

HYPERION STRATEGIC MORTGAGE INCOME FUND INC

Form N-CSRS

August 08, 2005

**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, 2005

Item 1. Reports to Shareholders.

THE HYPERION
STRATEGIC
MORTGAGE
INCOME
FUND, INC.

Semi-Annual Report

May 31, 2005

THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.

Portfolio Composition (Unaudited)

The chart that follows shows the allocation of the Fund's holdings by asset category as of May 31, 2005.

THE HYPERION STRATEGIC MORTGAGE INCOME, INC.

Portfolio of Investments as of May 31, 2005*

* As a percentage of total investments.

THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.

Report of the Investment Advisor

For the Six Months Ended May 31, 2005

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, 2005. 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), 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.

Portfolio Performance

For the six month period ended May 31, 2005, shareholders realized a total investment return of 5.54%, which assumes the reinvestment of dividends and is exclusive of brokerage commissions. Based on the NYSE closing price of \$14.74 on May 31, 2005, the Fund's shares had a current yield of 8.8%.

As of May 31, 2005, 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 3.1 years, as measured on a net asset basis.

Market Environment for the Semi Annual Period Ended May 31, 2005

Sometimes the markets respond to economic factors (fundamental valuation). Sometimes the pendulum swings to the other extreme and the markets respond to other market factors such as supply and demand and the relative ability and willingness of market participants to utilize leverage. So far in 2005, technical factors seemed to be dominating, both for credit spreads and the level of interest rates.

The economic numbers reflected an economy that continues to expand at a moderate pace. The consumer remains very healthy with home prices driving wealth thanks to stubbornly low long term interest rates and the advent of interest only and longer amortizing mortgages. Inflation indices have remained low thanks to the outsourcing of goods and services to low cost producers like China and India, a trend we expect to continue for the foreseeable future. Rising oil prices are definitely a problem for the economy and we believe that it will lead to a slowdown in the economy in 12 to 15 months.

We feel that the dominant factor that will drive the continued decline in long term interest rates is the consumer. With the consumer being over 67% of Gross National Product, interest rates should remain consumer-friendly, i.e. keep mortgage rates attractive for home ownership since the home is the largest asset for the consumer. As a result, the goal of monetary policy in a recession will be to drop interest rates low enough to cause a mortgage refinancing wave to

put money in the pocket of the consumer to therefore spend back into the economy. As long as the consumer is such a dominant force of Gross Domestic Product, this cycle will continue to drive long term interest rates lower.

The yield curve, as measured by the difference in interest rates between the UST 10-Year and 2-Year narrowed from 114 basis points to 34 basis points. We believe that the yield curve will continue to flatten and potentially invert where the yield on shorter maturity assets are higher than that of longer maturity assets. We anticipate that the Fed will raise Fed Funds to 3.25% at the upcoming June 30 meeting and then at least once again during the fall to 3.50%. At that point a yield curve with the 2-Year at 3.70% and a 10-Year at 3.95% would not be inconsistent if the markets begin to believe that the Fed is near the end of the tightening cycle. The yield curve inversion scenario would play out if the Fed raises the Funds target beyond 3.50%.

THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.

Report of the Investment Advisor

For the Six Months Ended May 31, 2005

Portfolio Strategy for the Semi Annual Period Ended May 31, 2005

Credit sectors, especially corporate bonds, came under some pressure over the last few months. Much of the pressure was concentrated in the corporate sector with the BB rated sector widening dramatically, triggered by a ratings downgrade of General Motors and Ford. Weakness in the overall corporate sector spilled into the CMBS sector with the BBB-rated classes widening about 20 basis points. The residential credit sector escaped the underperformance as the combination of large sums of money pre-committed for RMBS investment and the beneficial impact of lower interest rates on home prices and structural deleveraging kept yield spreads firm.

As the credit curve has narrowed in the RMBS market, we have reduced AA through BBB rated bonds in the sub-prime sector by 7.7%. The proceeds were reinvested primarily into the premium-priced Agency MBS sector (+6.5%). The bonds that were sold were largely floaters and the bonds that were purchased have limited sensitivity to interest rates, so the overall effective duration of the portfolio did not change dramatically. These trades resulted in the AAA rated allocation rising from about 47% to 53.7%. This is temporary, as over time we expect to redeploy those funds back into BBB rated bonds across the RMBS, CMBS and ABS sectors should yield spreads widen.

The allocation of below BBB rated exposures fell slightly from 17.5% to 17.0% as deals were prepaid, called, or upgraded to investment-grade. There were no material changes within the below-investment-grade exposures. Within the below-investment-grade sectors, we remain heavily skewed toward RMBS. Over time, we hope to add to the CMBS sector through an allocation to rated B-Notes.

We remain nearly fully leveraged to take advantage of the steepness in the yield curve, but are maintaining greater than 75% of the leveraged portion of the Fund in floaters or hedged with interest swaps out to approximately 2.3 years.

The duration of the Fund has been running between 3.0 and 3.5 years. We expect the duration to drift up slightly should interest rates rise and mortgage prepayments slow, but are comfortable that the duration will not extend dramatically.

THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.

Report of the Investment Advisor

For the Six Months Ended May 31, 2005

Conclusion

We remain committed to the Fund and its shareholders. As always, we will continue to actively seek 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

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, 2005

	Interest Rate	Maturity	Principal Amount (000s)	Value (Note 2)
U.S. GOVERNMENT & AGENCY				
OBLIGATIONS 71.5%				
U.S. Government				
Agency Pass-Through Certificates 66.2%				
Federal Home Loan Mortgage Corporation				
Pool A14559				
6.50%		09/01/33	\$2,470	\$2,565,245
Pool C68878				
7.00		06/01/32	505#	532,306
Pool C69047				
7.00		06/01/32	1,333	1,405,844
Pool G01466				
9.50		12/01/22	1,592	1,758,703
Pool 555559				
10.00		03/01/21	1,732	1,952,474
				8,214,572

Federal National Mortgage Association

Pool 694391				
5.50		03/01/33	4,135@	4,197,298
Pool 753914				
5.50		12/01/33	11,006@	11,171,737
Pool 754355				
6.00		12/01/33	6,980@	7,181,104
Pool 761836				
6.00		06/01/33	4,454@	4,585,874
Pool 763643				
6.00		01/01/34	8,559@	8,801,909
Pool 255413				
6.50		10/01/34	11,979@	12,450,872
Pool 323982				
6.50		10/01/06	443	449,005
Pool 795367				
6.50		09/01/34	5,655@	5,877,942
Pool 809989				
6.50		03/01/35	5,354@	5,565,284
Pool 626299				
7.00		06/01/32	831	877,932
Pool 635095				
7.00		06/01/32	1,285	1,356,880
Pool 641575				
7.00		04/01/32	593	625,966
Pool 645399				
7.00		05/01/32	2,857@	3,016,851
Pool 645466				

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7.00 05/01/32 3,012@ 3,180,306
Pool 650131
7.00 07/01/32 1,592 1,681,433
Pool 398800
8.00 06/01/12 813 868,358
Pool 827854
8.00 10/01/29 4,188 4,525,872
Pool 636449
8.50 04/01/32 2,803 3,047,563
Pool 823757
8.50 10/01/29 6,530 7,139,211
Pool 458132
9.41 03/15/31 2,216 2,444,302

89,045,699

**Total U.S. Government Agency Pass-Through
Certificates**

(Cost \$97,276,421)
97,260,271

U.S. Treasury Obligations 5.3%

United States Treasury Notes
4.00
02/15/15 1,173 1,170,250 4.25
11/15/14 6,500@ 6,617,306

Total U.S. Treasury Obligations

(Cost \$7,655,311)
7,787,556

Total U.S. Government & Agency Obligations

(Cost \$104,931,732)
105,047,827

ASSET-BACKED SECURITIES 22.7%

Housing Related Asset-Backed Securities 20.8%

Asset Backed Funding Certificates

Series 2005-AQ1, Class B1*(b)
5.75/6.25 06/25/35 1,000 856,321
Series 2005-AQ1, Class B2*(b)
5.75/6.25 06/25/35 1,057 863,438

1,719,759

See notes to financial statements.

THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.

Portfolio of Investments (Unaudited)

May 31, 2005

	Interest Rate	Maturity	Principal Amount (000s)	Value (Note 2)
ASSET-BACKED SECURITIES (continued)				
Equity One ABS, Inc.				
Series 2003-4, Class B2				
7.84%		11/25/33	\$345,698	
First Franklin Mortgage Loan Asset Backed Certificates				
Series 2003-FFH1, Class M4(a)				
6.59		09/25/33	4,740	4,898,890
Series 2004-FFH1, Class B*(a)				
6.59		03/25/34	1,550	1,480,664
Series 2004-FF2, Class B*(a)				
6.59		03/25/34	900	864,807
Series 2004-FFH2C, Class B1*(a)				
6.59		06/25/34	1,250	1,182,275
Series 2004-FF8, Class B4*(a)				
6.59		10/25/34	1,250	1,154,134
				9,580,770
Green Tree Financial Corp.				
Series 1997-6, Class B1				
7.17		01/15/29	4,614	743,171
Series 1997-3, Class M1				
7.53		03/15/28	2,000	1,220,000
				1,963,171
Harborview Mortgage Loan Trust				
Series 2005-1, Class B4*(a)				
4.84		03/19/35	629	532,405
Series 2005-1, Class B5*(a)				
4.84		03/19/35	914	592,806
Series 2005-1, Class B6*(a)				
4.84		03/19/35	1,144	257,340
Series 2005-2, Class B4*(a)				
4.84		05/19/35	1,489	1,261,131
				2,643,682
Long Beach Mortgage Loan Trust				
Series 2002-5, Class M3(a)				

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6.34 11/25/32 2,500 2,546,865

Mid-State Trust

Series 2004-1, Class M2

8.11 08/15/37 1,712 1,744,551

Structured Asset Investment Loan Trust

Series 2004-4, Class B*(b)

5.00/5.50 04/25/34 1,500 1,318,529

Series 2004-11, Class M9(b)

5.00/5.50 01/25/35 1,900 1,836,137

Series 2004-7, Class B(a)

5.59 08/25/34 2,161 1,964,106

Series 2004-8, Class B1(a)

5.59 09/25/34 1,000 965,152

Series 2004-10, Class M7(a)

5.59 11/25/34 2,000 2,016,460

Series 2004-2, Class B*(a)

6.09 03/25/34 1,074 980,466

9,080,850

Structured Asset Securities Corporation

Series 2005-6, Class B5

5.34 05/25/35 500 432,734

Series 2005-6, Class B6

5.34 05/25/35 500 329,688

Series 2005-6, Class B7

5.34 05/25/35 350 112,000

874,422

Total Housing Related Asset-Backed Securities

(Cost \$30,995,414)

30,499,768

Non-Housing Related Asset-Backed Securities 1.9%

Airplanes Pass Through Trust

Series 1R, Class A8

(Cost \$2,562,285)

3.46 03/15/19 2,969 2,791,179

Total Asset-Backed Securities

(Cost \$33,557,699)

33,290,947

See notes to financial statements.

THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.

Portfolio of Investments (Unaudited)

May 31, 2005

	Interest Rate	Maturity	Principal Amount (000s)	Value (Note 2)
COMMERCIAL MORTGAGE-BACKED SECURITIES 27.7%				
Bear Stearns Commercial Mortgage Securities				
Series 1999-C1, Class D				
6.53%	02/14/31	\$2,500	\$2,774,475	
Series 2000-WF1, Class E				
7.90	02/15/32	2,000	2,277,640	
				5,052,115
Chase Commercial Mortgage Securities Corp.				
Series 2000-2, Class I*				
6.65	07/15/32	1,000	623,300	
GE Capital Commercial Mortgage Corp.				
Series 2002-2A, Class G*				
6.04	08/11/36	3,000	3,148,149	
Series 2000-1, Class G*				
6.13	01/15/33	1,000	401,200	
Series 2002-2A, Class H*				
6.31	08/11/36	2,000	2,093,180	
Series 2000-1, Class E				
7.17	01/15/33	1,000	1,089,890	
				6,732,419
Government Lease Trust				
Series 1999-C1A, Class B3*				
4.00	05/18/11	2,500	2,316,288	
JP Morgan Chase Commercial Mortgage Securities				
Series 2003-LN1, Class G*				
5.48	10/15/37	1,600	1,637,291	
JP Morgan Commercial Mortgage Finance Corp.				
Series 1999-C7, Class F*				
6.00	10/15/35	2,000	2,061,960	
Morgan Stanley Capital I				
Series 2001-TOP1, Class A4				
6.66	02/15/33	4,500	4,972,275	
Series 1999-WF1, Class E				
7.00	11/15/31	5,500	5,952,562	
Series 1999-FNV1, Class E				

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7.47 03/15/31 2,000 2,198,400

13,123,237

Nationslink Funding Corp.

Series 1998-2, Class E

7.11 08/20/30 4,000 4,365,376

UBS 400 Atlantic Street Mortgage Trust

Series 2002-C1A, Class B3*

7.19 01/11/22 2,000 2,223,860

Wachovia Bank Commercial Mortgage Trust

Series 2004-WL4A, Class H*

4.07 10/15/15 700 701,184

Series 2005-C16, Class H*

5.30 10/15/41 2,000 1,946,290

2,647,474

Total Commercial Mortgage-Backed Securities

(Cost \$39,828,053)

40,783,320

NON-AGENCY RESIDENTIAL MORTGAGE-BACKED SECURITIES

25.3% Subordinated Collateralized Mortgage Obligations 25.3%

Bank of America Alternative Loan Trust

Series 2004-3, Class 30B4

5.50 04/25/34 1,002 844,763

Series 2004-3, Class 30B5

5.50 04/25/34 702 435,981

1,280,744

Bank of America Mortgage Securities, Inc.

Series 2004-A, Class B4

3.93 02/25/34 2,052 1,865,875

Series 2002-H, Class B4

4.71 08/25/32 225 218,959

Series 2002-H, Class B5

4.71 08/25/32 150 149,951

Series 2002-H, Class B6

4.71 08/25/32 376 346,173

See notes to financial statements.

THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.

Portfolio of Investments (Unaudited)

May 31, 2005

	Interest Rate	Maturity	Principal Amount (000s)	Value (Note 2)
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**NON-AGENCY RESIDENTIAL
MORTGAGE-BACKED SECURITIES
(continued)**

Series 2003-10, Class 1B4

5.50% 01/25/34 \$562 \$522,718

Series 2002-10, Class 1B3

6.00 11/25/32 1,453 1,470,100

Series 2002-9, Class 1B3

6.25 10/25/32 1,743 1,738,196

Series 2002-9, Class 1B4

6.25 10/25/32 1,162 1,158,922

7,470,894

Cendant Mortgage Corp.

Series 2002-4, Class B1

6.50 07/25/32 2,603 2,613,926

Series 2002-4, Class B2

6.50 07/25/32 1,041 1,045,325

Series 2002-4, Class B3

6.50 07/25/32 607 619,206

Series 2002-4, Class B4

6.50 07/25/32 347 338,135

Series 2002-4, Class B5

6.50 07/25/32 260 236,098

Series 2002-4, Class B6*

6.50 07/25/32 347 260,331

5,113,021

First Horizon Mortgage Pass-Through Trust

Series 2005-3, Class B4

5.50 06/25/35 460 405,894

G3 Mortgage Reinsurance Ltd.

Series 1, Class E*

23.10 05/25/08 4,277 4,790,449

JP Morgan Mortgage Trust

Series 2003-A1, Class B4

4.50 10/25/33 536 464,337

Residential Finance Limited Partnership

Series 2002-A, Class B7

8.79 10/10/34 1,941 1,978,598

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Residential Funding Mortgage Securities I,
Inc.

Series 2004-S1, Class B2
5.25 02/25/34 454 301,202
Series 2003-S7, Class B3
5.50 05/25/33 322 250,705
Series 2003-S7, Class B2
5.50 05/25/33 531 238,795

790,702

Resix Finance Limited Credit-Linked Note

Series 2004-C, Class B7*
6.59 09/10/36 991 1,012,125
Series 2004-B, Class B8*
7.84 02/10/36 804 828,292
Series 2003-CB1, Class B8*
9.84 06/10/35 971 1,014,948
Series 2004-B, Class B9*
11.30 02/10/36 1,232 1,281,148
Series 2004-A, Class B10*
14.60 02/10/36 492 511,433

4,647,946

Structured Asset Mortgage Investments,
Inc.

Series 2002-AR1, Class B4
4.69 03/25/32 823 803,060
Washington Mutual Mortgage Securities
Corp.
Series 2005-AR2, Class B10(a)
4.18 01/25/45 1,793 1,439,729
Series 2002-AR12, Class B4
4.69 10/25/32 1,086 1,052,930
Series 2002-AR12, Class B5
4.69 10/25/32 815 773,648
Series 2002-AR12, Class B6
4.69 10/25/32 1,359 1,005,488
Series 2002-AR10, Class B4*
4.96 10/25/32 1,259 1,226,618
Series 2002-AR10, Class B5*
4.96 10/25/32 944 894,196
Series 2002-AR10, Class B6*
4.96 10/25/32 1,575 1,165,803
Series 2002-AR11, Class B5
5.13 10/25/32 736 714,143

See notes to financial statements.

THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.

Portfolio of Investments (Unaudited)

May 31, 2005

	Interest Rate	Maturity	Principal Amount (000s)	Value (Note 2)
NON-AGENCY RESIDENTIAL MORTGAGE-BACKED SECURITIES				
(continued)				
Series 2002-AR11, Class B6				
5.13% 10/25/32 \$1,227 \$876,052				
<hr/>				
9,148,607				
<hr/>				
Wells Fargo Mortgage Backed Securities Trust				
Series 2002, Class B5				
6.00 06/25/32 362 336,679				
<hr/>				
Total Subordinated Collateralized Mortgage Obligations				
(Cost \$34,799,832)				
37,230,931				
<hr/>				
Total Non-Agency Residential Mortgage Backed Securities				
(Cost \$34,799,832)				
37,230,931				
<hr/>				
<hr/>				
Total Investments 147.2%				
(Cost \$213,117,316)				
216,353,025				
Liabilities in Excess of Other Assets (47.2)%				
(69,387,219)				
<hr/>				
NET ASSETS 100.0%				
\$146,965,806				
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@ Portion or entire principal amount delivered as collateral for reverse repurchase agreements (Note 5).

Variable Rate Security: Interest rate is the rate in effect May 31, 2005.

* 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. At that date these coupons increase to LIBOR plus a predetermined margin

(b)

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 when security steps up.

See notes to financial statements.

THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.

Statement of Assets and Liabilities (Unaudited)

May 31, 2005

Assets:

Investments in securities, at
market (cost \$213,117,316)
(Note 2)
\$216,353,025
Cash
558,319
Interest receivable
1,038,060
Principal paydowns receivable
633,746
Receivable from transfer agent
879
Prepaid expenses and other
assets
60,401

Total assets
218,644,430

Liabilities:

Reverse repurchase agreements
(Note 5)
69,517,000
Interest payable for reverse
repurchase agreements (Note 5)
69,756
Payable for investments
purchased
1,721,730
Unrealized depreciation on
swap contracts (Note 7)
222,714
Investment advisory fee
payable (Note 3)
81,170
Administration fee payable
(Note 3)
28,981
Directors' fees payable
12,466
Accrued expenses and other
liabilities
24,807

Total liabilities
71,678,624

Net Assets (equivalent to
\$14.49 per share based on
10,144,002 shares issued and
outstanding)
\$146,965,806

Composition of Net Assets:

Capital stock, at par value
(\$0.01) (Note 6)
\$101,440
Additional paid-in capital
(Note 6)
144,148,737
Accumulated undistributed net
investment income
1,135,914
Accumulated net realized loss
(1,433,280)
Net unrealized appreciation
3,012,995

Net assets applicable to capital
stock outstanding
\$146,965,806

See notes to financial statements.

THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.

Statement of Operations (Unaudited)

For the Six Months Ended May 31, 2005

Investment Income

(Note 2):

Interest
\$7,732,177

Expenses:

Investment advisory fee

(Note 3)

477,201

Administration fee

(Note 3)

150,837

Insurance

68,259

Custodian

38,480

Accounting and tax

services

49,863

Reports to shareholders

39,514

Transfer agency

14,050

Directors fees

34,904

Legal

13,368

Registration fees

8,381

Miscellaneous

5,985

Total operating expenses

900,842

Interest expense on reverse
repurchase agreements

(Note 5)

891,352

Total expenses

1,792,194

Net investment income

5,939,983

**Realized and Unrealized
Gain (Loss) on**

Investments (Notes 2
and 7):

Net realized gain (loss) on:

Investment transactions
508,811
Futures transactions
(199,462)
Swap contracts
88,813

Net realized gain (loss) on
investment transactions,
futures transactions and
swap contracts
398,162

Net change in unrealized
appreciation/ depreciation
on:

Investments
(177,665)
Futures
323
Swap contracts
(287,167)

Net change in unrealized
appreciation/ depreciation
on investments, futures and
swap contracts
(464,509)

Net realized and unrealized
loss on investments,
futures and swap contracts
(66,347)

Net increase in net assets
resulting from operations
\$5,873,636

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, 2005 (Unaudited)	For the Year Ended November 30, 2004
Increase (Decrease) in Net Assets Resulting from Operations:		
Net investment income		
\$5,939,983	\$12,144,805	
Net realized gain on investment transactions, futures transactions and swap contracts		
398,162	2,397,402	
Net change in unrealized appreciation/ depreciation on investments, futures and swap contracts		
(464,509)	46,772	
<hr/>		
<hr/>		
Net increase in net assets resulting from operations		
5,873,636	14,588,979	
<hr/>		
<hr/>		
Dividends to Shareholders (Note 2):		
Net investment income		
(6,572,854)	(13,144,369)	
<hr/>		
<hr/>		
Capital Stock Transactions (Note 6):		
Net asset value of shares issued through dividend reinvestment (1,366 and 1,416 shares, respectively)		
19,808	20,761	
<hr/>		
<hr/>		
Net increase from capital stock transactions		
19,808	20,761	
<hr/>		
<hr/>		
Total increase (decrease) in net assets		

(679,410) 1,465,371

Net Assets:

Beginning of period

147,645,216 146,179,845

End of period (including undistributed net
investment income of \$1,135,914 and
\$1,107,938, respectively)

\$146,965,806 \$147,645,216

See notes to financial statements.

THE HYPERION STRATEGIC MORTGAGE FUND, INC.

Statement of Cash Flows (Unaudited)

For the Six Months Ended May 31, 2005

Increase (Decrease) in Cash:

Cash flows provided by (used for) operating activities:

Net increase in net assets resulting from operations

\$5,873,636

Adjustments to reconcile net increase in net assets from operations to net cash used for operating activities:

Purchases of long-term portfolio investments

(61,275,460)

Proceeds from disposition of long-term portfolio investments, principal paydowns, and securities sold short

64,214,200

Purchases of short-term portfolio investments, net

1,500,000

Increase in interest receivable

(37,746)

Decrease in receivable for investments sold

1,720,460

Increase in receivable due from transfer agent

(879)

Increase in prepaid expenses and other assets

(46,484)

Decrease in variation margin payable

(100,972)

Increase in interest payable for reverse repurchase agreements

27,801

Decrease in payable for investments purchased

(952,444)

Increase in investment advisory fee payable

3,159

Increase in administration fee payable

317

Decrease in accrued expenses and other liabilities

(105,997)

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Net accretion on investments
(1,051,973)
Unrealized appreciation on
investments
464,509
Net realized gain on
investment transactions
(508,811)

Net cash provided by operating
activities
9,723,316

Cash flows provided by (used
for) financing activities:

Net cash provided by reverse
repurchase agreements
(2,984,750)
Dividends paid to
shareholders, net of
reinvestments
(6,553,925)

Net cash provided used for
financing activities
(9,538,675)

Net increase in cash
184,641
Cash at beginning of period
373,678

Cash at end of period
\$558,319

Interest payments for the six
months ended May 31, 2005,
totaled \$863,551.

Noncash financing activities
not included herein consist of
reinvestment of dividends of
\$19,808.

See notes to financial statements.

THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.

Financial Highlights

For the Six Months Ended May 31, 2005 (Unaudited)	For the Year Ended November 30, 2004	For the Year Ended November 30, 2003	For the Period Ended November 30, 2002@
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Per Share Operating Performance:

Net asset value, beginning of period

\$14.56 \$14.41 \$14.10 \$14.25*

Net investment income

0.59 1.20 1.22 0.37

Net realized and unrealized gain (loss) on investments,
short sales, futures transactions and swap contracts

(0.01) 0.25 0.39 (0.17)

Net increase in net asset value resulting from operations

0.58 1.45 1.61 0.20

Dividends from net investment income

(0.65) (1.30) (1.30) (0.32)

Offering costs charged to additional paid-in-capital

(0.03)

Net asset value, end of period
\$14.49 \$14.56 \$14.41 \$14.10

Market price, end of period
\$14.7400 \$14.6100 \$14.6700 \$13.6800

Total Investment Return+

5.54%(1) 9.10% 17.55% (6.66)%(1)

Ratios to Average Net Assets/ Supplementary Data:

Net assets, end of period (000 s)
\$146,966 \$147,645 \$146,180 \$142,921

Operating expenses
1.23%(2) 1.25% 1.28% 1.23%(2)

Interest expense
1.21%(2) 0.58% 0.51% 0.99%(2)

Total expenses
2.44%(2) 1.83% 1.79% 2.22%(2)

Net expenses
2.44%(2) 1.83% 1.79% 2.19%(2)

Net investment income
8.09%(2) 8.23% 8.54% 7.48%(2)

Portfolio turnover rate
28%(1) 65% 78% 70%(1)

+ 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 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, 2005

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 27% of the investments in securities held by the Fund at May 31, 2005) 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.

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

THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.

Notes to Financial Statements (Unaudited)

May 31, 2005

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 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, 2005.

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.

THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.

Notes to Financial Statements (Unaudited)

May 31, 2005

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

Pursuant to a transaction whereby Brascan Financial (U.S.) Corporation purchased all stock ownership of the holding company indirectly owning the Advisor as described in the proxy statement to stockholders dated March 18, 2005 (the Transaction) the Fund entered into a new Investment Advisory Agreement (the New Investment Advisory Agreement) with the Advisor on April 28, 2005. 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. Previously the Advisor advised the Fund pursuant to an Investment Advisory Agreement dated June 18, 2002. During the six months ended May 31, 2005, the Advisor earned \$477,201 in investment advisory fees.

Pursuant to the Transaction, the Advisor entered into a new Sub-Advisory Agreement the New Investment Sub-Advisory Agreement) with Hyperion/GMAC Capital Advisors, LLC (Hyperion/GMAC or the Sub-Advisor) on April 28, 2005. 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 monthly fee paid to Hyperion/GMAC by the Advisor 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. Previously, Hyperion/GMAC sub-advised the Fund pursuant to an Investment Sub-Advisory Agreement dated December 9, 2008.

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 HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.

Notes to Financial Statements (Unaudited)

May 31, 2005

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, 2005, the Administrator earned \$150,837 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.

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, 2005, were \$13,894,544 and \$23,869,434, respectively. Purchases and sales of U.S. Government securities, for the six months ended May 31, 2005, were \$47,380,916 and \$40,144,907, 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.

THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.

Notes to Financial Statements (Unaudited)

May 31, 2005

At May 31, 2005, the Fund had the following reverse repurchase agreements outstanding:

Face Value	Description	Maturity Amount
\$2,102,000	CS First Boston 3.08%, dated 05/27/05, maturity date 06/06/05	\$2,103,798
6,954,000	Goldman Sachs 3.09%, dated 05/23/05, maturity date 06/20/05	12,087,000
12,119,161	Goldman Sachs 3.09%, dated 05/23/05, maturity date 06/23/05	4,446,000
4,453,962	Goldman Sachs 3.07%, dated 05/31/05, maturity date 06/21/05	10,690,000
10,722,115	Lehman Brothers 3.09%, dated 05/19/05, maturity date 06/23/05	6,500,000
6,503,728	Lehman Brothers 2.95%, dated 05/26/05, maturity date 06/02/05	5,692,000
5,712,453	Merrill Lynch 3.08%, dated 05/12/05, maturity date 06/23/05	4,050,000
4,063,253	Morgan Stanley 3.10%, dated 05/06/05, maturity date 06/13/05	3,090,000
3,097,983	Morgan Stanley 3.10%, dated 05/17/05, maturity date 06/16/05	5,406,000
5,418,528	Wachovia Capital Markets 3.09%, dated 05/12/05, maturity date 06/08/05	8,500,000
8,521,158	Wachovia Capital Markets 3.09%, dated 05/23/05, maturity date 06/21/05	8,521,158
\$69,517,000		
	Maturity Amount, Including Interest Payable	\$69,686,852

Market Value of Assets Sold
Under
Agreements \$71,772,368

Weighted Average Interest
Rate 3.08%

The average daily balance of reverse repurchase agreements outstanding during the six months ended May 31, 2005, was approximately \$69,026,444 at a weighted average interest rate of 2.55%. The maximum amount of reverse repurchase agreements outstanding at any time during the period was \$73,979,250 as of December 3, 2004, which was 33.16% of total assets.

6. Capital Stock

There are 50 million shares of \$0.01 par value common stock authorized. Of the 10,144,002 shares outstanding at May 31, 2005, 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, 2005.

THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.
Notes to Financial Statements (Unaudited)
 May 31, 2005

As of May 31, 2005, the following swap agreements were outstanding:

Notional Amount	Expiration Date	Description	Net Unrealized Appreciation/ (Depreciation)
\$ 10,000,000	1/23/06	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.	\$ 67,077
11,000,000	12/15/14	Agreement with Morgan Stanley Capital Services, Inc., dated 12/13/04 to pay semi-annually the notional amount multiplied by 4.555% and to receive quarterly the notional amount multiplied by 3 month USD-LIBOR-BBA.	(289,791)
			\$ (222,714)

8. Federal Income Tax Information

The below information is based upon financial data and book/tax differences as of May 31, 2005. As a result, the amounts provided may change based upon year-end information. Income and capital gain distributions are determined in accordance with federal income tax regulations, which may differ from generally accepted accounting principles.

At May 31, 2005, the tax character of the \$6,572,854 of distributions paid was entirely from ordinary income. During the year ended November 30, 2004, the tax character of the \$13,144,369 of distributions paid was also entirely from ordinary income.

At May 31, 2005, the components of net assets (excluding paid-in-capital) on a tax basis were as follows:

Undistributed Tax ordinary income	\$938,364
Accumulated capital loss	(1,433,280)
Tax basis unrealized appreciation/(depreciation)	\$3,210,545
<hr/>	

Total	\$2,715,629
<hr/>	

The differences between book and tax basis unrealized appreciation/(depreciation) is primarily attributable to the differing treatment of swap interest income/(expense) for tax purposes.

Federal Income Tax Basis: The federal income tax basis of the Fund's investments at May 31, 2005 was \$213,117,316. Net unrealized appreciation was \$3,235,709 (gross unrealized appreciation \$5,781,967; gross unrealized depreciation \$2,546,258). At May 31, 2005, the Fund had a capital loss carryforward of \$1,433,280, of which \$1,070,268 expires on November 30, 2011 and \$363,012 expires on November 30, 2013, available to offset any future gains, to the extent provided by regulations.

Capital Account Reclassification: At May 31, 2005, the Fund's undistributed net investment income was increased by \$660,847 with an offsetting decrease in accumulated net realized loss. These adjustments were primarily the result of current period paydown reclassifications and swap interest income (expense) 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	06/21/05	06/30/05
\$0.0900	07/19/05	07/28/05

10. Contractual Obligations

The Fund enters into contracts that contain a variety of indemnifications. The Fund's maximum exposure under these arrangements is unknown. However, the Fund has not had prior claims or losses pursuant to these contracts and expects the risk of loss to be remote.

PROXY RESULTS (Unaudited)

During the six months ended May 31, 2005, The Hyperion Strategic Mortgage Fund, Inc. shareholders voted on the following proposals at a shareholders meeting on April 19, 2005. The description of each proposal and number of shares voted are as follows:

	Shares Voted For	Shares Voted Against	Shares Voted Abstain
1. To elect to the Fund's Board of Directors			
Clifford E. Lai: 9,776,394 0 101,224			
	Shares Voted for	Shares Voted Against	Shares Voted Abstain
2. To elect to the Fund's Board of Directors			
Leo M. Walsh, Jr: 9,787,719 0 89,899			
	Shares Voted For	Shares Voted Against	Shares Voted Abstain
3. Approval of New Investment Advisory Agreement:	9,672,842	86,249	118,527
	Shares Voted For	Shares Voted Against	Shares Voted Abstain
4. Approval of New Investment Sub-Advisory Agreement:	9,656,585	98,669	122,364
	Shares Voted for	Shares Voted Against	Shares Voted Abstain
5. To select PricewaterhouseCoopers LLP as the independent auditors:	9,721,791	53,248	102,579

THE HYPERION STRATEGIC MORTGAGE FUND, INC.

Board Considerations Relating to the New Investment Advisory Agreement (Unaudited)

On February 23, 2005, the Board of Directors held a meeting called for the purpose of considering the New Investment Advisory Agreement and, after careful review, determined that approving the New Investment Advisory Agreement was in the best interests of the stockholders. At the meeting, senior officers of the Advisor discussed the Transaction and discussed the need to approve the New Investment Advisory Agreement due to the change of control of the Advisor. The Board of Directors considered a wide range of information, including information of the type they regularly consider when determining to continue the Fund's advisory agreement. In determining that the New Investment Advisory Agreement was in the best interests of the stockholders, the Board of Directors considered all factors deemed to be relevant to the Fund, including, but not limited to:

the expectation that the operation of the Advisor and the Fund's day-to-day management, including the Fund's portfolio manager, will remain unchanged for the foreseeable future;

the Advisor and its personnel (including particularly those personnel with responsibilities for providing services to the Fund), resources and investment process will remain unchanged;

the Advisor will also have access to the resources and personnel of Brascan;

the financial viability of the Advisor will remain unchanged;

the terms of the New Investment Advisory Agreement, including the fee, will not change;

the nature, extent and quality of the services that the Advisor has been providing to the Fund will remain unchanged;

the investment performance of the Fund and of similar funds managed by other advisers over various periods;

the Advisory fee rate payable to the Advisor by the Fund and by other client accounts managed by the Advisor, and payable by similar funds managed by other advisers;

the total expense ratio of the Fund and of similar funds managed by other advisers;

compensation payable by the Fund to affiliates of the Advisor for other services; and

the profitability of the Advisor and its affiliates and the extent to which economies of scale would be realized as the Fund grows.

The Board considered the level and depth of knowledge of the Advisor. In evaluating the quality of services provided by the Advisor, the Board took into account its familiarity with the Advisor's management through board meetings, conversations and reports.

The Board compared the advisory fees and total expense ratio of the Fund with various comparative data that it had been provided with in approving the Fund's previous Investment Advisory Agreement. The Board considered the Fund's recent performance results and noted that the Board reviews on a quarterly basis information about the Fund's performance results, portfolio composition and investment strategies. The Board noted that the Fund's advisory fee was equal to the median of advisory fees paid by its peer group of funds and that the Fund's total advisory and administrative fees were only one basis point higher than the median of the Fund's peer group. The Board also considered that the Fund outperformed its peer group for the year ended October 31, 2004. The Board also took into

consideration the financial condition and profitability of the Advisor and Brascan and any indirect benefits derived by the Advisor from the Advisor's relationship with the Fund.

In considering the approval of the New Investment Advisory Agreement, the Board, including the Disinterested Directors, did not identify any single factor as controlling. Based on the Board's evaluation of all factors that it deemed to be relevant, the Board, including the Disinterested Directors, concluded that the Advisor has demonstrated that it possesses the capability and resources necessary to perform the duties required of it under the New Investment Advisory Agreement; performance of the Fund is reasonable in relation to the performance of funds with similar investment objectives; and the proposed Advisory fee is fair and reasonable, given the nature, extent and quality of the services to be rendered by the Advisor. The Board further determined that the change in control of the Advisor did not present any material change in the type and quality of service it would provide to the Fund.

The directors also considered the provisions of Section 15(f) of the 1940 Act, which provides, in relevant part, that affiliated persons may receive compensation if (1) for a period of three years after the Transaction at least 75 percent of the directors of the Fund are independent of the Advisor and (2) an unfair burden is not imposed on the Fund as a result of the Transaction. The Advisor has agreed not to seek any increase in the advisory fees for a period of at least two years and has agreed to pay incremental costs associated with the 2005 Annual Meeting of Stockholders due to the Transaction. In addition, it is expected that at least 75 percent of the Fund's directors will be Disinterested Directors.

After carefully reviewing all of these factors, the Board, including the Disinterested Directors, unanimously approved the New Investment Advisory Agreement and recommended that the Fund's stockholders vote to approve the New Investment Advisory Agreement.

THE HYPERION STRATEGIC MORTGAGE FUND, INC.

Board Considerations Relating to the New Investment Sub-Advisory Agreement (Unaudited)

On February 23, 2005, the Board of Directors held a meeting called for the purpose of considering the New Investment Sub-Advisory Agreement and, after careful review, determined that approving the New Investment Sub-Advisory Agreement was in the best interests of the stockholders. At the meeting, senior officers of the Advisor discussed the Transaction and discussed the need to approve the New Investment Sub-Advisory Agreement due to the change of control of the Sub-Advisor. The Board of Directors considered a wide range of information, including information of the type they regularly consider when determining to continue the Fund's sub-advisory agreement. In determining that the New Investment Sub-Advisory Agreement was in the best interests of the stockholders, the Board of Directors considered all factors deemed to be relevant to the Fund, including, but not limited to:

the expectation that the operation of the Sub-Advisor and the day-to-day management of the Fund's portfolio that is invested in CMBS will remain unchanged for the foreseeable future;

the Sub-Advisor and its personnel (including particularly those personnel with responsibilities for providing services to the Fund), research and credit analysis resources and investment process will remain unchanged;

the Sub-Advisor will also have access to the resources and personnel of Brascan Corporation;

the owners and financial viability of the Sub-Advisor will remain unchanged;

the terms of the New Investment Sub-Advisory Agreement will be not change;

the fees under the New Investment Sub-Advisory Agreement will stay the same and the Advisor will continue to pay the fees to the Sub-Advisor;

the nature, extent and quality of the services that the Sub-Advisor has been providing to the Fund will remain unchanged;

the profitability of the Sub-Advisor and the extent to which economies of scale would be realized as the Fund grows will remain unchanged; and

the investment performance and level of fees of the Fund compared with similar funds managed by other advisors over various periods; (CMBS portion of Fund's portfolio).

The Board considered the level and depth of knowledge of the Sub-Advisor. In evaluating the quality of services provided by the Sub-Advisor, the Board took into account its familiarity with the Sub-Advisor's management through board meetings, conversations and reports.

The Board compared the sub-advisory fees and total expense ratio of the Fund with various comparative data that it had been provided with in approving the Fund's previous Investment Sub-Advisory Agreement. The Board considered the Fund's recent performance results and noted that the Board reviews on a quarterly basis information about the Fund's performance results, portfolio composition and investment strategies. The Board noted that the Fund's advisory fee was equal to the median of advisory fees paid by its peer group of funds and that the Fund's total advisory and administrative fees were only one basis point higher than the median of the Fund's peer group. The Board also considered that the Fund outperformed its peer group for the year ended October 31, 2004. The Board also took into consideration the financial condition and profitability of the Sub-Advisor and Brascan and any indirect benefits derived by the Sub-Advisor from the Sub-Advisor's relationship with the Fund.

In considering the approval of the New Investment Sub-Advisory Agreement, the Board, including the Disinterested Directors, did not identify any single factor as controlling. Based on the Board's evaluation of all factors that it deemed to be relevant, the Board, including the Disinterested Directors, concluded that the Sub-Advisor has demonstrated that it possesses the capability and resources necessary to perform the duties required of it under the New Investment Sub-Advisory Agreement; performance of the Fund (CMBS portion) is reasonable in relation to the performance of funds with similar investment objectives; and the proposed Sub-Advisory fee to be paid by the Advisor is fair and reasonable, given the nature, extent and quality of the services to be rendered by the Sub-Advisor. The Board further determined that the change in control of the Sub-Advisor did not present any material change in the type and quality of service it would provide to the Fund.

After carefully reviewing all of these factors, the Board, including the Disinterested Directors, unanimously approved the New Investment Sub-Advisory Agreement and recommended that the Fund's stockholders vote to approve the New Investment Sub-Advisory Agreement.

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 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	Number of Portfolios in Fund Complex Overseen by Director
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Disinterested Directors

Class II Director to serve until 2007 Annual Meeting of Stockholders:

Rodman L. Drake
c/o One Liberty Plaza,
36th floor,
New York, New York
10006-1404

Age 62
[02-02-43]

Chairman Elected
December 9, 2003

Director since July 1989,
Member of the Audit
Committee, Chairman of
Nominating and
Compensation Committee

Elected for Three Year Term
Chairman (since December
2003) and Director of several
investment companies
advised by the Advisor
(1989-Present); Co-founder,
Baringo Capital LLC
(2002-Present); Director,
Jackson Hewitt Tax Services
Inc. (JTX) (2004- Present);
Director, Animal Medical
Center (2002-Present);
Director, Hotelevision, Inc.
(1999-2003); Director and/or
Lead Director, Parsons
Brinckerhoff, Inc.
(1995-Present); Director,
Absolute Quality Inc.
(2000-Present); Trustee of
Excelsior Funds (33) (1994-
Present); President,
Continuation Investments
Group Inc. (1997-2001). 5

Class I Director to serve

**until 2006 Annual Meeting
of Stockholders:**

Robert F. Birch
c/o One Liberty Plaza,
36th floor,
New York, New York
10006-1404

Age 69
[03-12-36]

Director since December
1998, Member of the Audit
Committee, Member of
Nominating and
Compensation Committee,
Member of Executive
Committee

Elected for Three Year Term
Director of several investment
companies advised by the
Advisor or by its affiliates
(1998- Present); Chairman
and President, New America
High Income Fund
(1992-Present); Director,
Brandywine Funds (3) (2001
to Present). 5 **Interested**

**Director Nominee
Class III Director to serve
until 2006 Annual Meeting
of Stockholders:**

Clifford E. Lai*
c/o One Liberty Plaza,
36th floor,
New York, New York
10006-1404

Age 52
[05-16-53]

Director since December
2003

Elected until 2005 Member of
Executive Committee

Elected for Three Year Term
President (1998-Present) and
Chief Investment Officer
(1993-2002) of Hyperion
Capital Management, Inc. (the
Advisor); Co- Chairman
(2003-Present) and Board of
Managers (1995-Present) of
Hyperion-GMAC Capital
Advisors, LLC (formerly
Lend Lease Hyperion Capital,
LLC); President and Director
of several investment
companies advised by the
Advisor (1995-Present). 3

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

Officers of the Trust

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, New York, New York 10006-1404 Age 52 [05-16-53]	President	Elected Annually Since June 2002	Please see Information Concerning Nominees/ Directors.
John Dolan* c/o One Liberty Plaza, 36th floor, New York, New York 10006-1404 Age 51 [08-19-53]	Vice President	Elected Annually Since June 2002	Chief Investment Strategist (1998-Present) and Chief Investment Officer (2002-Present) of the Advisor.
Daniel S. Kim*+ c/o One Liberty Plaza, 36th floor, New York, New York 10006-1404 Age 37 [3-13-68]	Chief Compliance Officer (CCO) & Secretary	Elected Annually CCO September 2004 and Secretary Since January 2005	Director and CCO (September 2004-Present), and Secretary (since January 2005) of the Adviser; Secretary (since January 2005) and CCO (September 2004-Present) of several investment companies advised by the Advisor; Secretary (since January 2005) and CCO (September 2004-Present) Hyperion GMAC Capital Advisors, LLC; Assistant General Counsel and CCO (May 2001-August 2004) Oak Hill Capital Management; Assistant General Counsel (May 2001-August 2004) of Oak Hill Advisors, LP; Lawyer (January 2001-April 2001) Arkin, Kaplan & Cohen; Law student preparing for the New York State Bar (January 2000-January 2001).
Thomas F. Doodian* c/o One Liberty Plaza, 36th floor, New York, New York 10006-1404 Age 46 [05-22-59]	Treasurer	Elected Annually Since June 2002	Managing Director, Chief Operating Officer (1998-Present) and Director of Finance and Operations of the Advisor (1995-Present); Treasurer of several investment companies advised by the Advisor (1996-Present); Treasurer of Hyperion GMAC Capital Advisors, LLC (formerly, Lend Lease Hyperion Capital Advisors, LLC) (1996-Present)

* Interested person as defined by the Investment Company Act of 1940 (the 1940 Act) because of affiliations with Hyperion Capital Management, Inc., the Fund s Advisor.

+ Joseph Tropeano served as the Fund s secretary until January 2005.

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 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 REGISTERED PUBLIC
ACCOUNTING FIRM**

PRICEWATERHOUSECOOPERS LLP

300 Madison Avenue
New York, New York 10017

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.

Quarterly Portfolio Schedule: The Fund will file Form N-Q with the Securities and Exchange Commission for the first and third quarters of each fiscal year. 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 Forms 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>.

Proxy Voting Policies and Procedures

A description of the policies and procedures that the Fund uses to determine how to vote proxies relating to portfolio securities is available without charge, upon request, by calling 1-800-497-3746 and on the Securities and Exchange Commission's website at <http://www.sec.gov>.

Proxy Voting Record

The Fund has filed with the Securities and Exchange Commission its proxy voting record for the 12-month period ending June 30 on Form N-PX. Once filed, the most recent Form N-PX will be available without charge, upon request, by calling 1-800-497-3746 or on the Securities and Exchange Commission's website at <http://www.sec.gov>.

Officers & Directors

Rodman L. Drake*
Chairman

Robert F. Birch*
Director

Clifford E. Lai
Director and President

John Dolan
Vice President

Thomas F. Doodian
Treasurer

Daniel Kim**
Secretary

* Audit Committee Members

** Elected January 2005

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

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 Daniel Kim at 1-800-HYPERION or by writing to Mr. Kim 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 Rodman L. Drake and Robert F. Birch.

Item 6. Schedule of Investments.

Please see Item 1.

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

Not applicable.

Item 8. Portfolio Managers of Closed-End Management Investment Companies.

Not applicable.

Item 9. Purchases of Equity Securities by Closed-End Management Investment Company and Affiliated Purchasers.

None.

Item 10. Submission of Matters to a Vote of Security Holders.

None.

Item 11. 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 quarter of the period covered by this report that has materially affected or is reasonably likely to materially affect the Registrant's internal control over financial reporting.

Item 12. 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 1, 2005

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 1, 2005

By: /s/ Thomas F. Doodian

Thomas F. Doodian

Treasurer and Principal Financial Officer

Date: August 1, 2005