberty Plaza, 165 Broadway, 36th Floor, New York, NY 10006-1404.

### Item 3. Audit Committee Financial Expert.

The Registrant's Board of Directors has determined that the Registrant has at least one audit committee financial expert serving on its audit committee, and his name is Rodman L. Drake. Mr. Drake is independent.

### Item 4. Principal Accountant Fees and Services.

Not applicable.

### Item 5. Audit Committee of Listed Registrants.

The Registrant has a separately-designated standing Audit Committee established in accordance with Section 3(a)(58)(A) of the Securities Exchange Act of 1934. The Registrant's Audit Committee members include Leo M. Walsh, Jr., Rodman L. Drake, Robert F. Birch and Harry E. Petersen, Jr.

### Item 6. Schedule of Investments

Not applicable.

### Item 7. Disclosure of Proxy Voting Policies and Procedures for Closed-End Management Investment Companies.

This Item is not applicable as the Registrant invested exclusively in non-voting securities during the period covered by this report.

### Item 8.

Not applicable.

### Item 9. Submission of Matters to a Vote of Security Holders.

Not applicable.

### Item 10. Controls and Procedures.

(a) The Registrant's principal executive officer and principal financial officer have concluded that the Registrant's Disclosure Controls and Procedures are effective, based on their evaluation of such Disclosure Controls and Procedures as of a date within 90 days of the filing of this report on Form N-CSR.

(b) As of the date of filing this Form N-CSR, the Registrant's principal executive officer and principal financial officer are aware of no changes in the Registrant's internal control over financial reporting that occurred during the Registrant's last fiscal half-year that has materially affected or is reasonably likely to materially affect the Registrant's internal control over financial reporting.

## Edgar Filing: HYPERION STRATEGIC MORTGAGE INCOME FUND INC - Form N-CSRS

Item 11. Exhibits.

(a) (1) None.

(2) A separate certification for each principal executive officer and principal financial officer of the Registrant as required by Rule 30a-2(a) under the Investment Company Act of 1940 is attached as an exhibit to this Form N-CSR.

(3) None.

(b) A separate certification for each principal executive officer and principal financial officer of the Registrant as required by Rule 30a-2(b) under the Investment Company Act of 1940 is attached as an exhibit to this Form N-CSR.

### SIGNATURES

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

THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.

By: /s/ Clifford E. Lai

\_\_\_\_\_  
Clifford E. Lai  
Principal Executive Officer

Date: August 6, 2004

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

By: /s/ Clifford E. Lai

\_\_\_\_\_  
Clifford E. Lai  
Principal Executive Officer

Date: August 6, 2004

By: /s/ Thomas F. Doodian

\_\_\_\_\_  
Thomas F. Doodian  
Treasurer and Principal Financial Officer

Date: August 6, 2004



