HYPERION STRATEGIC MORTGAGE INCOME FUND INC
Form N-CSR
February 09, 2006

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, 2005

Item 1. Reports to Shareholders.

THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.

Annual Report

November 30, 2005

THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.
Portfolio Composition

The chart that follows shows the allocation of the Fund s holdings by asset category as of November 30, 2005.

THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.

Portfolio of Investments As of November 30, 2005*

* As a percentage of total investments.

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THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.
Report of the Investment Advisor
For the Year Ended November 30, 2005

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, 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 fiscal year ending November 30, 2005, shareholders realized a total investment return of -5.20%, which assumes the reinvestment of dividends and is exclusive of brokerage commissions. Based on the NYSE closing price of $12.70 on November 30, 2005, the Fund s shares had a current yield of 7.69%.

As of November 30, 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 3.6 years, as measured on a net asset basis.

Market Outlook and Portfolio Strategy

2005 witnessed the continued resolve of the Federal Reserve to raise interest rates in an attempt to bring monetary policy towards a more neutral stance. Eight interest rate tightenings occurred in 2005 and it had its most dramatic affect on short-term interest rates where the yield on the 2-year Treasury increased by 123 bps over the year. A nominal increase in longer term interest rates of 15 bps was witnessed by the 10-year maturity Treasury. The tepid increase in long-term interest rates, especially when compared to the move of short-term interest rates, can be a result of many factors, but we cite lower than expected core (excluding food and energy) inflation and moderate economic growth as the primary factors.

We believe that 2006 will be a transition period for the U. S. economy and for U.S. bonds. The key for the economy is the consumer they make up over 70% of GDP and as a result, as the consumer goes so does the economy, and as the economy goes, so do interest rates. We believe that rising oil prices, reduced savings, increased consumer debt and an increase in mortgage costs due to resetting interest rates on short-term hybrid mortgages will weigh heavily on the consumer in the second half of 2006. We believe this will lead to a slowdown in the economy. We also believe that the Federal Reserve will react by first halting their tightening of monetary policy by the second quarter, and even begin to lower interest rate targets by the fourth quarter. It would not surprise us to see interest rates dip low enough to cause another dramatic wave of mortgage refinancings. After all, it has been these refinancings that have bailed out the consumer, which have in turn bailed out the economy. It is too early for us to call whether a full fledged recession will occur, but we do see headwinds against the economy forming.

Budget deficits, trade deficits, increased governmental borrowings, and a weak currency are all factors that can push interest rates higher, but we view these as long-term factors that have the potential to have a dramatic effect on interest rates. However, we believe that our dominate position in the world economy would have to dramatically change before these factors come into play. In the mean time, the focus is on the economy, and right now, at 75% of GNP, our focus is on the consumer.

Much has been written about the housing bubble over the last few months, and while the Fund does invest in mortgages backed by residential homes, our view is as follows: There has rarely been (if any) a simultaneous decline in home prices across the nation. Home price declines have typically been localized to specific regions of the country and are triggered by economic conditions that are unique to the specific geographic area. Having said that, we are extremely aware of the risks of certain areas of the country where home prices have dramatically exceeded the affordability characteristics of the borrowers. There are, however, ways for us to manage those risks. For example, we have been reviewing the structures of the securities in which we invest, moving up in credit, reviewing the borrowers, being cognizant of the vintage of securities in which we invest, and insuring that we invest in securities that have a diversified exposure across the country. These are but a few of the ways we can mitigate the risks in the investments that we make for the Fund.

The market s risk aversion away from residential MBS in 2005 caused an underperformance of the sector. This is a situation that we view as an opportunity to take selective positions in specific securities at attractive yield levels. We expect this scenario to continue to play out in 2006 as more stress is brought onto the consumer. As these opportunities present themselves, we expect to capitalize.

From a Fund duration point of view, we have been managing the portfolio to a conservative 3.6 years, a strategy that served us well in 2005. With our outlook for 2006, we intend to bring the duration more in line with its longer term target of between 4.0 and 4.5 years.

The sector allocation of the Fund reflects changes made to take advantage of opportunities in the market. Some below-investment-grade older issued CMBS holdings were sold at investment-grade levels to take advantage of their strong performance. Their performance was due to their higher subordination at issuance in 2000-2002, the overall rise in value of commercial real estate, and favorable lease roll-over rates. These sales had the impact of reducing our below-investment-grade exposures which we offset by buying some selected securities in the RMBS and ABS sectors. Finally, pass-throughs paid down and the proceeds from those paydowns, along with the CMBS sales, have been placed in Treasuries while we wait for other higher-yielding RMBS and ABS opportunities.

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

November 30, 2005

	Interest Rate	Maturity	Principal Amount (000s)	Value (Note 2)
U.S. GOVERNMENT & AGENCY OBLIGATIONS 76.7%				
U.S. Government Agency Pass-Through Certificates 57.5%				
Federal Home Loan Mortgage Corporation				
Pool A14559	6.50%	09/01/33	$2,370	$2,424,877
Pool C68878	7.00	06/01/32	501	522,647
Pool C69047	7.00	06/01/32	1,133	1,180,729
Pool G01466	9.50	12/01/22	1,364	1,496,679
Pool 555559	10.00	03/01/21	1,448	1,611,356
				7,236,288
Federal National Mortgage Association				
Pool 29596	5.50	12/01/99	5,000	4,923,440
Pool 694391	5.50	03/01/33	3,833	3,784,045
Pool 753914	5.50	12/01/33	8,969@	8,855,715
Pool 754355	6.00	12/01/33	5,385@	5,417,945
Pool 761836	6.00	06/01/33	3,173	3,194,345
Pool 763643	6.00	01/01/34	7,719@	7,766,242
Pool 255413	6.50	10/01/34	9,486@	9,714,424
Pool 323982	6.50	10/01/06	295	297,428
Pool 795367	6.50	09/01/34	4,560@	4,670,302
Pool 809989	6.50	03/01/35	4,295@	4,398,705
Pool 626299	7.00	06/01/32	530	553,624
Pool 635095	7.00	06/01/32	927	967,842
Pool 641575				

7.00 04/01/32 406 424,402
Pool 645399
7.00 05/01/32 2,515 2,626,439
Pool 645466
7.00 05/01/32 2,535 2,646,982
Pool 650131
7.00 07/01/32 1,529 1,597,292
Pool 398800
8.00 06/01/12 695 735,531
Pool 827854
8.00 10/01/29 2,926 3,122,651
Pool 636449
8.50 04/01/32 2,314 2,502,870
Pool 823757
8.50 10/01/29 4,183 4,536,641
Pool 458132
9.44 03/15/31 1,868 2,049,257

74,786,122

Total U.S. Government Agency Pass-Through Certificates
(Cost $83,376,156)
82,022,410

U.S. Treasury Obligations 19.2%
United States Treasury Notes
4.00
02/15/15 1,173 1,125,943 4.25
11/15/14 26,800@ 26,240,979

Total U.S. Treasury Obligations
(Cost $28,019,831)
27,366,922

Total U.S. Government & Agency Obligations
(Cost $111,395,987)
109,389,332

See notes to financial statements.

THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.
Portfolio of Investments

November 30, 2005	**Interest Rate**	**Maturity**	**Principal Amount (000s)**	**Value (Note 2)**
ASSET-BACKED SECURITIES 26.2%				
Housing Related Asset-Backed Securities 24.4%				
Asset Backed Funding Certificates				
Series 2005-AQ1, Class B1*(b)	5.75/6.25%	06/25/35	$993	$849,274
Series 2005-AQ1, Class B2*(b)	5.75/6.25	06/25/35	1,050	866,490
				1,715,764
Bank of America Funding Corp.				
Series 2005-2, Class B4	5.66	04/25/35	874	759,282
Series 2005-2, Class B5	5.66	04/25/35	700	461,147
Series 2005-2, Class B6	5.66	04/25/35	526	175,316
				1,395,745
First Franklin Mortgage Loan Asset Backed Certificates				
Series 2003-FFH1, Class M4(a)	7.69	09/25/33	4,740	4,832,032
Series 2004-FFH1, Class B*(a)	7.69	03/25/34	1,550	1,447,982
Series 2004-FF2, Class B*(a)	7.69	03/25/34	900	849,064
Series 2004-FFH2C, Class B1*(a)	7.69	06/25/34	1,250	1,142,905
Series 2004-FF8, Class B4*(a)	7.69	10/25/34	1,250	1,141,230
				9,413,213
Green Tree Financial Corp.				
Series 1997-3, Class M1	7.53	03/15/28	2,000	1,220,000

Series 1995-6, Class M1
8.10
09/15/26 4,325 4,488,052

5,708,052

Harborview Mortgage Loan Trust

Series 2005-1, Class B4*(a)
5.91 03/19/35 629 524,585
Series 2005-1, Class B5*(a)
5.91 03/19/35 914 610,927
Series 2005-1, Class B6*(a)
5.91 03/19/35 1,144 257,333
Series 2005-2, Class B4*(a)
5.91 05/19/35 1,488 1,217,541

2,610,386

Long Beach Mortgage Loan Trust

Series 2002-5, Class M3(a)
7.44 11/25/32 2,500 2,509,758
Mid-State Trust

Series 2004-1, Class M2
8.11 08/15/37 1,565 1,631,214
Structured Asset Investment Loan Trust

Series 2004-4, Class B*(b)
5.00/5.50 04/25/34 1,500 1,323,068
Series 2004-11, Class M9(b)
5.00/5.50 01/25/35 1,900 1,800,335
Series 2004-7, Class B(a)
6.69 08/25/34 2,161 1,941,576
Series 2004-8, Class B1(a)
6.69 09/25/34 1,000 958,017
Series 2004-10, Class M7(a)
6.69 11/25/34 2,000 2,016,072
Series 2004-2, Class B*(a)
7.19 03/25/34 1,074 989,525

9,028,593

See notes to financial statements.

THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.

Portfolio of Investments

November 30, 2005

	Interest Rate	Maturity	Principal Amount (000s)	Value (Note 2)
ASSET-BACKED SECURITIES (continued)				
Structured Asset Securities Corporation				
Series 2005-6, Class B5	5.34%	05/25/35	$496	$410,039
Series 2005-6, Class B6	5.34	05/25/35	496	315,723
Series 2005-6, Class B7	5.34	05/25/35	347	107,719
				833,481
Total Housing Related Asset-Backed Securities (Cost $35,195,433)				34,846,206
Non-Housing Related Asset-Backed Securities 1.8%				
Airplanes Pass Through Trust				
Series 1R, Class A8 (Cost $2,299,543)	4.49	03/15/19	2,668	2,494,573
Total Asset-Backed Securities (Cost $37,494,976)				37,340,779
COMMERCIAL MORTGAGE BACKED SECURITIES 16.6%				
Bear Stearns Commercial Mortgage Securities				
Series 1999-C1, Class D	6.53	02/14/31	2,500	2,652,750
Series 2000-WF1, Class E	7.90	02/15/32	2,000	2,190,560
				4,843,310
Chase Commercial Mortgage Securities Corp.				

Series 2000-2, Class I*
6.65 07/15/32 1,000 624,192
GE Capital Commercial Mortgage Corp.

Series 2002-2A, Class G*
6.04 08/11/36 3,000 3,101,898
Series 2000-1, Class G*
6.13 01/15/33 1,000 452,200
Series 2002-2A, Class H*
6.31 08/11/36 2,000 2,098,858

5,652,956

JP Morgan Chase Commercial
Mortgage Securities

Series 2003-LN1, Class G*
5.48 10/15/37 1,600 1,565,354
Morgan Stanley Capital I

Series 1999-FNV1, Class E
7.46 03/15/31 2,000 2,119,540
Nationslink Funding Corp.

Series 1998-2, Class E
7.11 08/20/30 4,000 4,221,852
UBS 400 Atlantic Street Mortgage Trust

Series 2002-C1A, Class B3*
7.19 01/11/22 2,000 2,128,840
Wachovia Bank Commercial Mortgage Trust

Series 2004-WL4A, Class H*
4.97 10/15/15 700 698,178
Series 2005-C16, Class H*
5.30 10/15/41 2,000 1,834,944

2,533,122

Total Commercial Mortgage
Backed Securities
(Cost $23,972,941)
23,689,166

See notes to financial statements.

THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.
Portfolio of Investments

November 30, 2005	Interest Rate	Maturity	Principal Amount (000s)	Value (Note 2)
NON-AGENCY RESIDENTIAL MORTGAGE BACKED SECURITIES — 25.5%				
Subordinated Collateralized Mortgage Obligations — 25.5%				
Bank of America Alternative Loan Trust				
Series 2004-3, Class 30B4*	5.50%	04/25/34	$995	$820,277
Series 2004-3, Class 30B5	5.50	04/25/34	697	430,634
				1,250,911
Bank of America Mortgage Securities, Inc.				
Series 2004-A, Class B4	3.91	02/25/34	2,042	1,880,881
Series 2003-10, Class 1B4	5.50	01/25/34	558	506,744
Series 2002-10, Class 1B3	6.00	11/25/32	1,442	1,436,081
				3,823,706
Cendant Mortgage Corp.				
Series 2002-4, Class B1	6.50	07/25/32	2,585	2,578,018
Series 2002-4, Class B2	6.50	07/25/32	1,034	1,031,008
Series 2002-4, Class B3	6.50	07/25/32	603	586,482
Series 2002-4, Class B4	6.50	07/25/32	345	324,128
Series 2002-4, Class B5	6.50	07/25/32	258	242,838
Series 2002-4, Class B6*	6.50	07/25/32	345	284,307
				5,046,781

First Horizon Alternative
Mortgage Securities

Series 2005-AA6, Class B4
5.48 08/25/35 849 720,937
Series 2005-AA6, Class B5
5.48 08/25/35 799 553,907
Series 2005-AA6, Class B6
5.48 08/25/35 500 142,392

1,417,236

First Horizon Mortgage
Pass-Through Trust

Series 2005-4, Class B4*
5.45 07/25/35 426 350,994
Series 2005-5, Class B4*
5.46 10/25/35 728 597,994
Series 2005-5, Class B5*
5.46 10/25/35 546 341,849
Series 2005-5, Class B6*
5.46 10/25/35 547 164,208
Series 2005-3, Class B4
5.50 06/25/35 457 376,353

1,831,398

G3 Mortgage Reinsurance Ltd.

Series 1, Class E*
24.00 05/25/08 4,213 4,671,049
JP Morgan Mortgage Trust

Series 2003-A1, Class B4
4.49 10/25/33 535 464,353
Residential Finance Limited Partnership

Series 2002-A, Class B7
9.80 10/10/34 1,921 1,961,815
Residential Funding Mortgage Securities
I, Inc.

Series 2004-S1, Class B2
5.25 02/25/34 451 295,578
Series 2003-S7, Class B3
5.50 05/25/33 319 227,139
Series 2003-S7, Class B2
5.50 05/25/33 527 200,991

723,708

Resix Finance Limited Credit-Linked Note

Series 2005-C, Class B7*			
7.20	09/10/37	1,996	1,995,565
Series 2004-C, Class B7*			
7.60	09/10/36	984	1,005,066
Series 2004-B, Class B8*			
8.85	02/10/36	798	821,811
Series 2003-CB1, Class B8*			
10.90	06/10/35	962	1,005,068

See notes to financial statements.

THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.
Portfolio of Investments

November 30, 2005

	Interest Rate	Maturity	Principal Amount (000s)	Value (Note 2)
NON-AGENCY RESIDENTIAL MORTGAGE BACKED SECURITIES (continued)				
Series 2004-B, Class B9*	12.40%	02/10/36	$1,222	$1,271,124
Series 2004-A, Class B10*	15.60	02/10/36	488	507,643
				6,606,277
Structured Asset Mortgage Investments, Inc.				
Series 2002-AR1, Class B4	5.53	03/25/32	641	632,129
Washington Mutual Mortgage Securities Corp.				
Series 2002-AR12, Class B4	4.67	10/25/32	929	896,616
Series 2002-AR12, Class B5	4.67	10/25/32	697	659,100
Series 2002-AR12, Class B6	4.67	10/25/32	1,162	860,145
Series 2002-AR10, Class B4*	4.95	10/25/32	945	915,704
Series 2002-AR10, Class B5*	4.95	10/25/32	708	668,439
Series 2002-AR10, Class B6*	4.95	10/25/32	1,182	874,705
Series 2005-AR2, Class B10(a)	5.03	01/25/45	1,792	1,452,131
Series 2002-AR11, Class B5	5.14	10/25/32	603	593,606
Series 2002-AR11, Class B6	5.14	10/25/32	809	621,615
				7,542,061
Wells Fargo Mortgage Backed Securities Trust				
Series 2002, Class B5	6.00	06/25/32	359	352,586
Total Subordinated Collateralized Mortgage Obligations (Cost $35,147,987)				

36,324,010

Total Non-Agency Residential Mortgage Backed Securities
(Cost $35,147,987)
36,324,010

SHORT TERM INVESTMENTS 0.1%
United States Treasury Bills

(Cost $99,333)
4.11 12/15/05 100 99,848

Total Investments 145.1%
(Cost $208,111,224)
206,843,135
Liabilities in Excess of Other Assets (45.1)%
(64,312,542)

NET ASSETS 100.0%
$142,530,593

@	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, 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.
(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
November 30, 2005

Assets:	
Investments in securities, at market (cost $208,111,224) (Note 2)	$206,843,135
Cash	671,319
Interest receivable	955,031
Principal paydowns receivable	1,743,497
Unrealized appreciation on swap contracts (Note 7)	385,848
Prepaid expenses and other assets	14,427
Total assets	210,613,257
Liabilities:	
Reverse repurchase agreements (Note 5)	62,805,000
Interest payable for reverse repurchase agreements (Note 5)	72,271
Payable for investments purchased	4,956,628
Investment advisory fee payable (Note 3)	76,189
Administration fee payable (Note 3)	18,783
Directors fees payable	24,812
Accrued expenses and other liabilities	128,981
Total liabilities	68,082,664
Net Assets (equivalent to $14.05 per share based on 10,144,002 shares issued and outstanding)	$142,530,593

Composition of Net Assets:

Capital stock, at par value ($.01) (Note 6)	$101,440
Additional paid-in capital (Note 6)	144,148,737
Accumulated undistributed net investment income	1,739,109
Accumulated net realized loss	(2,576,452)
Net unrealized depreciation	(882,241)
Net assets applicable to capital stock outstanding	$142,530,593

See notes to financial statements.

THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.
Statement of Operations
For the Year Ended November 30, 2005

Investment Income (Note 2):

Interest	$15,680,410

Expenses:

Investment advisory fee (Note 3)	948,388
Administration fee (Note 3)	287,152
Insurance	151,139
Custodian	76,225
Accounting and tax services	102,383
Reports to shareholders	80,717
Transfer agency	30,032
Directors fees	80,847
Legal	19,833
Registration fees	23,750
Miscellaneous	10,066
Total operating expenses	1,810,532
Interest expense on reverse repurchase agreements (Note 5)	2,121,336
Total expenses	3,931,868
Net investment income	11,748,542

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

Net realized gain (loss) on:

Investment transactions	(215,525)
Futures transactions	(168,844)
Swap contracts	94,348
Net realized loss on investment transactions, futures transactions and swap contracts	(290,021)
Net change in unrealized appreciation/depreciation on:	
Investments	(4,681,463)
Futures	323
Swap contracts	321,395
Net change in unrealized appreciation/depreciation on investments, futures and swap contracts	(4,359,745)
Net realized and unrealized loss on investments, futures and swap contracts	(4,649,766)
Net increase in net assets resulting from operations	$7,098,776

See notes to financial statements.

THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.

Statements of Changes in Net Assets

	For the Year Ended November 30, 2005	For the Year Ended November 30, 2004
Increase (Decrease) in Net Assets Resulting from Operations:		
Net investment income	$11,748,542	$12,144,805
Net realized gain (loss) on investment transactions, futures transactions and swap contracts	(290,021)	2,397,402
Net change in unrealized appreciation/depreciation on investments, futures and swap contracts	(4,359,745)	46,772
Net increase in net assets resulting from operations	7,098,776	14,588,979
Dividends to Shareholders (Note 2):		
Net investment income	(12,233,207)	(13,144,369)
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
Net increase from capital stock transactions	19,808	20,761
Total increase (decrease) in net assets	(5,114,623)	1,465,371
Net Assets:		

Beginning of year	147,645,216	146,179,845
End of year (including undistributed net investment income of $1,739,109 and $1,107,938, respectively)	$142,530,593	$147,645,216

See notes to financial statements.

THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.

Statement of Cash Flows

For the Year Ended November 30, 2005

Increase (Decrease) in Cash:

Cash flows provided by (used for) operating activities:

Net increase in net assets resulting from operations	$7,098,776
Adjustments to reconcile net increase in net assets from operations to net cash provided by operating activities:	
Purchases of long-term portfolio investments	(97,830,021)
Proceeds from disposition of long-term portfolio investments, principal paydowns, net of losses	105,940,558
Purchases of short-term portfolio investments, net	1,500,000
Decrease in interest receivable	45,283
Decrease in receivable for investments sold	610,709
Increase in prepaid expenses and other assets	(276)
Decrease in variation margin payable	(100,972)
Increase in interest payable for reverse repurchase agreements	30,316
Increase in payable for investments purchased	2,282,454
Decrease in investment advisory fee payable	(1,822)
Decrease in administration fee payable	(9,881)
Increase in accrued expenses and other liabilities	10,524
Net accretion on investments	(1,943,451)
Unrealized depreciation on investments	4,681,463
Unrealized appreciation on swaps	(321,395)

Net realized loss on investment transactions	215,525
Net cash provided by operating activities	22,207,790
Cash flows used for financing activities:	
Net cash provided by reverse repurchase agreements	(9,696,750)
Dividends paid to shareholders, net of reinvestments	(12,213,399)
Net cash used for financing activities	(21,910,149)
Net increase in cash	297,641
Cash at beginning of year	373,678
Cash at end of year	$671,319

Interest payments for the year ended November 30, 2005, totaled $2,091,020.

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 Year Ended November 30, 2005	For the Year Ended November 30, 2004	For the Year Ended November 30, 2003	For the Period Ended November 30, 2002@
Per Share Operating Performance:				
Net asset value, beginning of period	$14.56	$14.41	$14.10	$14.25*
Net investment income	1.16	1.20	1.22	0.37
Net realized and unrealized gain (loss) on investments, short sales, futures transactions and swap contracts	(0.46)	0.25	0.39	(0.17)
Net increase in net asset value resulting from operations	0.70	1.45	1.61	0.20
Dividends from net investment income	(1.21)	(1.30)	(1.30)	(0.32)
Offering costs charged to additional paid-in-capital				(0.03)

Net asset value, end of period
$14.05 $14.56 $14.41 $14.10

Market price, end of period
$12.7000 $14.6100 $14.6700 $13.6800

Total Investment Return+
(5.20%) 9.10% 17.55% (6.66%)(1)
Ratios to Average Net Assets/ Supplementary Data:

Net assets, end of period (000 s)
$142,531 $147,645 $146,180 $142,921
Operating expenses
1.24% 1.25% 1.28% 1.23%(2)
Interest expense
1.45% 0.58% 0.51% 0.99%(2)
Total expenses
2.69% 1.83% 1.79% 2.22%(2)
Net expenses
2.69% 1.83% 1.79% 2.19%(2)
Net investment income
8.05% 8.23% 8.54% 7.48%(2)
Portfolio turnover rate
46% 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
November 30, 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 17% of the investments in securities held by the Fund at November 30, 2005) at their fair value as determined in good faith, utilizing procedures approved by the Board of Directors, 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
November 30, 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 November 30, 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
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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: Through its custodian, the Fund 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 an 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. During the year ended November 30, 2005, the Advisor earned $948,388 in investment advisory fees.

The Advisor had entered into a Sub-Advisory Agreement with Hyperion/ GMAC Capital Advisors, LLC (Hyperion/ GMAC). Under the terms of the Sub-Advisory Agreement, Hyperion/ GMAC assisted 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 fee paid under the Sub-Advisory Agreement was paid by the Advisor, out of its advisory fee. The monthly fee was 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. On October 31, 2005, the Sub-Advisory Agreement between the Advisor and Hyperion/ GMAC was terminated.

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

THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.
Notes to Financial Statements
November 30, 2005

assets. During the year ended November 30, 2005 the Administrator earned $287,152 in administration fees. The Administrator is responsible for any fees due the Sub-Administrator.

Certain officers and directors of the Fund are officers and/or directors of the Advisor 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 year ended November 30, 2005, were $25,036,046 and $48,342,605, respectively. Purchases and sales of U.S. Government securities, for the year ended November 30, 2005, were $72,793,975 and $58,104,500, 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, 2005, the Fund had the following reverse repurchase agreements outstanding:

Face Value	Description	Maturity Amount
$9,437,000	Goldman Sachs 4.07%, dated 11/22/05, maturity date 12/06/05	$9,451,937
5,273,000	Goldman Sachs 4.20%, dated 11/22/05, maturity date 12/27/05	5,294,531
23,205,000	Lehman Brothers 3.95%, dated 11/29/05, maturity date 12/06/05	23,222,823
8,533,000	Lehman Brothers 4.24%, dated 11/10/05, maturity date	

01/12/06 8,596,315 4,528,000 Merrill Lynch 4.15%, dated 11/17/05, maturity date 12/15/05 4,542,615 7,323,000

Wachovia Capital Markets 4.23%, dated 11/14/05, maturity date 1/10/06 7,372,046 4,506,000

Wachovia Capital Markets 4.23%, dated 11/14/05, maturity date 1/10/06 4,536,179

$62,805,000

Maturity Amount, Including Interest Payable $63,016,446

Market Value of Assets Sold Under Agreements $60,077,805

Weighted Average Interest Rate 4.10%

The average daily balance of reverse repurchase agreements outstanding during the year ended November 30, 2005, was approximately $69,691,915 at a weighted average interest rate of 3.04%. 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 November 30, 2005, the Advisor owned 7,018 shares.

THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.
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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, 2005.

As of November 30, 2005, the following swap agreements were outstanding:

Notional Amount	Expiration Date	Description	Net Unrealized Appreciation/ (Depreciation)
$20,000,000	10/11/10	Agreement with Morgan Stanley Capital Services, Inc., dated 10/07/05 to pay semi-annually the notional amount multiplied by 4.716% and to receive quarterly the notional amount multiplied by 3 month USD-LIBOR-BBA.	$153,745
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.	232,103
			$385,848

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, 2005 the tax character of the $12,233,207 of distributions paid was entirely from ordinary income.

At November 30, 2005 the components of net assets (excluding paid-in-capital) on a tax basis were as follows:

Undistributed Tax ordinary income	$1,584,712
Accumulated capital loss	$(2,407,113)
Post October capital loss deferrals	(169,339)
Book basis unrealized appreciation/(depreciation)	(882,241)
Plus: Cumulative timing differences	154,397
Unrealized appreciation/(depreciation)	$(727,844)

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 differing treatment of swap income (expense) for tax purposes.

Federal Income Tax Basis: The federal income tax basis of the Fund s investments at November 30, 2005 was $208,111,224. Net unrealized depreciation was $1,268,089 (gross unrealized appreciation $2,739,861; gross unrealized

THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.
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depreciation $4,007,950). At November 30, 2005, the Fund had a capital loss carryforward of $2,407,113, which $1,070,268 expires in 2011 and $1,336,845 expires in 2013, available to offset any future gains, to the extent provided by regulations.

Capital Account Reclassification: At November 30, 2005, the Fund s undistributed net investment income was increased by $1,115,836 with an offsetting increase 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
$0.09	12/20/05	12/29/05
$0.09	12/30/05	01/27/06

10. Contractual Obligations

The Fund enters into contracts that have a variety of indemnification. 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.

11. Change of Independent Registered Public Accounting Firm

In connection with the Transaction, PricewaterhouseCoopers LLP (PwC) was unable to conclude that it continued to be independent with respect to the Fund as a result of this acquisition by the ultimate parent corporation, Brascan Corp. that is now Brookfield Asset Management, Inc. PwC resigned as the Fund s Independent Registered Public Accounting Firm, effective December 5, 2005. The Audit Committee of the Fund then submitted a recommendation to the Board of Directors to engage Briggs Bunting & Dougherty, LLP (BBD) as the Fund s Independent Registered Public Accounting Firm for the fiscal year ended November 30, 2005. During the fiscal years ended November 30, 2004 and 2003, PwC s audit reports contained no adverse opinion or disclaimer of opinion; nor were their reports qualified as to uncertainty, audit scope or accounting principles. Further, during the fiscal years ended November 30, 2004 and 2003 and through December 5, 2005, there were no disagreements between the Fund and PwC on accounting principles or practices, financial statement disclosure or audit scope, which, if not resolved to the satisfaction of PwC, would have caused them to make reference to the disagreement in their reports.

During the two most recent fiscal years and through December 5, 2005, the date the Board of Directors approved BBD as the Fund s auditor, the Fund did not consult BBD regarding either (1) the application of accounting principles to a specified transaction, either completed or proposed, or the type of audit opinion that might be rendered on the Fund s financial statements, or (2) any matter that was either the subject of a disagreement or a reportable event, as such terms are defined in Item 304 of Regulation S-K.

The Fund provided PwC with a copy of these disclosures and has requested PwC to furnish the Fund with a letter addressed to the Commission stating whether it agrees with the statements made by the Fund herein and, if not, detailing the particular statements with which it does not agree.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and Board of Directors of
The Hyperion Strategic Mortgage Income Fund, Inc.
New York, New York

We have audited the accompanying statement of assets and liabilities, including the portfolio of investments, of The Hyperion Strategic Mortgage Income Fund, Inc. as of November 30, 2005, and the related statements of operations and cash flows, changes in net assets and the financial highlights for the year then ended. These financial statements and financial highlights are the responsibility of the Fund s management. Our responsibility is to express an opinion on these financial statements and financial highlights based on our audit. The statement of changes in net assets for the year ended November 30, 2004 and the financial highlights for each of the years or period in the three-year period then ended, have been audited by other auditors, whose report dated January 26, 2005 expressed an unqualified opinion on such financial statement and financial highlights.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and financial highlights are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our procedures included confirmation of securities owned as of November 30, 2005, by correspondence with the custodian and brokers. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements and financial highlights referred to above present fairly, in all material respects, the financial position of The Hyperion Strategic Mortgage Income Fund, Inc. as of November 30, 2005, the results of its operations and cash flows, changes in its net assets and its financial highlights for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Briggs, Bunting & Dougherty, LLP

Philadelphia, Pennsylvania
January 11, 2006

TAX INFORMATION (Unaudited)

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, 2005) 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, 4.56% of the Fund s distributions during the fiscal year ended November 30, 2005 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 2005. 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 2006. Shareholders are advised to consult their own tax advisors with respect to the tax consequences of their investment in the Fund.

CHANGES TO INVESTMENT POLICIES (Unaudited)

On September 27, 2005, the Board of Directors voted to approve changes to the Fund s investment policies to permit the Fund to invest in three new types of investments. First, the Fund may now invest up to 20% of its gross assets in credit default swaps, limited to no more than 5% in any one issuer. Second, the Fund may now invest up to 10% of its gross assets in B-Notes and mezzanine loans, subject to a 5% limit in any one issuer. Third, the Fund may now invest up to 20% of its gross assets in total rate of return swaps, limited to 5% in any one issuer. These investments are described below.

Credit Default Swaps. In a credit default swap, one party agrees to pay another party a premium in exchange for receiving compensation if a third party or its obligation is subject to one or more specified adverse credit events (such as bankruptcy, failure to pay, acceleration of indebtedness, restructuring, or repudiation/moratorium) over a specified period.

B-Notes and Mezzanine Loans. A B-Note represents a subordinated interest in a loan collateralized by a commercial property. A mezzanine loan is an obligation that is secured by the borrower s equity interest in a property that is subject to a first mortgage. B-Notes and mezzanine loans are typically not rated by credit rating agencies.

Total Rate of Return Swaps. A total rate of return swap is a contract in which one party receives interest payments on a specific asset or group of assets plus any capital gains or losses over a specified period, while the other party receives a specified fixed or floating payment.

Credit and Interest Rate Risks. The Fund s investments in credit default swaps, B-Notes, mezzanine loans, and total rate of return swaps may subject the Fund to credit risk or interest rate risk. In addition, when the Fund enters into a credit default swap or a total rate of return swap, it is subject to counterparty risk. The Fund seeks to reduce (but cannot eliminate) this risk by entering into swap contracts only with creditworthy counterparties.

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	Number of Portfolios in Fund Complex Overseen by Director
Disinterested Director			
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			
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 or by its affiliates (1989-Present); Director of Crystal River Capital, Inc. (Crystal River)(2005-Present); Director of Student Loan Corporation (STU) (2005-Present), General Partner of Resource Capital Fund I, II & III, CIP L.P. (1998-Present); Co- founder, Baringo Capital LLC (2002-Present); Director, Jackson Hewitt Tax Services Inc. (JTX) (2004-Present); Director, Animal Medical Center (2002-Present); Director and/or Lead Director, Parsons Brinckerhoff, Inc.			

(1995-Present); Trustee of Excelsior Funds (33) (1994-Present). 5

Disinterested Director

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

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 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

Director since December 2003

Elected until 2005 Member of Executive Committee

Elected for Three Year Term

President (1998-Present), Managing Partner (April 2005-Present) and Chief Investment Officer (1993-2002) of the Advisor; President and Director of Crystal River (2005-Present); Co-Chairman (2003-Present) and Board of Managers (1995-Present) of Hyperion GMAC Capital Advisors, LLC (Hyperion/GMAC, and formerly Lend Lease Hyperion Capital, LLC); President and Director of several investment companies advised by the Advisor (1993-Present). 5

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

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

Disinterested Director

Class III Director to serve until 2006 Annual Meeting of Stockholders:
Louis P. Salvatore
c/o One Liberty
Plaza, 165
Broadway, 36th
Floor, New York,
New York 10006-1404

Age 59

Director since September 2005,

Director, Chairman of the Audit Committee, Member of Compensation and Nominating Committee

Elected until Next Annual Meeting of Stockholders

Director of several investment companies advised by the Advisor or by its affiliates (2005- Present); Director of Crystal River (2005- Present); Director of Turner Corp. (2003- Present); Director of Jackson Hewitt Tax Services, Inc. (2004-Present); Employee of Arthur Andersen LLP (2002-Present); Partner of Arthur Andersen LLP (1977-2002). 2

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	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 52	Vice President	Elected Annually Since June 2002	Managing Partner (April 2005-Present), Chief Investment Strategist (1998-Present) and Chief Investment Officer (2002-Present) of the Advisor; Chief Investment Officer of Crystal River (2005-Present).
Daniel S. Kim* c/o One Liberty Plaza, 36th floor, New York, New York 10006-1404 Age 37	Chief Compliance Officer (CCO) & Secretary	Elected Annually CCO Since September 2004 and Secretary Since January 2005	Director, General Counsel and CCO (September 2004-Present), and Secretary (January 2005- Present) of the Adviser; Secretary (January 2005-Present) and CCO (September 2004- Present) of several investment companies advised by the Advisor; Secretary (January 2005-Present) and CCO (September 2004-Present) of Hyperion/GMAC; Assistant Secretary of Crystal River (2005-Present), Assistant General Counsel (May 2001-August 2004) of Oak Hill Capital Management; Assistant General Counsel (May 2001-August 2004) of Oak Hill Advisors, LP; Lawyer (January 2001-April 2001) Arkin, Kaplan & Cohen.
Thomas F. Doodian* c/o One Liberty Plaza, 36th floor, New York, New York 10006-1404 Age 46	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 (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.

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:
1 (800) HYPERION

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:
1 (800) 937-5449

INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

BRIGGS, BUNTING & DOUGHERTY, LLP
Two Penn Center Plaza, Suite 820
Philadelphia, Pennsylvania 19102

LEGAL COUNSEL

SULLIVAN & WORCESTER LLP
1666 K Street, NW
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 November 30, 2005 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

Louis P. Salvatore*
Director

Clifford E. Lai
Director and President

John Dolan
Vice President

Thomas F. Doodian
Treasurer

Daniel Kim
CCO and Secretary

* Audit Committee Members

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 all three members serving on the Registrant s audit committee are audit committee financial experts. Their names are Rodman L. Drake, Robert F. Birch and Louis P. Salvatore. Mr. Drake, Mr. Birch and Mr. Salvatore are each independent.

Item 4. Principal Accountant Fees and Services.

<u>Audit Fees</u>

For the fiscal year ended November 30, 2005, PriceWaterhouseCoopers LLP (PwC) billed the Registrant aggregate fees of $99,333 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 and included in the Registrant s semi-annual report to shareholders.

For the fiscal year ended November 30, 2004, PwC billed the Registrant aggregate fees of $65,000 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 and included in the Registrant s semi-annual report to shareholders.

<u>Tax Fees</u>

For the fiscal year ended November 30, 2005, PwC billed the Registrant aggregate fees of $8,500 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, 2004, PwC billed the Registrant aggregate fees of $8,500 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.

<u>Audit-Related Fees</u>

For the fiscal year ended November 30, 2005, PwC billed the Registrant aggregate fees of $2,700 for assurance and related services reasonably related to the audit of the Registrant s annual financial statements. The nature of the services comprising the Audit-Related Fees was administrative costs to PwC related to its completion of the audit of the Registrant s annual financial statements.

For the fiscal year ended November 30, 2004, there were no Audit-Related Fees.

<u>All Other Fees</u>

For the fiscal year ended November 30, 2005, there were no Other Fees.

For the fiscal year ended November 30, 2004, PwC billed the Registrant aggregate fees of $32,500 for professional services rendered for the review of financial statements included in the Registrant s semi-annual report to shareholders.

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, Robert F. Birch and Louis P. Salvatore.

Item 6. Schedule of Investments.

Please see Item 1.

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

THE HYPERION STRATEGIC MORTGAGE INCOME FUND, INC.
POLICIES AND PROCEDURES FOR VOTING PROXIES

1. Purpose. The purpose of this document is to describe the policies and procedures for voting proxies received from issuers whose securities are held by the Funds. These policies and procedures are to be implemented by the investment adviser or sub-adviser, if any, (the Adviser) to the Funds.

2. Definition of Proxy. A proxy permits a shareholder to vote without being present at annual or special meetings. A proxy is the form whereby a person who is eligible to vote on corporate matters transmits written instructions for voting or transfers the right to vote to another person in place of the eligible voter.

3. Policy for Voting Proxies.

(a) Fiduciary Considerations. Proxies are voted solely in the interests of the shareholders of the Funds. Any conflict of interest must be resolved in the way that will most benefit the shareholders.

(b) Management Recommendations. Because the quality and depth of management is a primary factor considered when investing in a company, the recommendation of management on any issue should normally be given substantial weight.

The vote with respect to most routine issues presented in proxy statements should be cast in accordance with the position of the company s management, unless it is determined that supporting management s position would adversely affect the investment merits of owning the stock. However, each issue should be considered on its own merits, and the position of the company s management should not be supported in any situation where it is found not to be in the best interests of the Funds shareholders.

4. Conflicts of Interest. The Funds recognize that under certain circumstances their Adviser may have a conflict of interest in voting proxies on behalf of the Funds. Such circumstances may include, but are not limited to, situations where the Adviser or one or more of its affiliates, including officers, directors and employees, has or is seeking a client relationship with the issuer of the security that is the subject of the proxy vote. The Adviser shall periodically inform its employees that they are under an obligation to be aware of the potential for conflicts of interest on the part of the Adviser with respect to voting proxies on behalf of Funds, both as a result of the employee s personal relationships and due to circumstances that may arise during the conduct of the Adviser s business, and to bring conflicts of interest of which they become aware to the attention of the proxy manager (see below). The Adviser shall not vote proxies relating to such issuers on behalf of its client accounts until it has determined that the conflict of interest is not material or a method of resolving such conflict of interest has

been agreed upon by the Board of Directors for the Fund. A conflict of interest will be considered material to the extent that it is determined that such conflict has the potential to influence the Adviser s decision-making in voting a proxy. Materiality determinations will be based upon an assessment of the particular facts and circumstances. If the proxy manager determines that a conflict of interest is not material, the Adviser may vote proxies notwithstanding the existence of a conflict. If the conflict of interest is determined to be material, the conflict shall be disclosed to the Board of Directors and the Adviser shall follow the instructions of the Board of Directors. The proxy manager shall keep a record of all materiality decisions and report them to the Board of Directors on a quarterly basis.

5. Routine Proposals. Proxies for routine proposals (such as election of directors, selection of independent public accountants, stock splits and increases in capital stock) should generally be voted in favor of management.

6. Non-routine Proposals.

(a) Guidelines on Anti-takeover Issues. Because anti-takeover proposals generally reduce shareholders rights, the vote with respect to these proposals should generally be against. During review of the proposal, if it is concluded that the proposal is beneficial to shareholders, a vote for the proposal should be cast.

(b) Guidelines on Social and Political Issues. Social and political issues should be reviewed on a case by case basis. Votes should generally be cast with management on social or political issues, subject to review by the proxy manager.

7. Proxy Manager Approval. Votes on non-routine matters (including the matters in paragraph 6 and mergers, stock option and other compensation plans) and votes against a management s recommendations are subject to approval by the proxy manager. The chief investment officer or his delegatee shall be the proxy manager.

8. Proxy Voting Procedures. Proxy voting will be conducted in compliance with the policies and practices described in this memorandum and is subject to the proxy manager s supervision. A reasonable effort should be made to obtain proxy material and to vote in a timely fashion. Records should be maintained regarding the voting of proxies under these policies and procedures.

9. Report to the Board. On a quarterly basis, the proxy manager or his designee will report in writing to the Boards of Directors on the general manner in which proxy proposals relating to anti-takeover, social and political issues were voted, as well as proposals that were voted in opposition to management s recommendations.

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: February 8, 2006

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 8, 2006

By: /s/ Thomas F. Doodian
Thomas F. Doodian
Treasurer and Principal Financial Officer
Date: February 8, 2006