

HYPERION STRATEGIC MORTGAGE INCOME FUND INC  
Form N-CSR  
February 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: November 30, 2003

Item 1. Reports to Shareholders.

[GRAPHIC OMITTED] [GRAPHIC OMITTED]

[GRAPHIC OMITTED] [GRAPHIC OMITTED]

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THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.  
Report of the Investment Advisor  
For the Year Ended November 30, 2003  
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Dear Shareholder:

We welcome this opportunity to provide you with information about The Hyperion Strategic Mortgage Income Fund, Inc. (the "Fund") for the fiscal year ended November 30, 2003. The Fund's 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"), 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

For the fiscal year ended November 30, 2003, shareholders realized a total investment return of 17.55%, which assumes the reinvestment of dividends and is exclusive of brokerage commissions. Based on the NYSE closing price of \$14.67 on November 30, 2003, the Fund had a yield of 8.83%, which was 5.47% higher than the yield of the 5-year U.S. Treasury Note, and competitive with the yields of other multi-sector bond funds in its category.

As of November 30, 2003, the Fund, inclusive of the effect of leverage, was managed with an average duration (a bond's duration is the weighted average number of years until maturity of all its cash flows, including coupon payments and principal) of 3.6 years, as measured on a net asset basis.

#### Market Environment

After struggling for several years, the momentum of the economy turned more positive in the second half of 2003. Housing sales and mortgage refinancings had another very strong year in 2003 and helped to keep consumer activity robust. Tax reductions and strength in the stock market added further fuel to the economy with economic growth surging to 8.2% in the third quarter, its highest rate since 1984. While we believe that we have seen the cyclical lows in economic activity and in interest rates, the pace of the recovery and accompanying rise in interest rates may be slower than past recoveries. The unemployment rate remains stubbornly high and job creation subdued. In excess of 5 million jobs were lost in the recession that began in 2000 and it will take some time to fully employ the population. Monthly job creation of at least 250,000 is needed to make significant steps towards long term and sustained

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economic growth. Until then, the Federal Reserve will remain aggressive with respect to Monetary Policy and keep interest rates low.

While corporate earnings have improved, and have helped push the stock market higher, most of those gains have been due to reductions in expenses rather than increases in revenues. Although clearly a positive for the equity markets, revenue increases are needed for sustained stock market growth.

A growing concern for the economy has been weakness in the dollar, particularly against the Euro which hit lifetime highs in the last month. The high current account deficit combined with a growing budget deficit makes the U.S. ever more dependent on foreign investment. A stronger economy, rising stock market, and higher interest rates will attract foreigners to hold dollar financial assets and temper any dollar decline. The key risk to the markets and the economy is economic weakness that translates into dollar distress.

With the recent improvement in the economy and the weakness in the dollar we now look for the Fed to begin shifting their bias toward tightening sometime in mid-2004 (versus late 2004 or even 2005 as we had thought a few months ago). The markets will be paying particularly close attention to the minutes of Fed meetings and any Fed testimony for any signals to changes from their current policy.

### Portfolio Strategy

The Fund continues to be allocated primarily among the Agency MBS, RMBS and CMBS sectors. We have also introduced some mortgage-related Asset-Backed Securities ("ABS"), such as Home Equity and Manufactured Housing ABS, into the portfolio over the last four months. The Fund's limit on ABS is 10% of total assets and we are currently near that limit as we view this sector as offering the best yield and risk characteristics at the A and BBB rating levels. The Fund's allocation to ABS comes from selectively decreasing the Fund's allocation to below-investment-grade CMBS, where commercial real estate fundamentals have continued to weaken due to rising vacancies and declining rents. An upturn in commercial real estate fundamentals typically lags the general economic recovery by 6 to 8 months and is highly dependent on employment growth: the more people at work, the more office space needed, the higher the demand for both hotel rooms and retail space. Commercial real estate delinquencies have continued to rise as yield spreads on CMBS have narrowed, leading to our negative outlook on the sector in favor of ABS. We are comfortable with our remaining CMBS exposures and expect the entire CMBS sector to improve from these levels.

In the RMBS allocation of the Fund, we continue to maintain a mix of Fannie Mae and Freddie Mac premium-priced MBS. While prepayment rates have been high in this sector, these securities have offered an attractive alternative to other shorter duration securities. RMBS have performed exceptionally well over the past few years and have benefited from the faster prepayment environment. With most of the RMBS held in the portfolio purchased at discount dollar prices, the high levels of prepayment rates have led not only to strong price performance but also to numerous credit rating upgrades.

In the summer of 2003, as interest rates fell below the cyclical level of 3.2% yield on the 10-year Treasury, we lowered the duration of the Fund by approximately one year. Signs of an economic recovery and increasing budget deficit contributed to this strategy. At various points during the year, we managed the portfolio near full leverage to take advantage of historically low borrowing rates and have utilized interest rate swaps and floating rate securities to hedge against rises in borrowing costs.

In 2003, the Fund outperformed many of the broad market bond indices due to its allocation to below-investment-grade MBS, along with strength in the RMBS sector

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due to faster prepayments, and to the strategic move to shorten duration during the summer of 2003.

The below-investment-grade allocation to the Fund (16.5% of total assets) is still well below the 20% allowed. As the economy improves we may elect to increase that allocation.

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,

[GRAPHIC OMITTED][GRAPHIC OMITTED]

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

[GRAPHIC OMITTED][GRAPHIC OMITTED]

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

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 THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.  
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Portfolio of Investments November 30, 2003	Interest Rate	Maturity	Princip Amount (000s)
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 See notes to financial statements.

U.S. GOVERNMENT & AGENCY OBLIGATIONS -- 58.3%			
U.S. Government Agency Pass-Through Certificates -- 58.3%			
Federal Home Loan Mortgage Corporation			
Pool C68878.....	7.00%	06/01/32	\$ 793
Pool C69047.....	7.00	06/01/32	1,921

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Federal National Mortgage Association			
TBA.....	5.50	TBA	28,000
Pool 694391.....	5.50	03/01/33	5,273
TBA.....	6.00	TBA	20,000
Pool 626299.....	7.00	06/01/32	1,601
Pool 635095.....	7.00	06/01/32	2,120
Pool 641575.....	7.00	04/01/32	945
Pool 645399.....	7.00	05/01/32	5,005
Pool 645466.....	7.00	05/01/32	4,921
Pool 650131.....	7.00	07/01/32	3,064
Pool 636449.....	8.50	04/01/32	9,194

Total U.S. Government Agency Pass-Through Certificates  
(Cost-- \$84,890,939).....

Total U.S. Government & Agency Obligations  
(Cost-- \$84,890,939).....

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ASSET-BACKED SECURITIES -- 13.6%			
Housing Related Asset-Backed Securities -- 13.6%			
Asset Backed Funding Corp.			
Series 2003-OPT1, Class M4.....	3.92+	07/25/33	3,000
Equity One ABS, Inc.			
Series 2003-4, Class B2.....	5.87+	11/25/33	1,000
First Franklin Mortgage Loan Asset Backed Certificates			
Series 2003-FF4, Class M4.....	4.02+	10/25/33	3,000
Series 2003-FF1, Class M4.....	4.12+	03/25/33	2,000
Series 2003-FFH1, Class M4.....	4.62+	09/25/33	4,740
Long Beach Mortgage Loan Trust			
Series 2002-5, Class M2.....	3.12+	11/25/32	4,000
Merit Securities Corp.			
Series 12-1, Class 1A3(a).....	6.45/6.95	07/28/33	1,989
Total Housing Related Asset-Backed Securities (Cost-- \$19,719,579).....			
Total Asset-Backed Securities (Cost-- \$19,719,579).....			

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THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.

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Portfolio of Investments  
November 30, 2003

Interest  
Rate

Maturity

Princip  
Amount  
(000s)

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See notes to financial statements.

COMMERCIAL MORTGAGE BACKED SECURITIES -- 28.5%

Bear Stearns Commercial Mortgage Securities

Series 1999-C1, Class G*.....	5.64%	02/14/31	\$ 2,390
Series 1999-C1, Class D.....	6.53	02/14/31	2,500
Series 2000-WF1, Class E.....	7.90+	02/15/32	2,000

GE Capital Commercial Mortgage Corp.

Series 2002-2A, Class G*.....	6.04	08/11/36	3,000
Series 2000-1, Class G*.....	6.13	01/15/33	1,000
Series 2002-2A, Class H*.....	6.31	08/11/36	2,000
Series 2000-1, Class E.....	7.17+	01/15/33	1,000

Government Lease Trust

Series 1999-C1A, Class B3*.....	4.00	05/18/11	2,500
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JP Morgan Chase Commercial Mortgage Securities

Series 2003-LN1, Class G*.....	5.48+	10/15/37	1,600
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JP Morgan Commercial Mortgage Finance Corp.

Series 1999-C7, Class F*.....	6.00	10/15/35	2,000
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Morgan Stanley Capital I

Series 1999-FNV1, Class A2.....	6.53	03/15/31	2,000
Series 1999-WF1, Class E.....	6.99+	11/15/31	5,500
Series 1999-FNV1, Class E.....	7.46+	03/15/31	2,000

Morgan Stanley Dean Witter Capital I

Series 2001-TOP1, Class A4.....	6.66	02/15/33	4,500
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Nationslink Funding Corp.

Series 1998-2, Class E.....	7.11	08/20/30	4,000
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UBS 400 Atlantic Street Mortgage Trust

Series 2002-C1A, Class B3*.....	7.19	01/11/22	2,000
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Total Commercial Mortgage Backed Securities

(Cost-- \$41,029,937).....

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NON-AGENCY RESIDENTIAL MORTGAGE BACKED SECURITIES -- 40.7%

Subordinated Collateralized Mortgage Obligations -- 40.7%

ABN AMRO Mortgage Corp.

Series 2002-7, Class B2.....	6.20+	09/25/32	1,066
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Bank of America Mortgage Securities, Inc.

Series 2002-H, Class B4.....	4.69+	08/25/32	417
Series 2002-H, Class B5.....	4.69+	08/25/32	278
Series 2002-H, Class B6.....	4.69+	08/25/32	696

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Series 2002-I, Class B4.....	4.74+	08/25/32	694
Series 2002-10, Class 1B3.....	6.00	11/25/32	1,482
Series 2002-8, Class 1B1.....	6.25	08/25/32	7,327
Series 2002-8, Class 1B4*.....	6.25	08/25/32	1,086
Series 2002-8, Class 1B5*.....	6.25	08/25/32	814
Series 2002-8, Class 1B6*.....	6.25	08/25/32	815
Series 2002-9, Class 1B3.....	6.25	10/25/32	1,777
Series 2002-9, Class 1B4.....	6.25	10/25/32	1,185
NON-AGENCY RESIDENTIAL MORTGAGE BACKED SECURITIES (continued)			
Cendant Mortgage Corp.			
Series 2002-4, Class B1.....	6.50	07/25/32	2,659
Series 2002-4, Class B2.....	6.50	07/25/32	1,064
Series 2002-4, Class B3.....	6.50	07/25/32	620
Series 2002-4, Class B4.....	6.50	07/25/32	355
Series 2002-4, Class B5.....	6.50	07/25/32	266
Series 2002-4, Class B6*.....	6.50	07/25/32	355
Citicorp Mortgage Securities, Inc.			
Series 2002-8, Class B1.....	6.18%+	07/25/32	\$ 3,602
Series 2002-8, Class B2.....	6.18+	07/25/32	1,567
Series 2002-8, Class B3.....	6.18+	07/25/32	783
Countrywide Home Loans			
Series 2001-12, Class B4.....	6.50	07/25/31	887
Series 2001-12, Class B5.....	6.50	07/25/31	830
G3 Mortgage Reinsurance Ltd.			
Series 1, Class E*.....	21.12+	05/25/08	4,386
Master Asset Securitization Trust			
Series 2002-3, Class B5.....	6.25+	07/25/32	769
Series 2002-3, Class B6.....	6.25+	07/25/32	769
Residential Finance Ltd. Partnership			
Series 2002-A, Class B5*.....	3.47+	10/10/34	1,979
Series 2002-A, Class B7.....	6.82+	10/10/34	1,991
Residential Funding Mortgage Security I			
Series 2003-S7, Class B2.....	5.50	05/25/33	542
Series 2003-S7, Class B3.....	5.50	05/25/33	328
Series 2002-S10, Class B1*.....	6.50	07/25/32	713
Series 2002-S10, Class B2*.....	6.50	07/25/32	535
Series 2002-S10, Class B3*.....	6.50	07/25/32	535
Structured Asset Mortgage Investments, Inc.			
Series 2002-AR1, Class B4.....	4.62+	03/25/32	1,258
Washington Mutual Mortgage Securities Corp.			
Series 2002-AR12, Class B4.....	4.74+	10/25/32	1,672

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Series 2002-AR12, Class B5.....	4.74+	10/25/32	1,254
Series 2002-AR12, Class B6.....	4.74+	10/25/32	2,092
Series 2002-AR10, Class B4*.....	5.02+	10/25/32	1,982
Series 2002-AR10, Class B5*.....	5.02+	10/25/32	1,486
Series 2002-AR10, Class B6*.....	5.02+	10/25/32	2,480
Series 2002-AR11, Class B5.....	5.16+%	10/25/32	1,170
Series 2002-AR11, Class B6.....	5.16+	10/25/32	1,951
Wells Fargo Mortgage Backed Securities Trust			
Series 2002, Class B5.....	6.00	06/25/32	370
Series 2002-15, Class B1.....	6.50	08/25/32	5,140
Series 2002-15, Class B4.....	6.50	08/25/32	593
Series 2002-15, Class B5.....	6.50	08/25/32	791
Series 2002-15, Class B6.....	6.50	08/25/32	594
Total Subordinated Collateralized Mortgage Obligations			
(Cost-- \$57,040,567).....			
Total Non-Agency Residential Mortgage Backed Securities			
(Cost-- \$57,040,567).....			
NON-AGENCY RESIDENTIAL MORTGAGE BACKED SECURITIES (continued)			
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SHORT TERM INVESTMENTS -- 0.9%			
Short Term Investments -- 0.9%			
Federal National Mortgage Association Discount			
Note(b)			
(Cost-- \$1,300,000).....	0.95%	12/01/03	\$ 1,300
Total Investments -- 142.0%			
(Cost-- \$203,981,022).....			
Liabilities in Excess of Other			
Assets-- (42.0)%.....			
NET ASSETS-- 100.0%.....			
-----			

@ -- Portion or entire principal amount delivered as collateral for reverse repurchase agreements (Note 5).

+ -- Variable Rate Security: Interest rate is the rate in effect November 30, 2003.

\* -- Security exempt from registration under Rule 144A of the Securities Act of 1933. These securities may only be resold in transactions exempt from registration, normally to qualified institutional buyers.

# -- Portion or entire principal amount is held as collateral for open futures contracts (Note 7).

(a) -- Security is a "step up" bond where coupon increases or steps up at a predetermined date. Rates shown are current coupon and next coupon rate



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when security steps up.

(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.

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THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.  
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Statement of Assets and Liabilities  
November 30, 2003  
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See notes to financial statements.

Assets:

Investments in securities, at market (cost \$203,981,022) (Note 2).....  
Cash.....  
Interest receivable.....  
Principal paydowns receivable.....  
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.....  
Payable on open swap contracts.....  
Unrealized depreciation on swap contracts (Note 7).....  
Investment advisory fee payable (Note 3).....  
Payable for variation margin.....  
Administration fee payable (Note 3).....  
Directors' fees payable.....  
Accrued expenses and other liabilities.....

Total liabilities.....

Net Assets (equivalent to \$14.41 per share based on 10,141,220 shares issued and outstanding)...

Composition of Net Assets:

Capital stock, at par value (\$.01) (Note 6).....  
Additional paid-in capital (Note 6).....

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Accumulated undistributed net investment income.....  
Accumulated net realized loss.....  
Net unrealized appreciation.....  
  
Net assets applicable to capital stock outstanding.....

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THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.  
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Statement of Operations  
For the Year Ended November 30, 2003  
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See notes to financial statements.

Investment Income (Note 2):

Interest.....

Expenses:

Investment advisory fee (Note 3).....  
Administration fee (Note 3).....  
Insurance.....  
Accounting 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).....

Interest expense on swaps (Note 2).....

Total expenses.....

Net investment income.....

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

Net realized gain (loss) on:

Investment transactions.....

Futures transactions.....

Swap contracts.....

Net realized gain on investment transactions, futures transactions and swap contracts.....

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Net change in unrealized appreciation/depreciation on:

Investments.....  
 Futures.....  
 Swap contracts.....

Net change in unrealized appreciation/depreciation on investments, futures and swap contracts....

Net realized and unrealized gain on investments, futures and swap contracts.....

Net increase in net assets resulting from operations.....

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

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See notes to financial statements.

	For the Year Ended November 30, 2003
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Increase (Decrease) in Net Assets Resulting from Operations:	
Net investment income.....	\$ 11,871,290
Net realized gain (loss) on investment transactions, futures transactions, swap contracts and short sales.....	248,278
Net change in unrealized appreciation/depreciation on investments, futures, swap contracts and short sales.....	4,237,236
	-----
Net increase in net assets resulting from operations.....	16,356,804
	-----
Dividends to Shareholders (Note 2):	
Net investment income.....	(13,140,962)
	-----
Capital Stock Transactions (Note 6):	
Net proceeds from sale of shares (10,130,000 shares; net of offering costs of \$304,111).....	--
Net asset value of shares issued through dividend reinvestment (2,924 and 1,278 shares, respectively).....	42,722
	-----
Net increase from capital stock transactions.....	42,722

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Total increase in net assets.....	3,258,564
Net Assets:	
Beginning of period.....	142,921,281
	-----
End of period (including undistributed net investment income of \$1,159,112 and \$540,088, respectively).....	\$ 146,179,845
	=====

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\* Commenced operations on July 26, 2002

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THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.

Statement of Cash Flows  
For the Year Ended November 30, 2003

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See notes to financial statements.

Increase (Decrease) in Cash:

Cash flows provided by (used for) operating activities:

Interest received (including net accretion of \$1,855,456).....  
Interest expense paid.....  
Operating expenses paid.....  
Purchases of short-term portfolio investments, net.....  
Purchases of long-term portfolio investments.....  
Proceeds from disposition of long-term portfolio investments and principal paydowns.....  
Net cash provided by futures transactions.....

Net cash provided by operating activities.....

Cash flows used for financing activities:

Net cash used for reverse repurchase agreements.....  
Cash dividends paid.....

Net cash used for financing activities.....

Net decrease in cash.....  
Cash at beginning of year.....

Cash at end of year.....

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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.....	
Decrease in investments, at cost.....	
Increase in net unrealized appreciation/depreciation on investments and swaps.....	
Decrease in interest receivable.....	
Decrease in variation margin receivable.....	
Increase in other assets.....	
Increase in payables and other liabilities.....	
 Total adjustments.....	
 Net cash provided by operating activities.....	

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

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THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.  
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Financial Highlights

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See notes to financial statements.

	For the Year Ended November 30, 2003
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Per Share Operating Performance:	
Net asset value, beginning of period.....	\$ 14.10
	-----
Net investment income.....	1.17
Net realized and unrealized gain (loss) on investments,	
futures transactions, swap contracts and short sales.....	0.44
	-----
Net increase in net asset value resulting from operations.....	1.61
	-----
Dividends from net investment income.....	(1.30)
Offering costs charged to additional paid-in-capital.....	--
	-----
Net asset value, end of period.....	\$ 14.41

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Market price, end of period.....	=====
	\$ 14.6700
	=====
Total Investment Return+.....	17.55%
Ratios to Average Net Assets/Supplementary Data:	
Net assets, end of period (000's).....	\$ 146,180
Operating expenses.....	1.28%
Interest expense.....	0.87%
Total expenses.....	2.15%
Net expenses.....	2.15%
Net investment income.....	8.18%
Portfolio turnover rate.....	78%
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+ Total investment return is calculated assuming a purchase of common stock at the current market price on the first day and a sale at the current market price on the last day of the period reported. For the period ended November 30, 2002, total investment return is based on a beginning period price of \$15.00 (initial offering price). Total investment return for subsequent periods is computed based upon the New York Stock Exchange market price of the Fund's shares. Dividends and distributions, if any, are assumed for purposes of this calculation, to be 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

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

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 THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.  
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Notes to Financial Statements  
 November 30, 2003  
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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").

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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 30% of the investments in securities held by the Fund at November 30, 2003) 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.

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.

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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, is recorded as unrealized gain or loss in the Statement of Operations. Net payments of interest on interest rate swap agreements are included as part of interest expense. For the year ended November 30, 2003, such net payments made by the Fund amounted to \$522,260. 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 November 30, 2003.



**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 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.

**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

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 year ended November 30, 2003, the Advisor earned \$943,303 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 equal 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 year ended November 30, 2003, the Administrator earned \$290,247 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.

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## 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 year ended November 30, 2003, were \$28,988,752 and \$18,372,494, respectively. Purchases and sales of U.S. Government securities, for the year ended November 30, 2003, were \$134,894,566 and \$155,041,494, 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 November 30, 2003 the Fund had the following reverse repurchase agreements outstanding:

Face Value	Description
\$ 4,540,000	UBS Warburg, 1.08%, dated 11/26/03, maturity date 12/10/03.....
8,948,000	Lehman Brothers, 1.12%, dated 11/26/03, maturity date 12/17/03.....
\$ 13,488,000	
=====	
	Maturity Amount, Including Interest Payable.....
	Market Value of Assets Sold Under Agreements.....
	Weighted Average Interest Rate.....

The average daily balance of reverse repurchase agreements outstanding during

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the year ended November 30, 2003, was approximately \$62,803,448 at a weighted average interest rate of 1.20%. The maximum amount of reverse repurchase agreements outstanding at any time during the period was \$75,802,346 as of April 15, 2003, which was 34.39% of total assets.

### 6. Capital Stock

There are 50 million shares of \$0.01 par value common stock authorized. Of the 10,141,220 shares outstanding at November 30, 2003, 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 year ended November 30, 2003.

As of November 30, 2003, the following swap agreements were outstanding:

Notional Amount	Expiration Date	Description
\$ 18,800,000	01/02/06	Agreement with Goldman Sachs Capital Markets, LP, dated 12/30/02 pay semi-annually the notional amount multiplied by 2.458% and receive quarterly the notional amount multiplied by 3 mo USD-LIBOR-BBA.
\$ 25,800,000	01/02/06	Agreement with Morgan Stanley Capital Services Inc., dated 12/30 to pay semi-annually the notional amount multiplied by 2.457% to receive quarterly the notional amount multiplied by 3 mo USD-LIBOR-BBA.

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As of November 30, 2003, the following futures contract was outstanding:

Long:

Notional Amount	Type	Expiration Date	Cost at Trade Date	Value at November 30,
\$ 11,000,000	5 Yr. U.S. Treasury Note	March 2004	\$ 12,219,419	\$ 12,141,2

8. Federal Income Tax Information

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

During the year ended November 30, 2003 the tax character of the \$13,140,962 of distributions paid was from ordinary income. During the year ended November 30, 2002 the tax character of the \$3,284,670 of distributions paid was from ordinary income.

At November 30, 2003 the components of net assets (excluding paid-in-capital) on a tax basis were as follows:

Undistributed Tax ordinary income.....	\$ 1,
Accumulated capital loss.....	\$ (2,
Book basis unrealized appreciation/(depreciation).....	\$ 3,
Plus: Cumulative timing differences.....	\$
Unrealized appreciation/(depreciation).....	\$ 3,

The cumulative timing differences under tax basis capital loss carryover are due to post-October losses. The differences between book and tax basis unrealized appreciation/(depreciation) is primarily attributable to the mark-to-market of futures.

Federal Income Tax Basis: The federal income tax basis of the Fund's investments at November 30, 2003 was \$203,981,022. Net unrealized appreciation was \$3,619,393 (gross unrealized appreciation -- \$4,409,073; gross unrealized depreciation -- \$789,680). At November 30, 2003, the Fund had a capital loss

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carryforward of \$2,697,776, of which \$914,308 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 year ended November 30, 2003, the Fund's undistributed net investment income was increased by \$1,888,696 with an offsetting decrease in accumulated net realized loss. These adjustments were primarily the result of current year paydown reclassifications.

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	12/16/03	12/26/03
\$0.1080	12/30/03	01/29/04

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 THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.  
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Report of Independent Auditors  
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 To the Board of Directors and Shareholders of  
 The Hyperion Strategic Mortgage Income Fund, Inc.:

In our opinion, the accompanying statement of assets and liabilities, including the portfolio of investments, and the related statements of operations, of cash flows and of changes in net assets and the financial highlights present fairly, in all material respects, the financial position of The Hyperion Strategic Mortgage Income Fund, Inc. (the "Fund") at November 30, 2003, the results of its operations and its cash flows for the year then ended, and the changes in its net assets and the financial highlights for the year then ended and for the period July 26, 2002 (date of commencement of operations) through November 30, 2002, in conformity with accounting principles generally accepted in the United States of America. These financial statements and financial highlights (hereafter referred to as "financial statements") are the responsibility of the Fund's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these financial statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits, which included confirmation of securities at November 30, 2003 by correspondence with the custodian and brokers, provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

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New York, NY  
January 23, 2004

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TAX INFORMATION (Unaudited)

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The Fund is required by subchapter M of the Internal Revenue Code of 1986, as amended, to advise you within 60 days of the Fund's fiscal year end (November 30, 2003) as to the federal tax status of distributions received by shareholders during such fiscal year. Accordingly, we are advising you that all distributions paid during the fiscal year were derived from net investment income and are taxable as ordinary income. In addition, 2.60% of the Fund's distributions during the fiscal year ended November 30, 2003 were earned from U.S. Treasury obligations. None of the Fund's distributions qualify for the dividends received deduction available to corporate shareholders.

Because the Fund's fiscal year is not the calendar year, another notification will be sent with respect to calendar 2003. The second notification, which will reflect the amount to be used by calendar year taxpayers on their federal, state and local income tax returns, will be made in conjunction with Form 1099-DIV and will be mailed in January 2004. Shareholders are advised to consult their own tax advisors with respect to the tax consequences of their investment in the Fund.

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PROXY RESULTS (Unaudited)

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During the year ended November 30, 2003, The Hyperion Strategic Mortgage Income Fund, Inc. shareholders voted on the following proposals at a shareholders' meeting on April 15, 2003. The description of each proposal and number of shares voted are as follows:

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	Shares Voted for	Shares Voted Against
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1. To elect to the Fund's Board of Directors Robert F. Birch:	9,924,202	0
	Shares Voted for	Shares Voted Against
2. To select PricewaterhouseCoopers LLP as the independent auditors:	9,896,051	39,179

Subsequent to November 30, 2003, The Hyperion Strategic Mortgage Income Fund, Inc. shareholders voted on the following proposal at the shareholders' meeting on December 9, 2003. The description of the proposal and number of shares voted are as follows:

	Shares Voted for	Shares Voted Against
1. Approval of New Investment Sub-Advisory Agreement:	9,528,731	108,960

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 Strategic Mortgage Income Fund, 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 and Other Directorships Held by Director
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Disinterested Directors

Class II Directors to serve until 2004 Annual Meeting of Stockholders:



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<p>Rodman L. Drake c/o One Liberty Plaza, 36th floor, New York, New York 10006-1404</p> <p>Age 60</p>	<p>Chairman  Elected 12/9/03  Director, Member of the Audit Committee, Chairman of Nominating and Compensation Committee  Elected for Two Year Term/Director since June 2002</p>	<p>Chairman (since 2003) and Director and/o Trustee of several investment companie advised by Hyperion Capital Management, Inc (the "Advisor") (1989- Present); Co-founder Baringo Capital LLC (2002- Present); Director Animal Medical Center (2002- Present) Director, Hotelevision, Inc. (1999-2003) Director and/or Lead Director, Parson Brinckerhoff, Inc. (1995-Present); Director Absolute Quality 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, New York 10006-1404</p> <p>Age 78</p>	<p>Director, Member of the Audit Committee, Member of Compensation and Nominating Committee, Member of Executive Committee  Elected for Two Year Term/Director since June 2002</p>	<p>Director and/or Trustee of several investmen companies advised by the Advisor or by it affiliates (1992-Present); Senior Consultan to Cornerstone Equity Advisors, Inc (1998-2001).</p>

Class I Director to serve until 2006 Annual Meeting of Stockholders:

<p>Robert F. Birch c/o One Liberty Plaza, 36th floor, New York, New York 10006-1404</p> <p>Age 67</p>	<p>Director, Member of the Audit Committee, Member of Nominating and Compensation Committee, Member of Executive Committee  Elected for Three Year Term/Director since June 2002</p>	<p>Director and/or Trustee of several investmen companies advised by the Advisor or by it affiliates (1998-Present); Director, Hyperio Strategic Bond Fund, Inc. (formerly Lend Leas Hyperion High Yield CMBS Fund, Inc. (2002-Present); Chairman and President, Ne America High Income Fund (1992-Present) Chairman of the Board and Co-Founder, Th China Business Group, Inc. (1996-Present) Director, Brandywine Funds (3) (2001 t Present).</p>
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THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.  
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Information Concerning Directors and Officers (Unaudited)

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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 and Other Directorships Held by Director
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 Class III Director to serve until 2005 Annual Meeting of Stockholders:

Leo M. Walsh, Jr. c/o One Liberty Plaza, 36th floor, New York, New York 10006-1404  Age 71	Director, Chairman of the Audit Committee, Member of Nominating and Compensation Committee  Elected for Three Year Term/Director since June 2002	Director and/or Trustee of several investment companies advised by the Advisor or by its affiliates (1989-Present); Financial Consultant for Medco Health Solutions Inc (1994-2003); Director, Hyperion Strategic Bond Fund, Inc. (formerly Lend Lease Hyperion High Yield CMBS Fund, Inc.) (1999-Present).
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Interested Directors

Clifford E. Lai* c/o One Liberty Plaza, 36th floor, New York, New York 10006-1404  Age 50	Director  Elected December 9, 2003  President  Elected Annually Since June 2002	President (1998-Present) and Chief Investment Officer (1993-2002) of the Advisor; Co-Chairman (2003-Present) and Board of Managers (1995-Present) Hyperion GMAC Capital Advisors, LLC (formerly Lend Lease Hyperion Capital, LLC); President of several investment companies advised by the Advisor (1995-Present).
Lewis S. Ranieri** c/o One Liberty Plaza, 36th floor, New York, New York 10006-1404  Age 57	Director, Member of the Executive Committee  Resigned December 9, 2003  Elected for Three Year Term Director since June 1989  Chairman Elected annually since June 2002  Resigned December 9, 2003	Director (1989-Present) and Chairman of the Board (1989-1998 and 2002-Present) of the Advisor; Formerly, Vice Chairman of the Board of the Advisor (1998-2002); Chairman and Chief Executive Officer of Ranieri & Co., Inc (1988-Present); President of LSR Hyperion Corp., a general partner of the limited partnership that is the general partner of Hyperion Partners L.P. ("Hyperion Partners") (1988-Present); Director and President of Hyperion Funding II Corp., the general partner of the limited partnership that is the general partner of Hyperion Partners II L.P. ("Hyperion Partners II") (1996-Present) Chairman and President of various other direct and indirect subsidiaries of Hyperion Partners (1988-2002) and Hyperion Partners I (1995-Present); Chairman of the Board (1989-1998 and 2002-2003) and/or Director (1989-2003) of several investment companies advised by the Advisor or by its affiliates; Director and Chairman of Bank United Corp. and Director of Bank United (1988-2001).

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 \* Interested person as defined in the 1940 Act, because of affiliations with Hyperion Capital Management, Inc., the Fund's Advisor.

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\*\* Mr. Ranieri 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. Mr. Ranieri serves as a Director and Chairman of the Advisor. As a result of his service with the Advisor and certain affiliations with the Advisor as described, the Fund considers Mr. Ranieri to be an "interested person" of the Fund within the meaning of Section 2(a)(19) of the 1940 Act.

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 THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.

Information Concerning Directors and Officers (Unaudited)

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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
Lewis S. Ranieri c/o One Liberty Plaza, 36th floor, New York, New York 10006-1404  Age 57	Chairman  Resigned December 9, 2003	Elected Annually Since June 2002	Please see "Information Conc and Officers" page 23.
Rodman L. Drake c/o One Liberty Plaza, 36th floor, New York, New York 10006-1404  Age 60	Chairman  Director, Member of the Audit Committee, Chairman of Nominating and Compensation Committee	Elected 12/9/03  Elected for Two Year Term/Director since June 2002	Please see "Information Conc and Officers" page 22.
Clifford E. Lai c/o One Liberty Plaza, 36th floor, New York, New York 10006-1404  Age 50	Director  President	Elected December 9, 2003  Elected Annually Since June 2002	Please see "Information Conc and Officers" page 23.
John Dolan c/o One Liberty Plaza,	Vice President	Elected Annually Since June 2002	Chief Investment Strategist Chief Investment Officer (20

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36th floor, New York,  
New York 10006-1404

Advisor.

Age 50

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

Vice President

Elected Annually  
Since June 2002

Consultant of Ranieri & Co.,  
(2000-Present); Secretary, D  
Trustee of several investmen  
by the Advisor or by its aff  
2002).

Age 60

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

Secretary

Elected Annually  
Since June 2002

Director and Compliance Offi  
(1993- Present); Secretary a  
Officer of several investmen  
by the Advisor (1994- Presen  
Compliance Officer, Hyperion  
Advisors (formerly Lend Leas  
Advisors, LLC) (1995-Present  
Compliance Officer of Hyperi  
Fund, Inc. (formerly Lend Le  
High-Yield CMBS Fund, Inc.)  
Assistant Secretary and Comp  
Hyperion Inc. (1994-2002); V  
Compliance Officer, Hyperion  
(1994-1998).

Age 42

Thomas F. Doodian  
c/o One Liberty Plaza,  
36th floor, New York,  
New York 10006-1404  
Age 44

Treasurer

Elected Annually  
Since June 2002

Managing Director, Chief Ope  
(1998-Present) and Director  
Operations of the Advisor (J  
Treasurer of several investm  
advised by the Advisor (Febr

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.

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DIVIDEND REINVESTMENT PLAN  
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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

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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 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.

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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, Northwest  
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.

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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  
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\* Audit Committee Members

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[GRAPHIC OMITTED] [GRAPHIC OMITTED]

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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

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.

Audit Fees

For the fiscal year ended November 30, 2003, PriceWaterhouseCoopers LLP ("PwC") billed the Registrant aggregate fees of \$59,000 for professional services rendered for the audit of the Registrant's annual financial statements and review of financial statements included in the Registrant's annual report to shareholders.

For the fiscal year ended November 30, 2002, PwC billed the Registrant aggregate fees of \$53,500 for professional services rendered for the audit of the Registrant's annual financial statements and review of financial statements included in the Registrant's annual report to shareholders.

Tax Fees

For the fiscal year ended November 30, 2003, PwC billed the Registrant aggregate fees of \$7,000 for professional services rendered for tax compliance, tax advice and tax planning. The nature of the services comprising the Tax Fees was the review of the Registrant's income tax returns and tax distribution requirements.

For the fiscal year ended November 30, 2002, PwC billed the Registrant aggregate fees of \$8,160 for professional services rendered for tax compliance, tax advice and tax planning. The nature of the services comprising the Tax Fees was the review of the Registrant's income tax returns and tax distribution requirements.

All Other Fees

For the fiscal year ended November 30, 2003, PwC billed the Registrant aggregate fees of \$39,500 for professional services rendered for the review of financial statements included in the Registrant's semi-annual report to shareholders.

For the fiscal year ended November 30, 2002, PwC billed the Registrant aggregate fees of \$8,000 for comfort letters provided to the Registrant.



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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. [Reserved]

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 second fiscal half-year that has materially affected or is reasonably likely to materially affect the Registrant's internal control over financial reporting.

Item 11. Exhibits.

(a) None.

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

(c) None.

### 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.

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By: /s/ Clifford E. Lai

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Clifford E. Lai  
Principal Executive Officer

Date: February 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: February 6, 2004

By: /s/ Thomas F. Doodian

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

Date: February 6, 2004