

DWS STRATEGIC MUNICIPAL INCOME TRUST  
Form N-CSR  
February 06, 2006

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D. C. 20549

FORM N-CSR

Investment Company Act file number 811-05767

SCUDDER STRATEGIC MUNICIPAL INCOME TRUST

-----  
(Exact Name of Registrant as Specified in Charter)

222 South Riverside Plaza, Chicago, IL 60606

-----  
(Address of Principal Executive Offices) (Zip Code)

Registrant's Telephone Number, including Area Code: (212) 454-7190  
-----

Paul Schubert  
345 Park Avenue  
New York, NY 10154

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(Name and Address of Agent for Service)

Date of fiscal year end: 11/30

Date of reporting period: 11/30/05

|   |  |
|---|--|
| <b>Scudder Strategic<br/>Municipal<br/>Income Trust</b> |  |
|   |  |
|   | <b>Annual<br/>Report to<br/>Shareholders</b> |
|   | <b>November 30,<br/>2005</b>                 |

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Investments in funds involve risk. Certain investors' income may be subject to the federal Alternative Minimum Tax (AMT), and federal, state and local taxes may also apply. Closed-end funds, unlike open-end funds, are not continuously offered. There is a one time public offering and once issued, shares of closed-end funds are sold in the open market through a stock exchange. Shares of closed-end funds frequently trade at a discount to net asset value. The price of the fund's shares is determined by a number of factors, several of which are beyond the control of the fund. Therefore, the fund cannot predict whether its shares will trade at, below or above net asset value. The fund invests in individual bonds whose yields and market values fluctuate, so that your investment may be worth more or less than its original cost. Bond investments are subject to interest-rate risk such that when interest rates rise, the prices of the bonds, and thus the value of the bond fund, can decline and the investor can lose principal value.

Scudder Investments is part of Deutsche Asset Management, which is the marketing name in the US for the asset management activities of Deutsche Bank AG, Deutsche Investment Management Americas Inc., Deutsche Asset Management, Inc., Deutsche Bank Trust Company Americas and Scudder Trust Company.

Fund shares are not FDIC-insured and are not deposits or other obligations of, or guaranteed by, any bank. Fund shares involve investment risk, including possible loss of principal.

## Performance Summary November 30, 2005

Performance is historical, assumes reinvestment of all dividend and capital gain distributions, and does not guarantee future results. Investment return and principal value fluctuate with changing market conditions so that, when sold, shares may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. Please visit [scudder.com](http://scudder.com) for the Fund's most recent performance.

| Average Annual Total Returns as of 11/30/05       |        |        |        |         |
|---|--------|--------|--------|---------|
| Scudder Strategic Municipal Income Trust          | 1-Year | 3-Year | 5-Year | 10-Year |
| Based on Net Asset Value <sup>(a)</sup>           | 7.59%  | 8.80%  | 8.87%  | 7.19%   |
| Based on Market Price <sup>(a)</sup>              | 22.68% | 14.26% | 13.75% | 8.77%   |
| Lehman Brothers Municipal Bond Index <sup>+</sup> | 3.88%  | 4.86%  | 5.92%  | 5.72%   |

Sources: Lipper Inc. and Deutsche Investment Management Americas Inc.

| Net Asset Value and Market Price |                |                |
|----------------------------------|----------------|----------------|
|                                  | As of 11/30/05 | As of 11/30/04 |
| Net Asset Value                  | \$ 12.29       | \$ 12.26       |
| Market Price                     | \$ 14.15       | \$ 12.38       |

Prices and net asset value fluctuate and are not guaranteed.

| Distribution Information   |         |
|--|---------|
| Twelve Months:   |         |
| Income Dividends (common shareholders) as of 11/30/05  | \$ .90  |
| November Income Dividend (common shareholders)   | \$ .075 |
| Current Annualized Distribution Rate (Based on Net Asset Value) as of 11/30/05 <sup>++</sup> | 7.32%   |
| Current Annualized Distribution Rate (Based on Market Price) as of 11/30/05 <sup>++</sup>    | 6.36%   |
| Tax Equivalent Distribution Rate (Based on Net Asset Value) as of 11/30/05 <sup>++</sup>     | 11.26%  |
| Tax Equivalent Distribution Rate (Based on Market Price) as of 11/30/05 <sup>++</sup>        | 9.78%   |

<sup>(a)</sup> Total return based on net asset value reflects changes in the Fund's net asset value during each period. Total return based on market value reflects changes in market value. Each figure assumes that dividend and capital gain distributions, if any, were reinvested. These figures will differ depending upon the level of any discount from or premium to NAV at which the Fund's shares traded during the period.

<sup>+</sup> The unmanaged, unleveraged Lehman Brothers Municipal Bond Index is a market-value-weighted measure of municipal bonds issued across the United States. Index issues have a credit rating of at least Baa and a maturity of at least two years. Index returns assume reinvestment of dividends and, unlike Fund returns, do not reflect any fees or expenses. It is not possible to invest directly into an index.

<sup>++</sup> Current annualized distribution rate is the latest monthly dividend shown as an annualized percentage of net asset value/market price on November 30, 2005. Distribution rate simply measures the level of dividends and is not a complete measure of performance. Tax equivalent distribution rate is based on the Fund's

*distribution rate and a marginal income tax rate of 35%. Distribution rates are historical and will fluctuate.*

## Portfolio Management Review

### Scudder Strategic Municipal Income Trust: A Team Approach to Investing

Deutsche Investment Management Americas Inc. ("DeIM" or the "Advisor"), which is part of Deutsche Asset Management, is the investment advisor for Scudder Strategic Municipal Income Trust. DeIM and its predecessors have more than 80 years of experience managing mutual funds and DeIM provides a full range of investment advisory services to institutional and retail clients. DeIM is also responsible for selecting brokers and dealers and for negotiating brokerage commissions and dealer charges.

Deutsche Asset Management is a global asset management organization that offers a wide range of investing expertise and resources. This well-resourced global investment platform brings together a wide variety of experience and investment insight across industries, regions, asset classes and investing styles.

## Portfolio Management Team

*Philip G. Condon*

Managing Director of Deutsche Asset Management and Co-Manager of the fund.

Joined Deutsche Asset Management in 1983 and the fund in 1998.

Over 29 years of investment industry experience.

BA, MBA, University of Massachusetts at Amherst.

*Rebecca Flinn*

Vice President of Deutsche Asset Management and Co-Manager of the fund.

Joined Deutsche Asset Management in 1986 and the fund in 1998.

Over 19 years of investment industry experience.

BA, University of Redlands, California.

Philip G. Condon and Rebecca Flinn serve as co-manager of Scudder Strategic Municipal Income Trust. In the following interview, Scudder's municipal bond team discusses the fund's performance for the period and the market environment for municipal bonds.

### **Q: Will you describe the general market environment during the annual period ended November 30, 2005?**

**A:** Municipal bonds and the broad bond market delivered positive results over the period, as longer-term interest rates were relatively stable or actually declined despite Federal Reserve tightening with respect to short-term rates. The municipal bond market, as measured by the Lehman Brothers Municipal Bond Index, delivered a total return of 3.88% for the 12 months ended November 30, 2005.<sup>1</sup> The broad bond market, as measured by the Lehman Brothers Aggregate Bond Index, delivered a total return of 2.40% for the same period.<sup>2</sup>

<sup>1</sup> The unmanaged, unleveraged Lehman Brothers Municipal Bond Index is a market-value-weighted measure of municipal bonds issued across the United States. Index issues have a credit rating of at least Baa and a maturity of at least two years.

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<sup>2</sup> The Lehman Brothers Aggregate Bond Index is an unmanaged, unleveraged index representing domestic taxable investment-grade bonds, with index components for government and corporate securities, mortgage pass-through securities and asset-backed securities with average maturities of one year or more.

Index returns assume reinvestment of all distributions and, unlike fund returns, do not include any fees or expenses. It is not possible to invest directly into an index.

The relationship between supply and demand for municipal issues can be an important factor in the performance of this market. High demand or low supply can drive municipal bond prices higher, while low demand or high supply can have the reverse effect. For the period, the supply of municipal issues coming to market was heavy, driven in large part by refunding as issuers sought to take advantage of historically low interest rates. In fact, through the end of November, municipal issuance in 2005 was on pace to exceed the record for any calendar year. On the demand side, interest from retail investors was generally soft because of low yields and concerns about the potential for a rise in interest rate levels (and decline in bond prices). Institutions such as insurance companies and hedge funds continued to support the market, while mutual fund flows have also been positive, although largely focused on high-yield vehicles.

During the 12-month period, the Federal Reserve Board (the Fed) increased the federal funds rate the interbank overnight lending rate and a benchmark for market interest rates from 2.00% to 4.00% in eight increments of 0.25%. This caused yields on shorter-term bonds, which are highly sensitive to Fed moves, to rise. Since a bond's yield moves in the opposite direction of its price, this meant that prices of short-term bonds generally fell. Longer-term interest rates confounded expectations by remaining relatively stable in the face of Fed tightening, with maturities over 15 years experiencing a modest decline in yield over the fiscal year.

The overall result was that the tax-free yield curve flattened significantly over the course of the year.<sup>3</sup> On the municipal bond curve, yields on two-year issues increased by 105 basis points while bonds with 30-year maturities experienced a yield decrease of 21 basis points, resulting in a total flattening of 126 basis points. (100 basis points equals one percentage point. See the accompanying graph for a depiction of municipal bond yield changes between the beginning and end of the period.)

<sup>3</sup> The yield curve is a graph with a left-to-right line that shows how high or low yields are, from the shortest to the longest maturities. Typically (and when the yield curve is characterized as "steep," this is especially true) the line rises from left to right as investors who are willing to tie up their money for a longer period are rewarded with higher yields.

### Municipal bond yield curve (as of 11/30/04 and 11/30/05)

| Maturity |
|----------|
|----------|

Source: Municipal Market Data

This chart is for illustrative purposes only and does not represent the yield of any Scudder product.

### **Q: How did Scudder Strategic Municipal Income Trust perform for the 12-month period ended November 30, 2005?**

**A:** For the period, Scudder Strategic Municipal Income Trust delivered a total return based on net asset value of 7.59%. The fund posted a total return based on market value of 22.68%. Its average peer in the Lipper High Yield Municipal Debt Funds category for closed-end funds delivered a total return based on net asset value of 8.32% for the period.<sup>4</sup> The fund's benchmark, the unmanaged Lehman Brothers Municipal Bond Index, returned 3.88%. (Past performance is no guarantee of future results. Please see page 3 for more complete performance information.)

<sup>4</sup> The Lipper High Yield Municipal Debt Funds category includes funds that invest at least 50% of their assets in lower-rated municipal debt issues. Lipper figures represent the average of the total returns reported by all of the mutual funds designated by Lipper Inc. as falling into the High Yield Municipal Debt Funds category. For the one-, five- and 10-year periods this categories average was 6.26% (78 funds), 6.06% (69 funds) and 4.95% (35 funds), respectively, as of November 30, 2005.

It is not possible to invest directly into a Lipper category.

### **Q: How was the fund positioned, and how did this positioning contribute to its performance for the annual period?**

**A:** High-yield municipal bonds continued to outperform the broader municipal market over the annual period. Interest rates remain low by historical standards and investors continue to seek out higher-yielding, lower-quality investments. This increase in demand led high-yield securities to outperform higher-quality bonds in the period. In addition, the US economy continued to show signs of improvement throughout the period, strengthening the outlook for entities that issue high-yield bonds. As a result, the yield spread provided by high-yield bonds to compensate investors for assuming the incremental risk of these issues narrowed during the period, with a positive impact on prices.<sup>5</sup>

<sup>5</sup> The yield spread is the difference between the yield of a municipal bond security and the yield of an AAA-rated municipal credit. A large spread indicates that investors require yields substantially above those of Treasuries in order to invest in high-yield bonds. This is generally indicative of a higher-risk environment. A smaller spread generally indicates a more positive environment, since investors are less concerned about risk and therefore willing to accept lower yields. A drop in the yield spread is a positive.

In managing the fund, we continue to focus strongly on maintaining an attractive dividend and minimizing taxable capital gains distributions, while taking a prudent approach to investing in the full range of municipal credits. From a total return perspective, the fund's performance was somewhat constrained due to a slightly more conservative positioning along the yield curve. At the same time, our underexposure to airline-related issues helped performance, as this sector continued to experience distress in the aftermath of bankruptcy filings by Delta and Northwest. Our holdings of issues related to hospitals and senior living centers helped returns as these sectors benefited from spread tightening and refunding activity (which generally results in an improved credit profile for the affected issues).

We do not focus on trying to predict the overall level of interest rates, and we attempt to keep the fund's duration and overall interest rate sensitivity similar to that of its peers and its benchmark, the Lehman Brothers Municipal Bond Index.<sup>6</sup> At the same time, we continue to monitor the municipal yield curve and position the fund's investments along the curve based upon where we believe the best total return opportunities lie. In this vein, the fund's performance for the period would have benefited from greater exposure to long-term issues, which outperformed as yields fell and prices rose. We are currently emphasizing bonds with maturities in the 10-15 year range and that are priced to a call. This positioning reflects our assessment of the relative attractiveness from a risk/reward standpoint of different segments of the municipal market.

<sup>6</sup> Duration is a measure of bond price volatility. Duration can be defined as the approximate percentage change in price for a 100-basis-point (one single percentage point) change in market interest rate levels. A duration of 1.25 years, for example, means that the price of a bond or bond portfolio should rise by approximately 1.25% for a one percentage-point drop in interest rates, and that it should fall by 1.25% for a one percentage-point rise in interest rates.

The views expressed in this report reflect those of the portfolio managers only through the end of the period of the report as stated on the cover. The managers' views are subject to change at any time based on market and other conditions and should not be construed as a recommendation.

## Portfolio Summary November 30, 2005

| Asset Allocation         | 11/30/05 | 11/30/04 |
|--------------------------|----------|----------|
| Revenue Bonds            | 71%      | 71%      |
| ETM/Prerefunded Bonds    | 22%      | 16%      |
| General Obligation Bonds | 5%       | 10%      |
| Lease Obligations        | 2%       | 3%       |
|                          | 100%     | 100%     |

| Quality   | 11/30/05 | 11/30/04 |
|-----------|----------|----------|
| AAA       | 31%      | 34%      |
| AA        | 5%       | 2%       |
| A         | 10%      | 11%      |
| BBB       | 24%      | 20%      |
| BB        | 2%       | 2%       |
| B         | 1%       | 2%       |
| Not Rated | 27%      | 29%      |
|           | 100%     | 100%     |

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| Interest Rate Sensitivity | 11/30/05  | 11/30/04  |
|---------------------------|-----------|-----------|
| Average Maturity          | 6.0 years | 8.2 years |
| Duration                  | 4.7 years | 5.7 years |

| Top Five State Allocations        |          |          |
|-----------------------------------|----------|----------|
| (% of Total Investment Portfolio) | 11/30/05 | 11/30/04 |
| 1. Texas                          | 15%      | 14%      |
| 2. New York                       | 10%      | 8%       |
| 3. Illinois                       | 8%       | 8%       |
| 4. California                     | 7%       | 7%       |
| 5. Massachusetts                  | 5%       | 5%       |

Asset allocation, quality, interest rate sensitivity and top five state allocations are subject to change.

The quality ratings represent the lower of Moody's Investors Service, Inc. ("Moody's") or Standard & Poor's Corporation ("S&P") credit ratings. The ratings of Moody's and S&P represent their opinions as to the quality of the securities they rate. Ratings are relative and subjective and are not absolute standards of quality. The Fund's credit quality does not remove market risk.

For more complete details about the Fund's investment portfolio, see page 11. A quarterly Fact Sheet is available upon request. Please see the Additional Information section for contact information.

Following the Fund's fiscal first and third quarter-end, a complete portfolio holdings listing is filed with the SEC on Form N-Q. The form will be available on the SEC's Web site at [www.sec.gov](http://www.sec.gov), and it also may be reviewed and copied at the SEC's Public Reference Room in Washington, D.C. Information on the operation of the SEC's Public Reference Room may be obtained by calling (800) SEC-0330.

## Investment Portfolio as of November 30, 2005

|   | Principal Amount (\$) | Value (\$)        |
|---|-----------------------|-------------------|
| <b>Municipal Bonds and Notes 152.2%</b>   |                       |                   |
| <b>Alabama 2.7%</b>   |                       |                   |
| Alabama, Sales & Special Tax Revenue, Public School and College Authority, Series C, 5.625%, 7/1/2013           | 1,000,000             | 1,082,660         |
| Huntsville, AL, Hospital & Healthcare Revenue, Health Care Authority, Series A, 5.75%, 6/1/2031                 | 1,500,000             | 1,573,245         |
| Sylacauga, AL, Health Care Authority Revenue, Coosa Valley Medical Center, Series A, 6.0%, 8/1/2035             | 1,000,000             | 1,005,730         |
|   |                       | <b>3,661,635</b>  |
| <b>Arizona 1.5%</b>   |                       |                   |
| Arizona, Project Revenue, Health Facilities Authority, The New Foundation Project, 8.25%, 3/1/2019              | 1,975,000             | <b>1,983,492</b>  |
| <b>California 11.1%</b>   |                       |                   |
| California, Special Assessment Revenue, Golden State Tobacco Securitization Corp.:                              |                       |                   |
| Series B, 5.625%, 6/1/2038  | 1,890,000             | 2,109,165         |
| Series 2003-A-1, 6.75%, 6/1/2039  | 4,500,000             | 5,070,060         |
| California, State Public Works Board, Lease Revenue, Department of Corrections, Series C, 5.5%, 6/1/2019        | 1,920,000             | 2,072,582         |
| Hayward, CA, Multi-Family Housing Revenue, Timbers Apartments, Series A, AMT, 3.06%*, 3/15/2033                 | 1,400,000             | 1,400,000         |
| Sacramento County, CA, Sales & Special Tax Revenue, Bradshaw Road Project, 7.2%, 9/2/2015                       | 1,130,000             | 1,137,198         |
| Sacramento, CA, Project Revenue, City Financing Authority, Convention Center Hotel, Series A, 6.25%, 1/1/2030   | 2,000,000             | 2,089,740         |
| Southern California, Metropolitan Water District, Waterworks Revenue, Series C-2, 2.92%*, 7/1/2036              | 1,000,000             | 1,000,000         |
|   |                       | <b>14,878,745</b> |
| <b>Colorado 3.8%</b>  |                       |                   |
| Colorado, Hospital & Healthcare Revenue, Portercare Adventist Health Project, 6.5%, 11/15/2031                  | 1,000,000             | 1,151,590         |
| Colorado, Transportation/Tolls Revenue, Northwest Parkway Public Highway Authority, Series D, 7.125%, 6/15/2041 | 1,150,000             | 1,241,460         |
| Denver, CO, Sales & Special Tax Revenue, Urban Renewal Authority, AMT, 7.75%, 9/1/2016                          | 1,615,000             | 1,680,472         |
| Mesa County, CO, Valley School District No. 051 Grand Junction, Series A, 5.0%, 12/1/2024 (a)                   | 1,000,000             | 1,047,610         |
|   |                       | <b>5,121,132</b>  |
| <b>Connecticut 2.7%</b>   |                       |                   |
| Greenwich, CT, Multi-Family Housing Revenue, 6.35%, 9/1/2027  | 2,000,000             | 2,112,080         |
| Mashantucket, CT, Sports, Expo & Entertainment Revenue, Mashantucket Western Pequot Tribe:                      |                       |                   |

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|  |           |                   |
|--|-----------|-------------------|
| Series B, 144A, Zero Coupon, 9/1/2017  | 2,000,000 | 1,059,100         |
| Series B, 144A, Zero Coupon, 9/1/2018  | 1,000,000 | 499,990           |
|  |           | <b>3,671,170</b>  |
| <b>District of Columbia 0.8%</b>   |           |                   |
| District of Columbia, Core City General Obligation, Series A, 5.0%, 6/1/2018 (a)   | 1,000,000 | <b>1,041,760</b>  |
| <b>Florida 5.9%</b>  |           |                   |
| Alachua County, FL, Health Facilities Authority Revenue, Shands Teaching Hospital, Series A, 3.0%*, 12/1/2032, SunTrust Bank (b)         | 200,000   | 200,000           |
| Hillsborough County, FL, Industrial Development Revenue, University Community Hospital Project, Series A, 5.625%, 8/15/2023              | 2,000,000 | 2,049,600         |
| Miami Beach, FL, Health Facilities Authority Hospital Revenue, Mount Sinai Medical Center, 144A, 6.75%, 11/15/2029                       | 1,600,000 | 1,777,584         |
| Nassau County, FL, ICF/MR-Intercare Facilities Mentally Retarded Revenue, GF/Amelia Island Properties Project, Series A, 9.75%, 1/1/2023 | 1,845,000 | 1,849,612         |
| Orlando, FL, Greater Orlando Aviation Authority, Airport Facilities Revenue, Jet Blue Airways Corp., AMT, 6.5%, 11/15/2036               | 1,000,000 | 974,370           |
| Orlando, FL, Special Assessment Revenue, Conroy Road Interchange Project, Series A, 5.8%, 5/1/2026                                       | 1,000,000 | 1,009,040         |
|  |           | <b>7,860,206</b>  |
| <b>Georgia 0.9%</b>  |           |                   |
| Americus-Sumter County, GA, Hospital & Healthcare Revenue, Hospital Authority, South Georgia Methodist, Series A, 6.375%, 5/15/2029      | 1,250,000 | <b>1,252,575</b>  |
| <b>Hawaii 1.0%</b>   |           |                   |
| Hawaii, State General Obligation:  |           |                   |
| Series CU, 5.75%, 10/1/2011 (a)  | 1,185,000 | 1,296,544         |
| Prerefunded, Series CU, 5.75%, 10/1/2011 (a)   | 65,000    | 71,406            |
|  |           | <b>1,367,950</b>  |
| <b>Illinois 11.6%</b>  |           |                   |
| Chicago, IL, Core City General Obligation, Board of Education, Series A, 5.75%, 12/1/2017 (a)  | 1,380,000 | 1,535,112         |
| Illinois, Core City General Obligation, 5.0%, 6/1/2019 (a)   | 3,000,000 | 3,160,770         |
| Illinois, Finance Authority Revenue, Clare at Water Tower Project, Series A, 6.125%, 5/15/2038   | 1,000,000 | 1,000,120         |
| Illinois, Finance Authority Revenue, Landing At Plymouth Place Project, Series A, 6.0%, 5/15/2037  | 1,000,000 | 994,340           |
| Illinois, Hospital & Healthcare Revenue, 6.75%, 2/15/2016  | 2,180,000 | 2,443,780         |
| Illinois, State General Obligation, Prerefunded, 6.0%, 1/1/2013 (a)  | 3,315,000 | 3,627,207         |
| Illinois, Upper River Valley Development Authority, Solid Waste Disposal Revenue, Waste Recovery Project, AMT, 5.9%, 2/1/2014            | 1,615,000 | 1,636,205         |
| University Park, IL, Sales & Special Tax Revenue, Governors Gateway Industrial Park, 8.5%, 12/1/2011                                     | 1,105,000 | 1,121,906         |
|  |           | <b>15,519,440</b> |
| <b>Indiana 2.3%</b>  |           |                   |
| Indiana, Senior Care Revenue, Health Facilities Finance Authority, Franciscan Eldercare Community Services, 5.875%, 5/15/2029            | 3,000,000 | <b>3,017,520</b>  |
| <b>Iowa 0.8%</b>   |           |                   |
| Lake City, IA, Senior Care Revenue, Health Care Facility, Opportunity Living Project, 144A, 6.45%, 5/1/2011                              | 1,050,000 | <b>1,073,740</b>  |
| <b>Kansas 3.1%</b>   |           |                   |
| Manhattan, KS, Senior Care Revenue, Meadowlark Hills Retirement, Series A, 6.5%, 5/15/2028   | 500,000   | 517,290           |
| Overland Park, KS, Industrial Development Revenue, Series A, 7.375%, 1/1/2032  | 2,000,000 | 2,172,420         |
| Wyandotte County, KS, Unified Government Special Obligation Revenue, Sales Tax, Series B, 5.0%, 12/1/2020                                | 1,400,000 | 1,440,978         |
|  |           | <b>4,130,688</b>  |
| <b>Kentucky 0.8%</b>   |           |                   |
| Kentucky, Hospital & Healthcare Revenue, Economic Development Finance Authority, Norton Healthcare, Inc., Series A, 6.625%, 10/1/2028    | 1,000,000 | <b>1,087,150</b>  |
| <b>Louisiana 2.3%</b>  |           |                   |
| Morehouse Parish, LA, Pollution Control Revenue, International Paper Co. Project, Series A, 5.25%, 11/15/2013                            | 3,000,000 | <b>3,100,980</b>  |
| <b>Maryland 7.7%</b>   |           |                   |
| Anne Arundel County, MD, General Obligation, National Business Park Project, Prerefunded, 144A, 7.375%, 7/1/2028                         | 997,000   | 1,170,947         |
| Anne Arundel County, MD, Revenue Lease, Arundel Mills Project, Prerefunded, 7.1%, 7/1/2029   | 1,500,000 | 1,707,150         |
| Maryland, Higher Education Revenue, Collegiate Housing Foundation:   |           |                   |
| Series A, 5.75%, 6/1/2019  | 1,000,000 | 1,040,320         |
| Series A, 5.75%, 6/1/2031  | 1,000,000 | 1,031,570         |
| Maryland, Hospital & Healthcare Revenue, University of Maryland Medical System, 6.75%, 7/1/2030  | 1,000,000 | 1,142,580         |
| Maryland, Project Revenue, Economic Development Corp., Chesapeake Bay, Series B, 7.625%, 12/1/2022                                       | 4,000,000 | 4,271,600         |
|  |           | <b>10,364,167</b> |
| <b>Massachusetts 8.0%</b>  |           |                   |



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|---|-----------|-------------------|
| Massachusetts, Hospital & Healthcare Revenue, Health & Educational Facilities Authority, Civic Investments, Series A, 9.0%, 12/15/2015          | 1,900,000 | 2,307,417         |
| Massachusetts, Hospital & Healthcare Revenue, Partners Healthcare System, Series C, 5.75%, 7/1/2032   | 1,000,000 | 1,085,650         |
| Massachusetts, Industrial Development Revenue, Development Finance Agency, Series A, 7.1%, 7/1/2032   | 1,955,000 | 1,995,781         |
| Massachusetts, Project Revenue, Health & Educational Facilities Authority, Jordan Hospital, Series E, 6.75%, 10/1/2033                          | 1,790,000 | 1,945,551         |
| Massachusetts, State General Obligation, Consolidated Loan:   |           |                   |
| Series B, Prerefunded, 5.0%, 4/1/2016 (a)   | 915,000   | 955,077           |
| Series B, 5.0%, 4/1/2016 (a)  | 2,260,000 | 2,358,988         |
|   |           | <b>10,648,464</b> |
| <b>Michigan 3.7%</b>  |           |                   |
| Kalamazoo, MI, Industrial Development Revenue, Economic Development Corp., Series A, 7.5%, 5/15/2029  | 2,000,000 | 2,182,440         |
| Saginaw, MI, Hospital & Healthcare Revenue, Hospital Finance Authority, Covenant Medical Center, Series F, 6.5%, 7/1/2030                       | 1,000,000 | 1,080,440         |
| Tawas City, MI, Hospital Finance Authority, St. Joseph Health Services:   |           |                   |
| Series A, ETM, 5.6%, 2/15/2013  | 345,000   | 362,002           |
| Series A, ETM, 5.75%, 2/15/2023   | 1,300,000 | 1,377,259         |
|   |           | <b>5,002,141</b>  |
| <b>Missouri 2.7%</b>  |           |                   |
| St. Louis, MO, Industrial Development Authority Revenue, St. Louis Convention Center:   |           |                   |
| AMT, Series A, 6.875%, 12/15/2020   | 1,000,000 | 761,470           |
| AMT, Series A, 7.2%, 12/15/2028   | 2,000,000 | 1,523,120         |
| St. Louis, MO, Special Assessment Revenue, Scullin Redevelopment Area, Series A, 10.0%, 8/1/2010  | 1,175,000 | 1,321,029         |
|   |           | <b>3,605,619</b>  |
| <b>Nebraska 0.0%</b>  |           |                   |
| Nebraska, Single Family Housing Revenue, Investment Finance Authority, AMT, Series A, 6.7%, 9/1/2026  | 40,000    | <b>40,263</b>     |
| <b>Nevada 1.6%</b>  |           |                   |
| Las Vegas, NV, Transportation/Tolls Revenue, Las Vegas Monorail Project, 7.375%, 1/1/2030   | 2,000,000 | 2,097,900         |
| Nevada, Single Family Housing Revenue, AMT, Series C, 6.5%, 4/1/2028  | 55,000    | 56,308            |
|   |           | <b>2,154,208</b>  |
| <b>New Hampshire 3.5%</b>   |           |                   |
| New Hampshire, Higher Education Revenue, Health & Educational Facilities Authority, New Hampshire College Issue, 7.4%, 1/1/2023                 | 1,000,000 | 1,175,060         |
| New Hampshire, Hospital & Healthcare Revenue, Rivermead at Peterborough Retirement Community, 5.75%, 7/1/2028                                   | 1,500,000 | 1,528,920         |
| New Hampshire, Senior Care Revenue, Higher Education Revenue, Havenwood Heritage Heights, 7.45%, 1/1/2025                                       | 2,000,000 | 2,043,200         |
|   |           | <b>4,747,180</b>  |
| <b>New Jersey 5.3%</b>  |           |                   |
| New Jersey, Economic Development Authority Revenue, Cigarette Tax, 5.75%, 6/15/2034   | 290,000   | 302,812           |
| New Jersey, Economic Development Authority Revenue, Motor Vehicle Surplus Revenue:  |           |                   |
| Series A, 5.0%, 7/1/2022 (a)  | 1,430,000 | 1,501,700         |
| Series A, 5.0%, 7/1/2023 (a)  | 1,770,000 | 1,854,872         |
| New Jersey, Higher Education Revenue, Education Facilities Authority, Caldwell College, Series A, 7.25%, 7/1/2025                               | 1,785,000 | 1,797,263         |
| New Jersey, Resource Recovery Revenue, Tobacco Settlement Financing Corp., 5.75%, 6/1/2032  | 1,665,000 | 1,705,293         |
|   |           | <b>7,161,940</b>  |
| <b>New Mexico 2.1%</b>  |           |                   |
| Farmington, NM, Pollution Control Revenue, 5.8%, 4/1/2022   | 2,750,000 | <b>2,798,510</b>  |
| <b>New York 14.8%</b>   |           |                   |
| Nassau County, NY, Hospital & Healthcare Revenue, 6.0%, 8/1/2016 (a)  | 2,825,000 | 3,124,902         |
| Nassau County, NY, Project Revenue, North Shore Healthcare Systems Project, Series B, 5.875%, 11/1/2011   | 670,000   | 715,406           |
| New York, Core City General Obligation, Series C, 7.0%, 2/1/2010  | 315,000   | 316,840           |
| New York, Sales & Special Tax Revenue, Metropolitan Transportation Authority, Series A, Prerefunded, 5.125%, 4/1/2019 (a)                       | 1,450,000 | 1,587,851         |
| New York, Sales & Special Tax Revenue, Transitional Finance Authority, Series B, 6.0%, 11/15/2013   | 490,000   | 545,640           |
| New York, State Dormitory Authority Revenues, Non-State Supported Debt, North Shore-LI Jewish, Series A, 2.96%*, 11/1/2034, Citibank NA (b)     | 325,000   | 325,000           |
| New York, State General Obligation Lease, Higher Education Revenue, Dormitory Authority, State University, Prerefunded, 5.125%, 5/15/2021 (a)   | 1,880,000 | 1,964,074         |
| New York, Transitional Finance Authority, Series B, Prerefunded, 6.0%, 11/15/2013   | 1,510,000 | 1,681,460         |
| New York, Transportation/Tolls Revenue, Triborough Bridge and Tunnel Authority Systems, ETM, Series Y, 6.0%, 1/1/2012                           | 5,000,000 | 5,511,700         |
| New York City, NY, Industrial Development Agency Revenue, Liberty-7, World Trade Center, Series A, 6.25%, 3/1/2015                              | 2,000,000 | 2,093,320         |
| New York City, NY, Industrial Development Agency, Special Facility Revenue, American Airlines, JFK International Airport, AMT, 8.0%**, 8/1/2028 | 2,000,000 | 1,993,220         |
|   |           | <b>19,859,413</b> |

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| <b>North Carolina 1.9%</b>   |           |                   |
|--|-----------|-------------------|
| North Carolina, Electric Revenue, Municipal Power Agency:  |           |                   |
| Series C, 5.375%, 1/1/2017   | 1,000,000 | 1,058,450         |
| Series B, 6.375%, 1/1/2013   | 1,300,000 | 1,422,473         |
|  |           | <b>2,480,923</b>  |
| <b>North Dakota 0.8%</b>   |           |                   |
| Grand Forks, ND, Hospital & Healthcare Revenue, Altru Health Care System, 7.125%, 8/15/2024  | 1,000,000 | <b>1,093,840</b>  |
| <b>Pennsylvania 6.9%</b>   |           |                   |
| Montgomery County, PA, Industrial Development Authority Revenue, Whitemarsh Continuing Care, 6.25%, 2/1/2035                                       | 600,000   | 625,428           |
| Montgomery County, PA, Senior Care Revenue, Higher Education & Health Authority, Philadelphia Geriatric Center, Series A, 7.25%, 12/1/2027         | 2,000,000 | 2,283,160         |
| Pennsylvania, Higher Educational Facilities Authority Revenue, Philadelphia College of Textiles and Science, 6.7%, 4/1/2014                        | 2,000,000 | 2,052,280         |
| Pennsylvania, Hospital & Healthcare Revenue, Economic Development Financing Authority, UPMC Health System, Series A, 6.0%, 1/15/2031               | 750,000   | 812,813           |
| Pennsylvania, St. Mary Hospital Authority, Health Systems Revenue, Catholic Health East, Series B, 5.5%, 11/15/2024                                | 1,465,000 | 1,555,903         |
| Philadelphia, Redevelopment Authority Revenue, First Lien Mortgage, Series A, 6.5%, 1/1/2029   | 640,600   | 658,242           |
| Westmoreland County, PA, Senior Care Revenue, Industrial Development Authority, Health Care Facilities-Redstone, Series B, 8.125%, 11/15/2030      | 1,000,000 | 1,201,050         |
|  |           | <b>9,188,876</b>  |
| <b>Rhode Island 1.5%</b>   |           |                   |
| Rhode Island, Special Assessment Revenue, Series A, 6.125%, 6/1/2032   | 2,000,000 | <b>2,069,220</b>  |
| <b>South Carolina 7.1%</b>   |           |                   |
| South Carolina, Hospital & Healthcare Revenue, Jobs Economic Development Authority, Bon Secours Health Systems, Inc., Series A, 5.625%, 11/15/2030 | 2,000,000 | 2,098,400         |
| South Carolina, Hospital & Healthcare Revenue, Jobs Economic Development Authority, Palmetto Health Alliance:                                      |           |                   |
| Series C, 7.0%, 8/1/2030   | 1,545,000 | 1,790,346         |
| Series A, Prerefunded, 7.375%, 12/15/2021  | 1,000,000 | 1,186,210         |
| South Carolina, Transportation/Tolls Revenue, Series A, 5.375%, 10/1/2024 (a)  | 4,150,000 | 4,470,172         |
|  |           | <b>9,545,128</b>  |
| <b>South Dakota 1.6%</b>   |           |                   |
| South Dakota, Hospital & Healthcare Revenue, Sioux Valley Hospital, Series E, 5.375%, 11/1/2024  | 2,000,000 | <b>2,084,700</b>  |
| <b>Tennessee 1.8%</b>  |           |                   |
| Clarksville, TN, Public Building Authority Revenue, Pooled Financing Program, 3.03%*, 7/1/2031, Bank of America NA (b)                             | 100,000   | 100,000           |
| Johnson City, TN, Hospital & Healthcare Revenue, Health & Educational Facilities Board Hospital, Series A, 7.5%, 7/1/2033                          | 2,000,000 | 2,335,060         |
|  |           | <b>2,435,060</b>  |
| <b>Texas 22.3%</b>   |           |                   |
| Abilene, TX, Senior Care Revenue, Health Facilities Development, Sears Methodist Retirement Facilities, Series A, 5.9%, 11/15/2025                 | 2,500,000 | 2,528,775         |
| Austin, TX, Project Revenue, Bergstrom Landhost Enterprises, Inc. Airport Hotel Project, Series A, 6.75%, 4/1/2027***                              | 1,995,000 | 1,036,004         |
| Crowley, TX, School District General Obligation, 5.125%, 8/1/2025  | 4,000,000 | 4,177,400         |
| Hidalgo County, TX, Hospital & Healthcare Revenue, Mission Hospital, Inc. Project, 6.75%, 8/15/2016  | 2,000,000 | 2,121,480         |
| Houston, TX, General Obligation:   |           |                   |
| Prerefunded, Series A, 5.0%, 3/1/2016  | 1,365,000 | 1,413,471         |
| 5.0%, 3/1/2016   | 1,635,000 | 1,678,834         |
| Houston, TX, School District General Obligation, Series A, 5.0%, 2/15/2024   | 2,000,000 | 2,089,260         |
| Houston, TX, Transportation/Tolls Revenue, Special Facilities, Continental Airlines, Inc., AMT, Series E, 6.75%, 7/1/2029                          | 2,000,000 | 1,769,020         |
| Tarrant County, TX, Hospital & Healthcare Revenue, Health Facilities Development Corp., 6.7%, 11/15/2030   | 1,000,000 | 1,142,350         |
| Texas, Electric Revenue, Lower Colorado River Authority, Series B, 6.0%, 5/15/2013 (a)   | 5,000,000 | 5,432,750         |
| Texas, Industrial Development Revenue, Waste Disposal Authority, AMT, Series A, 6.1%, 8/1/2024   | 1,000,000 | 1,061,940         |
| Travis County, TX, Health Facilities Development Corp., Retirement Facility Revenue, Querencia Barton Creek Project, 5.65%, 11/15/2035             | 1,250,000 | 1,219,300         |
| Travis County, TX, Hospital & Healthcare Revenue, Ascension Health Credit, Series A, 6.0%, 11/15/2012 (a)  | 3,860,000 | 4,199,564         |
|  |           | <b>29,870,148</b> |
| <b>Utah 0.0%</b>   |           |                   |
| Utah, Single Family Housing Revenue, Housing Finance Agency, AMT, Series B2, 6.65%, 7/1/2026   | 35,000    | <b>35,072</b>     |
| <b>Virgin Islands 2.5%</b>   |           |                   |
| Virgin Islands, Sales & Special Tax Revenue, Public Finance Authority, Series A, 6.375%, 10/1/2019   | 3,000,000 | <b>3,342,750</b>  |
| <b>Virginia 1.8%</b>   |           |                   |
| Fairfax County, VA, Hospital & Healthcare Revenue, Economic Development Authority, Greenspring Retirement Community, Series A, 7.25%, 10/1/2019    | 2,000,000 | 2,172,860         |

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|  |           |                  |
|--|-----------|------------------|
| Loudoun County, VA, Industrial Development Authority Revenue, Howard Hughes Medical, Series A, 2.98%*, 2/15/2038               | 200,000   | 200,000          |
|  |           | <b>2,372,860</b> |
| <b>West Virginia 1.7%</b>  |           |                  |
| West Virginia, Hospital & Healthcare Revenue, Hospital Finance Authority, Charleston Medical Center, Series A, 6.75%, 9/1/2022 | 390,000   | 428,626          |
| West Virginia, Hospital Finance Authority, Charleston Medical Center, Prerefunded, 6.75%, 9/1/2022                             | 1,610,000 | 1,842,065        |
|  |           | <b>2,270,691</b> |
| <b>Wisconsin 1.6%</b>  |           |                  |
| Wisconsin, Hospital & Healthcare Revenue, Health & Education Facilities Authority, Aurora Health Care, Inc.:                   |           |                  |
| Series A, 5.6%, 2/15/2029  | 1,000,000 | 1,022,170        |
| 6.875%, 4/15/2030  | 1,000,000 | 1,124,890        |
|  |           | <b>2,147,060</b> |

|  | % of Net Assets | Value (\$)          |
|--|-----------------|---------------------|
| <b>Total Investment Portfolio</b> (Cost \$188,957,888) + | 152.2           | <b>204,086,416</b>  |
| <b>Other Assets and Liabilities, Net</b>                 | 0.0             | <b>26,317</b>       |
| <b>Preferred Stock, at Redemption Value</b>              | (52.2)          | <b>(70,000,000)</b> |
| <b>Net Assets Applicable to Common Shareholders</b>      | 100.0           | <b>134,112,733</b>  |

\* Variable rate demand notes are securities whose interest rates are reset periodically at market levels. These securities are often payable on demand and are shown at their current rates as of November 30, 2005.

\*\* Floating rate notes are securities whose yield vary with a designated market index or market rate, such as the coupon-equivalent of the US Treasury bill rate. These securities are shown at their current rate as of November 30, 2005.

\*\*\* Non-income producing security. In the case of a bond, generally denotes that the issuer has defaulted on the payment of principal or interest or has filed for bankruptcy. The following table represents bonds that are in default.

| Security                     | Coupon | Maturity Date | Principal Amount (\$) | Acquisition Cost (\$) | Value (\$) |
|------------------------------|--------|---------------|-----------------------|-----------------------|------------|
| Austin TX, Project Revenue   |        |               |                       |                       |            |
| Bergstrom, Landhost          |        |               |                       |                       |            |
| Enterprises, Inc. Airport    |        |               |                       |                       |            |
| Hotel Project, Inc. Series A | 6.75   | 4/1/2027      | USD 1,995,000         | 1,995,000             | 1,036,004  |

+ The cost for federal income tax purposes was \$188,344,541. At November 30, 2005, net unrealized appreciation for all securities based on tax cost was \$15,741,875. This consisted of aggregate gross unrealized appreciation for all securities in which there was an excess of value over tax cost of \$17,458,960 and aggregate gross unrealized depreciation for all securities in which there was an excess of tax cost over value of \$1,717,085.

(a) Bond is insured by one of these companies:

| Insurance Coverage                   | As a % of Total Investment Portfolio |
|--------------------------------------|--------------------------------------|
| Ambac Financial Group                | 2.2                                  |
| Financial Guaranty Insurance Company | 2.7                                  |
| Financial Security Assurance Inc.    | 5.0                                  |
| MBIA Corp.                           | 9.3                                  |

(b) Security incorporates a letter of credit from a major bank.

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

AMT: Subject to alternative minimum tax

ETM: Bonds bearing the description ETM (escrowed to maturity) are collateralized by US Treasury securities which are held in escrow and used to pay principal and interest on bonds so designated.

Prerefunded: Bonds which are prerefunded are collateralized by US Treasury securities which are held in escrow and are used to pay principal and interest on tax-exempt issues and to retire the bonds in full at the earliest refunding date.

The accompanying notes are an integral part of the financial statements.

## Financial Statements

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| <b>Statement of Assets and Liabilities</b> as of November 30, 2005   |                       |
|--|-----------------------|
| <b>Assets</b>  |                       |
| Investments in securities, at value (cost \$188,957,888)   | \$ 204,086,416        |
| Receivable for investments sold  | 235,000               |
| Interest receivable  | 3,463,394             |
| Other assets   | 3,455                 |
| <b>Total assets</b>  | <b>207,788,265</b>    |
| <b>Liabilities</b>   |                       |
| Due to custodian bank  | 524,950               |
| Dividends payable  | 5,752                 |
| Payable for investments purchased  | 2,938,157             |
| Accrued management fee   | 104,782               |
| Other accrued expenses and payables  | 101,891               |
| <b>Total liabilities</b>   | <b>3,675,532</b>      |
| <b>Preferred shares, at redemption value</b>   | <b>70,000,000</b>     |
| <b>Net assets applicable to common shareholders</b>  | <b>\$ 134,112,733</b> |
| <b>Net Assets</b>  |                       |
| Net assets applicable to common shareholders consist of:   |                       |
| Undistributed net investment income  | 950,781               |
| Net unrealized appreciation (depreciation) on investments  | 15,128,528            |
| Accumulated net realized gain (loss)   | (2,941,256)           |
| Paid-in capital  | 120,974,680           |
| <b>Net assets applicable to common shareholders</b>  | <b>\$ 134,112,733</b> |
| <b>Net Asset Value</b>   |                       |
| <b>Net Asset Value</b> , per common share (\$134,112,733 ÷ 10,910,224 outstanding shares of beneficial interest, \$.01 par value, unlimited number of shares authorized) | <b>\$ 12.29</b>       |

The accompanying notes are an integral part of the financial statements.

| <b>Statement of Operations</b> for the year ended November 30, 2005         |                      |
|---|----------------------|
| <b>Investment Income</b>  |                      |
| Income:   |                      |
| Interest  | \$ 12,049,198        |
| Expenses:   |                      |
| Management fee  | 1,230,820            |
| Services to shareholders  | 35,246               |
| Custodian fees  | 8,080                |
| Auditing  | 51,517               |
| Legal   | 16,765               |
| Trustees' fees and expenses   | 23,439               |
| Reports to shareholders   | 126,833              |
| Auction agent fee   | 167,264              |
| Stock exchange listing fees   | 22,114               |
| Other   | 90,950               |
| Total expenses, before expense reductions                                   | 1,773,028            |
| Expense reductions  | (2,986)              |
| Total expenses, after expense reductions                                    | 1,770,042            |
| <b>Net investment income</b>  | <b>10,279,156</b>    |
| <b>Realized and Unrealized Gain (Loss) on Investment Transactions</b>       |                      |
| Net realized gain (loss) from investments                                   | 258,506              |
| Net unrealized appreciation (depreciation) during the period on investments | 1,219,295            |
| <b>Net gain (loss) on investment transactions</b>                           | <b>1,477,801</b>     |
| <b>Dividends on preferred shares</b>  | <b>(1,631,764)</b>   |
| <b>Net increase (decrease) in net assets resulting from operations</b>      | <b>\$ 10,125,193</b> |

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The accompanying notes are an integral part of the financial statements.

| Statement of Changes in Net Assets   |                          |                       |
|--|--------------------------|-----------------------|
| Increase (Decrease) in Net Assets  | Years Ended November 30, |                       |
|  | 2005                     | 2004                  |
| Operations:  |                          |                       |
| Net investment income  | \$ 10,279,156            | \$ 10,618,828         |
| Net realized gain (loss) on investment transactions  | 258,506                  | (150,392)             |
| Net unrealized appreciation (depreciation) on investment transactions during the period                                | 1,219,295                | 430,552               |
| Dividends on preferred shares  | (1,631,764)              | (828,120)             |
| Net increase (decrease) in net assets resulting from operations  | 10,125,193               | 10,070,868            |
| Distributions to common shareholders from:   |                          |                       |
| Net investment income  | (9,790,616)              | (9,712,693)           |
| Fund share transactions:   |                          |                       |
| Net proceeds from shares issued to common shareholders in reinvestment of distributions                                | 753,305                  | 564,302               |
| Net increase (decrease) in net assets from Fund share transactions   | 753,305                  | 564,302               |
| <b>Increase (decrease) in net assets</b>   | <b>1,087,882</b>         | <b>922,477</b>        |
| Net assets at beginning of period  | 133,024,851              | 132,102,374           |
| Net assets at end of period (including undistributed net investment income of \$950,781 and \$2,334,063, respectively) | <b>\$ 134,112,733</b>    | <b>\$ 133,024,851</b> |
| <b>Other Information</b>   |                          |                       |
| Common shares outstanding at beginning of period   | 10,850,831               | 10,805,100            |
| Shares issued to common shareholders in reinvestment of distributions  | 59,393                   | 45,731                |
| Common shares outstanding at end of period   | 10,910,224               | 10,850,831            |

The accompanying notes are an integral part of the financial statements.

## Financial Highlights

| Years Ended November 30,   | 2005            | 2004            | 2003            | 2002 <sup>a</sup> | 2001 <sup>b</sup> |
|--|-----------------|-----------------|-----------------|-------------------|-------------------|
| <b>Selected Per Share Data</b>                                     |                 |                 |                 |                   |                   |
| Net asset value, beginning of period                               | \$ 12.26        | \$ 12.23        | \$ 11.84        | \$ 11.83          | \$ 11.37          |
| <i>Income (loss) from investment operations:</i>                   |                 |                 |                 |                   |                   |
| Net investment income <sup>c</sup>                                 | .95             | .98             | .99             | 1.01              | 1.01              |
| Net realized and unrealized gain (loss) on investment transactions | .13             | .03             | .34             | (.13)             | .40               |
| <i>Dividends on preferred shares (common share equivalent):</i>    |                 |                 |                 |                   |                   |
| From net investment income   | (.15)           | (.08)           | (.07)           | (.09)             | (.20)             |
| <b>Total from investment operations</b>                            | <b>.93</b>      | <b>.93</b>      | <b>1.26</b>     | <b>.79</b>        | <b>1.21</b>       |
| <i>Less distributions from:</i>                                    |                 |                 |                 |                   |                   |
| Net investment income to common shareholders                       | (.90)           | (.90)           | (.87)           | (.78)             | (.75)             |
| <b>Net asset value, end of period</b>                              | <b>\$ 12.29</b> | <b>\$ 12.26</b> | <b>\$ 12.23</b> | <b>\$ 11.84</b>   | <b>\$ 11.83</b>   |
| <b>Market value, end of period</b>                                 | <b>\$ 14.15</b> | <b>\$ 12.38</b> | <b>\$ 12.62</b> | <b>\$ 11.78</b>   | <b>\$ 12.01</b>   |
| <b>Total Return</b>  |                 |                 |                 |                   |                   |
| Based on net asset value (%) <sup>d</sup>                          | 7.59            | 7.98            | 10.85           | 7.00              | 10.98             |
| Based on market value (%) <sup>d</sup>                             | 22.68           | 5.58            | 15.16           | 4.86              | 21.78             |

| Years Ended November 30, (continued)                      | 2005 | 2004 | 2003 | 2002 <sup>a</sup> | 2001 <sup>b</sup> |
|---|------|------|------|-------------------|-------------------|
| <b>Ratios to Average Net Assets and Supplemental Data</b> |      |      |      |                   |                   |
|   | 134  | 133  | 132  | 127               | 127               |

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|  |        |        |        |        |        |
|--|--------|--------|--------|--------|--------|
| Net assets, end of period (\$ millions)  |        |        |        |        |        |
| Ratio of expenses (%) (based on net assets of common shares)                                   | 1.31   | 1.25   | 1.28   | 1.32   | 1.26   |
| Ratio of expenses (%) (based on net assets of common and preferred shares)                     | .86    | .82    | .83    | .86    | .81    |
| Ratio of net investment income (loss) (%) (based on net assets of common shares)               | 7.60   | 8.03   | 8.26   | 8.49   | 8.55   |
| Ratio of net investment income (loss) (%) (based on net assets of common and preferred shares) | 5.01   | 5.25   | 5.36   | 5.48   | 5.52   |
| Portfolio turnover rate (%)  | 19     | 15     | 14     | 7      | 15     |
| Preferred shares information at end of period:   |        |        |        |        |        |
| Aggregate amount outstanding (\$ millions)   | 70     | 70     | 70     | 70     | 70     |
| Asset coverage per share (\$) <sup>e</sup>   | 72,900 | 72,500 | 72,200 | 70,500 | 70,400 |
| Liquidation and market value per share (\$)  | 25,000 | 25,000 | 25,000 | 25,000 | 25,000 |

<sup>a</sup> As required, effective December 1, 2001, the Fund adopted the provisions of the AICPA Audit and Accounting Guide for Investment Companies and began accreting market discount on debt securities. The effect of this change for the year ended November 30, 2002 was to increase net investment income by \$.01, decrease net realized and unrealized gain (loss) per share by \$.01, and increase the ratio of net investment income to average net assets from 8.42% to 8.49%. Per share data and ratios for periods prior to December 1, 2001 have not been restated to reflect this change in presentation.

<sup>b</sup> In 2001 the Fund changed its method of classifying preferred shares.

<sup>c</sup> Based on average common shares outstanding during the period.

<sup>d</sup> Total return based on net asset value reflects changes in the Fund's net asset value during the period. Total return based on market value reflects changes in market value. Each figure includes reinvestment of dividends. These figures will differ depending upon the level of any discount from or premium to net asset value at which the Fund's shares trade during the period.

<sup>e</sup> Asset coverage per share equals net assets of common shares plus the redemption value of the preferred shares divided by the total number of preferred shares outstanding at the end of the period.

## Notes to Financial Statements

### A. Significant Accounting Policies

Scudder Strategic Municipal Income Trust (the "Fund") is registered under the Investment Company Act of 1940, as amended (the "1940 Act"), as a closed-end, diversified management investment company organized as a Massachusetts business trust.

The Fund's financial statements are prepared in accordance with accounting principles generally accepted in the United States of America which require the use of management estimates. Actual results could differ from those estimates. The policies described below are followed consistently by the Fund in the preparation of its financial statements.

**Security Valuation.** Investments are stated at value determined as of the close of regular trading on the New York Stock Exchange on each day the exchange is open for trading. Debt securities are valued by independent pricing services approved by the Trustees of the Fund, whose valuations are intended to reflect the mean between the bid and asked

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prices. If the pricing services are unable to provide valuations, the securities are valued at the average of the means based on the most recent bid quotation and asked or evaluated price obtained from two broker-dealers. Such services may use various pricing techniques which take into account appropriate factors such as yield, quality, coupon rate, maturity, type of issue, trading characteristics and other data, as well as broker quotes.

Money market instruments purchased with an original or remaining maturity of sixty days or less, maturing at par, are valued at amortized cost.

Securities and other assets for which market quotations are not readily available or for which the above valuation procedures are deemed not to reflect fair value are valued in a manner that is intended to reflect their fair value as determined in accordance with procedures approved by the Trustees.

**Federal Income Taxes.** The Fund's policy is to comply with the requirements of the Internal Revenue Code, as amended, which are applicable to regulated investment companies, and to distribute all of its taxable and tax-exempt income to its shareholders. Accordingly, the Fund paid no federal income taxes and no federal income tax provision was required.

At November 30, 2005, the Fund had a net tax basis capital loss carryforward of approximately \$3,535,000, which may be applied against any realized net taxable capital gains of each succeeding year until fully utilized or until November 30, 2008 (\$15,000), November 30, 2010 (\$170,000), November 30, 2011 (\$3,165,000) and November 30, 2012 (\$185,000), the respective expiration dates, whichever occurs first.

During the year ended November 30, 2005, the Fund utilized \$245,000 of prior year capital loss carryforwards.

**Distribution of Income and Gains.** Net investment income of the Fund, if any, is distributed to shareholders monthly. Net realized gains from investment transactions, in excess of available capital loss carryforwards, would be taxable to the Fund if not distributed, and, therefore, will be distributed to shareholders at least annually.

The timing and characterization of certain income and capital gains distributions are determined annually in accordance with federal tax regulations which may differ from accounting principles generally accepted in the United States of America. These differences primarily relate to certain securities sold at a loss and accretion of market discount on debt securities. As a result, net investment income (loss) and net realized gain (loss) on investment transactions for a reporting period may differ significantly from distributions during such period. Accordingly, the Fund may periodically make reclassifications among certain of its capital accounts without impacting the net asset value of the Fund.

At November 30, 2005, the Fund's components of distributable earnings (accumulated losses) on a tax-basis were as follows:

|   |                |
|---|----------------|
| Undistributed tax-exempt income                           | \$ 980,732     |
| Capital loss carryforwards                                | \$ (3,535,000) |
| Net unrealized appreciation (depreciation) on investments | \$ 15,741,875  |

In addition, the tax character of distributions paid to shareholders by the Fund are summarized as follows:

|                                      | Years Ended November<br>30, |               |
|--------------------------------------|-----------------------------|---------------|
|                                      | 2005                        | 2004          |
| Distributions from tax-exempt income | \$ 11,422,380               | \$ 10,540,813 |

**Preferred Shares.** The Fund has issued and outstanding 2,800 Series T municipal auction rate cumulative preferred shares, each at a liquidation value of \$25,000 per share. The preferred shares are senior to and have certain class specific preferences over the common shares. The dividend rate on each series is set through an auction process, and

the dividends are generally paid every 7 days. The auction agent will pay each broker-dealer a service charge from funds provided by the Fund (auction agent fee). The 1940 Act requires that the preferred shareholders of the Fund, voting as a separate class, have the right to: a) elect at least two trustees at all times, and b) elect a majority of the trustees at any time when dividends on the preferred shares are unpaid for two full years. Unless otherwise required by law or under the terms of the preferred shares designation statement, each preferred share is entitled to one vote and preferred shareholders will vote together with common shareholders as a single class and have the same voting rights.

**Contingencies.** In the normal course of business, the Fund may enter into contracts with service providers that contain general indemnification clauses. The Fund's maximum exposure under these arrangements is unknown as this would involve future claims that may be made against the Fund that have not yet been made. However, based on experience, the Fund expects the risk of loss to be remote.

**Other.** Investment transactions are accounted for on a trade date plus one basis for daily net asset value calculations. However, for financial reporting purposes, investment transactions are reported on trade date. Interest income is recorded on the accrual basis. Realized gains and losses from investment transactions are recorded on an identified cost basis. All premiums and discounts are amortized/accreted for financial reporting purposes, with the exception of securities in default of principal.

## **B. Purchases and Sales of Securities**

During the year ended November 30, 2005, purchases and sales of investment securities (excluding short-term investments) aggregated \$41,981,051 and \$39,330,812, respectively.

## **C. Related Parties**

**Management Agreement.** Under the Management Agreement with Deutsche Investment Management Americas Inc. ("DeIM" or the "Advisor"), an indirect, wholly owned subsidiary of Deutsche Bank AG, the Advisor directs the investments of the Fund in accordance with its investment objectives, policies and restrictions. The Advisor determines the securities, instruments and other contracts relating to investments to be purchased, sold or entered into by the Fund. In addition to portfolio management services, the Advisor provides certain administrative services in accordance with the Management Agreement. The Fund pays a monthly investment management fee of 1/12 of the annual rate of 0.60% of the Fund's average weekly net assets, of common shares plus the value of preferred shares, at redemption value, computed and accrued daily and payable monthly.

**Service Provider Fees.** Scudder Investments Service Company ("SISC"), an affiliate of the Advisor, is the transfer, dividend-paying and shareholder service agent for the Fund. Pursuant to a sub-transfer agency agreement between SISC and DST systems, Inc. ("DST"), SISC has delegated certain transfer agent and dividend paying agent functions to DST. SISC compensates DST out of the shareholder servicing fee it receives from the Fund. For the year ended November 30, 2005, the amount charged to the Fund by SISC aggregated \$24,122, of which \$3,997 is unpaid at November 30, 2005.

**Typesetting and Filing Service Fees.** Under an agreement with DeIM, the Advisor is compensated for providing typesetting and regulatory filing services to the Fund. For the year ended November 30, 2005, the amount charged to the Fund by DeIM included in the reports to shareholders aggregated \$8,400, of which \$4,200 is unpaid at November 30, 2005.

**Trustees' Fees and Expenses.** The Fund paid each Trustee not affiliated with the Advisor retainer fees plus specified amounts for attended board and committee meetings.

**Other Related Parties.** Deutsche Bank Trust Co. Americas, an affiliate of the Advisor, is the transfer agent for the preferred shares of the Fund. For the year ended November 30, 2005, the amount charged to the Fund by the Deutsche Bank Trust Co. Americas aggregated \$6,000, all of which has been paid.



#### **D. Expense Reductions**

For the year ended November 30, 2005, the Advisor agreed to reimburse the Fund \$2,549, which represents a portion of the fee savings expected to be realized by the Advisor related to the outsourcing by the Advisor of certain administrative services to an unaffiliated service provider.

In addition, the Fund has entered into arrangements with its custodian whereby credits realized as a result of uninvested cash balances were used to reduce a portion of the Fund's custodian expenses. During the year ended November 30, 2005, the Fund's custodian fees were reduced by \$437 for custodian credits earned.

#### **E. Line of Credit**

The Fund and several other affiliated funds (the "Participants") share in a \$1.1 billion revolving credit facility administered by J.P. Morgan Chase Bank for temporary or emergency purposes that otherwise might require the untimely disposition of securities. The Participants are charged an annual commitment fee which is allocated, based upon net assets, among each of the Participants. Interest is calculated at the Federal Funds Rate plus 0.5 percent. The Fund may borrow up to a maximum of 33 percent of its net assets under the agreement.

#### **F. Regulatory Matters and Litigation**

Since at least July 2003, federal, state and industry regulators have been conducting ongoing inquiries and investigations ("inquiries") into the mutual fund industry, and have requested information from numerous mutual fund companies, including Scudder Investments. The funds' advisors have been cooperating in connection with these inquiries and are in discussions with these regulators concerning proposed settlements. Publicity about mutual fund practices arising from these industry-wide inquiries serves as the general basis of a number of private lawsuits against the Scudder funds. These lawsuits, which previously have been reported in the press, involve purported class action and derivative lawsuits, making various allegations and naming as defendants various persons, including certain Scudder funds, the funds' investment advisors and their affiliates, and certain individuals, including in some cases fund Trustees/Directors, officers, and other parties. Each Scudder fund's investment advisor has agreed to indemnify the applicable Scudder funds in connection with these lawsuits, or other lawsuits or regulatory actions that may be filed making allegations similar to these lawsuits regarding market timing, revenue sharing, fund valuation or other subjects arising from or related to the pending inquiries. It is not possible to determine with certainty what the outcome of these inquiries will be or what the effect, if any, would be on the funds or their advisors. Based on currently available information, however, the funds' investment advisors believe the likelihood that the pending lawsuits and any regulatory settlements will have a material adverse financial impact on a Scudder fund is remote and such actions are not likely to materially affect their ability to perform under their investment management agreements with the Scudder funds.

In connection with litigation or regulatory action related to possible improper market timing or other improper trading activity or possible improper marketing and sales activity in the Fund, the Fund's investment advisor has agreed, subject to applicable law and regulation, to indemnify and hold harmless the applicable Funds against any and all loss, damage, liability and expense, arising from market timing or marketing and sales matters alleged in any enforcement actions brought by governmental authorities involving or potentially affecting the Fund or the investment advisor ("Enforcement Actions") or that are the basis for private actions brought by shareholders of the Fund against the Fund, their directors and officers, the Fund's investment advisor and/or certain other parties ("Private Litigation"), or any proceedings or actions that may be threatened or commenced in the future by any person (including governmental authorities), arising from or similar to the matters alleged in the Enforcement Actions or Private Litigation. In recognition of its undertaking to indemnify the applicable Funds and in light of the rebuttable presumption generally afforded to independent directors/trustees of investment companies that they have not engaged in disabling conduct, the Fund's investment advisor has also agreed, subject to applicable law and regulation, to indemnify the applicable Funds' Independent Trustees against certain liabilities the Independent Trustees may incur from the matters alleged in

any Enforcement Actions or Private Litigation or arising from or similar to the matters alleged in the Enforcement Actions or Private Litigation, and advance expenses that may be incurred by the Independent Trustees in connection with any Enforcement Actions or Private Litigation. The applicable investment advisor is not, however, required to provide indemnification and advancement of expenses: (1) with respect to any proceeding or action with respect to which the applicable Fund's Board determines that the Independent Trustee ultimately would not be entitled to indemnification or (2) for any liability of the Independent Trustee to the Fund or their shareholders to which the Independent Trustee would otherwise be subject by reason of willful misfeasance, bad faith, gross negligence or reckless disregard of the Independent Trustee's duties as a director or trustee of the Fund as determined in a final adjudication in such action or proceeding. The estimated amount of any expenses that may be advanced to the Independent Trustees or indemnity that may be payable under the indemnity agreements is currently unknown. These agreements by the Fund's investment advisor will survive the termination of the investment management agreements between the applicable investment advisor and the Fund.

### **G. Subsequent Event**

Effective February 6, 2006, Scudder Investments will change its name to DWS Scudder and the Scudder funds will be renamed DWS funds. Scudder Strategic Municipal Income Trust will be renamed DWS Strategic Municipal Income Trust. The DWS Scudder name represents the alignment of Scudder with all of Deutsche Bank's mutual fund operations around the globe. The Web site for all Scudder funds will change to [www.dws-scudder.com](http://www.dws-scudder.com)

## **Report of Independent Registered Public Accounting Firm**

### **To the Board of Trustees and Shareholders of Scudder Strategic Municipal Income Trust:**

We have audited the accompanying statement of assets and liabilities of Scudder Strategic Municipal Income Trust (the "Fund"), including the portfolio of investments, as of November 30, 2005, and the related statement of operations for the year then ended, the statement of changes in net assets for each of the two years in the period then ended, and the financial highlights for each of the five years in the period 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 audits.

We conducted our audits 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. We were not engaged to perform an audit of the Fund's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements and financial highlights, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our procedures included confirmation of securities owned as of November 30, 2005, by correspondence with the custodian and brokers or by other appropriate auditing procedures where replies from brokers were not received. We believe that our audits provide 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 Scudder Strategic Municipal Income Trust at November 30, 2005, the results of its operations for the year then ended, the changes in its net assets for each of the two years in the period then ended, and the financial highlights for each of the five years in the period then ended, in conformity with U.S. generally accepted accounting principles.

Boston, Massachusetts  
January 20, 2006

## Tax Information (Unaudited)

Of the dividends paid from net investment income for the taxable year ended November 30, 2005, 100% are designated as exempt interest dividends for federal income tax purposes.

Please consult a tax advisor if you have questions about federal or state income tax laws, or on how to prepare your tax returns. If you have specific questions about your account, please call 1-800-294-4366.

## Dividend Reinvestment Plan

### A. Participation

We invite you to review the description of the Dividend Reinvestment Plan (the "Plan") which is available to you as a shareholder of Scudder Strategic Municipal Income Trust (the "Fund"). If you wish to participate and your shares are held in your own name, simply contact Scudder Investments Service Company, whose address and phone number are provided in Paragraph E, for the appropriate form. If your shares are held in the name of a brokerage firm, bank, or other nominee, you must instruct that nominee to re-register your shares in your name so that you may participate in the Plan, unless your nominee has made the Plan available on shares held by them. Shareholders who so elect will be deemed to have appointed UMB Bank, N.A. ("United Missouri Bank" or "UMB") as their agent and as agent for the Fund under the Plan.

### B. Dividend Investment Account

The Fund's transfer agent and dividend disbursing agent or its delegate (the "Transfer Agent") will establish a Dividend Investment Account (the "Account") for each shareholder participating in the Plan. The Transfer Agent will credit to the Account of each participant funds it receives from the following sources: (a) cash dividends and capital gains distributions paid on shares of beneficial interest (the "Shares") of the Fund registered in the participant's name on the books of the Fund; and (b) cash dividends and capital gains distributions paid on Shares registered in the name of the Transfer Agent but credited to the participant's Account. Sources described in clauses (a) and (b) of the preceding sentence are hereinafter called "Distributions."

### C. Investment of Distribution Funds Held in Each Account

If on the record date for a Distribution (the "Record Date"), Shares are trading at a discount from net asset value per Share (according to the evaluation most recently made on Shares of the Fund), funds credited to a participant's Account will be used to purchase Shares (the "Purchase"). UMB will attempt, commencing five days prior to the Payment Date and ending at the close of business on the Payment Date ("Payment Date" as used herein shall mean the last business day of the month in which such Record Date occurs), to acquire Shares in the open market. If and to the extent that UMB is unable to acquire sufficient Shares to satisfy the Distribution by the close of business on the Payment Date, the Fund will issue to UMB Shares valued at net asset value per Share (according to the evaluation most recently made on Shares of the Fund) in the aggregate amount of the remaining value of the Distribution. If, on the Record Date, Shares are trading at a premium over net asset value per Share, the Fund will issue on the Payment Date, Shares valued at net asset value per Share on the Record Date to the Transfer Agent in the aggregate amount of the funds credited to the participants' accounts.

### D. Voluntary Cash Contributions

A participant may from time to time make voluntary cash contributions to his Account by sending to Transfer Agent a check or money order, payable to Transfer Agent, in a minimum amount of \$100 with appropriate accompanying instructions. (No more than \$500 may be contributed per month.) Transfer Agent will inform UMB of the total funds available for the purchase of Shares and UMB will use the funds to purchase additional Shares for the participant's Account the earlier of: (a) when it next purchases Shares as a result of a Distribution or (b) on or shortly after the first day of each month and in no event more than 30 days after such date except when temporary curtailment or suspension of purchases is necessary to comply with applicable provisions of federal securities laws. Cash contributions received more than fifteen calendar days or less than five calendar days prior to a Payment Date will be returned uninvested. Interest will not be paid on any uninvested cash contributions. Participants making voluntary cash investments will be charged a \$.75 service fee for each such investment and will be responsible for their pro rata share of brokerage commissions.

#### **E. Additional Information**

Address all notices, correspondence, questions, or other communication regarding the Plan, or if you would like a copy of the Plan, to:

**Scudder Investments Service Company**  
P.O. Box 219066  
Kansas City, Missouri 64121-9066  
1-800-294-4366

#### **F. Adjustment of Purchase Price**

The Fund will increase the price at which Shares may be issued under the Plan to 95% of the fair market value of the shares on the Record Date if the net asset value per Share of the Shares on the Record Date is less than 95% of the fair market value of the Shares on the Record Date.

#### **G. Determination of Purchase Price**

The cost of Shares and fractional Shares acquired for each participant's Account in connection with a Purchase shall be determined by the average cost per Share, including brokerage commissions as described in Paragraph H hereof, of the Shares acquired by UMB in connection with that Purchase. Shareholders will receive a confirmation showing the average cost and number of Shares acquired as soon as practicable after the Transfer Agent has received or UMB has purchased Shares. The Transfer Agent may mingle the cash in a participant's account with similar funds of other participants of the Fund for whom UMB acts as agent under the Plan.

#### **H. Brokerage Charges**

There will be no brokerage charges with respect to Shares issued directly by the Fund as a result of Distributions. However, each participant will pay a pro rata share of brokerage commissions incurred with respect to UMB's open market purchases in connection with the reinvestment of Distributions. Brokerage charges for purchasing small amounts of Shares for individual Accounts through the Plan can be expected to be less than the usual brokerage charges for such transactions, as UMB will be purchasing Shares for all participants in blocks and prorating the lower commission thus attainable.

#### **I. Service Charges**

There is no service charge by the Transfer Agent or UMB to shareholders who participate in the Plan other than service charges specified in Paragraphs D and M hereof. However, the Fund reserves the right to amend the Plan in the future to include a service charge.

### **J. Transfer of Shares Held by Agent**

The Transfer Agent will maintain the participant's Account, hold the additional Shares acquired through the Plan in safekeeping and furnish the participant with written confirmation of all transactions in the Account. Shares in the Account are transferable upon proper written instructions to the Transfer Agent. Upon request to the Transfer Agent, a certificate for any or all full Shares in a participant's Account will be sent to the participant.

### **K. Shares Not Held in Shareholder's Name**

Beneficial owners of Shares which are held in the name of a broker or nominee will not be automatically included in the Plan and will receive all distributions in cash. Such shareholders should contact the broker or nominee in whose name their Shares are held to determine whether and how they may participate in the Plan.

### **L. Amendments**

Experience under the Plan may indicate that changes are desirable. Accordingly, the Fund reserves the right to amend or terminate the Plan, including provisions with respect to any Distribution paid, subsequent to notice thereof sent to participants in the Plan at least ninety days before the record date for such Distribution, except when such amendment is necessary or appropriate to comply with applicable law or the rules or policies of the Securities and Exchange Commission or any other regulatory authority, in which case such amendment shall be effective as soon as practicable. The amendment shall be deemed to be accepted by each participant unless, prior to the effective date thereof, the Transfer Agent receives notice of the termination of such participant's account under the Plan in accordance with the terms hereof. The Plan may be terminated by the Fund.

### **M. Withdrawal from Plan**

Shareholders may withdraw from the Plan at any time by giving the Transfer Agent a written notice. If the proceeds are \$100,000 or less and the proceeds are to be payable to the shareholder of record and mailed to the address of record, a signature guarantee normally will not be required for notices by individual account owners (including joint account owners), otherwise a signature guarantee will be required. In addition, if the certificate is to be sent to anyone other than the registered owner(s) at the address of record, a signature guarantee will be required on the notice. A notice of withdrawal will be effective for the next Distribution following receipt of the notice by the Transfer Agent provided the notice is received by the Transfer Agent at least ten days prior to the Record Date for the Distribution. When a participant withdraws from the Plan, or when the Plan is terminated in accordance with Paragraph L hereof, the participant will receive a certificate for full Shares in the Account, plus a check for any fractional Shares based on market price; or if a Participant so desires, the Transfer Agent will notify UMB to sell his Shares in the Plan and send the proceeds to the participant, less brokerage commissions and a \$2.50 service fee.

### **N. Tax Implications**

Shareholders will receive tax information annually for personal records and to assist in preparation of their Federal income tax returns. If Shares are purchased at a discount, the amount of the discount is considered taxable income and is added to the cost basis of the purchased shares.

## **Investment Management Agreement Approval**

The Board of Trustees, including the Independent Trustees, approved the renewal of your Fund's investment management agreement (the "Agreement") with Deutsche Investment Management Americas Inc. ("DeIM" or the "Advisor") in September 2005. As part of its review process, the Board requested and evaluated all information it deemed reasonably necessary to evaluate the Agreement. Over the course of several months, the Contract Review

Committee, in coordination with the Fixed-Income Oversight Committee and the Operations Committee of the Board, reviewed comprehensive materials received from the Advisor, independent third parties and independent counsel. The Board also received extensive information throughout the year regarding performance and operating results of the Fund. After their review of the information received, the Committees presented their findings and recommendations to the Independent Trustees as a group. The Independent Trustees then reviewed the Committees' findings and recommendations and presented their recommendations to the full Board.

In connection with the contract review process, the various Committees and the Board considered the factors discussed below, among others. The Board also considered that the Advisor and its predecessors have managed the Fund since its inception, and the Board believes that a long-term relationship with a capable, conscientious advisor is in the best interests of the Fund. The Board considered, generally, that shareholders invested in the Fund, or approved the investment management agreement for the Fund, knowing that the Advisor managed the Fund and knowing the investment management fee schedule. In connection with recent and ongoing efforts by Deutsche Bank to restructure its US mutual fund business, which resulted in turnover of senior management and other personnel of the Advisor, the Board considered Deutsche Bank's commitment that it will devote to the Advisor and its affiliates all attention and resources that are necessary to provide the Fund with top-quality investment management and shareholder, administrative and product distribution services.

**Nature, Quality and Extent of Services.** The Board considered the nature, extent and quality of services provided under the Agreement, including portfolio management services and administrative services. The Board considered the experience and skills of senior management and investment personnel, the resources made available to such personnel, the ability of the Advisor to attract and retain high-quality personnel, and the organizational depth and stability of the Advisor. The Board reviewed the Fund's performance over short-term and long-term periods and compared those returns to various agreed-upon performance measures, including market indices and peer groups. The Board considered whether investment results were consistent with the Fund's investment objective and policies. The Board also noted that it has put a process into place of identifying "Focus Funds" (e.g., funds performing poorly relative to their peer group), and receives more frequent reporting and information from the Advisor regarding such funds, along with the Advisor's remedial plans to address underperformance. The Board believes this process is an effective manner of addressing poorly performing funds at this time.

On the basis of this evaluation and the ongoing review of investment results by the Fixed-Income Oversight Committee, the Board concluded that the nature, quality and extent of services provided by the Advisor historically have been and continue to be satisfactory, and that the Fund's performance over time was satisfactory.

**Fees and Expenses.** The Board considered the Fund's management fee rate, operating expenses and total expense ratio, and compared management fees to a peer group and total expenses to a broader peer universe based on information and data supplied by Lipper Inc. ("Lipper"). For purposes of this comparison, the Board relied on historical data compiled by Lipper for the peer funds and the Advisor's estimate of current expenses for the Fund. The information provided to the Board showed that the Fund's management fee rate was above the median of the peer group but below the fourth quartile, and that the Fund's total expense ratio was above the median of the peer universe but below the fourth quartile. The Board also considered the Fund's management fee rate as compared to fees charged by the Advisor and certain of its affiliates for comparable funds and for similarly managed institutional accounts. With respect to institutional accounts, the Board noted that (i) both the mix of services provided and the level of responsibility required under the Agreement were significantly greater as compared to the Advisor's obligations for similarly managed institutional accounts; and (ii) the management fees of institutional accounts are less relevant to the Board's consideration because they reflect significantly different competitive forces from those in the fund marketplace. With respect to other comparable Scudder Funds, the Board considered differences in fund and fee structures among the various legacy organizations.

On the basis of the information provided, the Board concluded that management fees were reasonable and appropriate in light of the nature, quality and extent of services provided by the Advisor. The Board noted that although the Fund's

management fee rate was above the median of the peer group and the total expense ratio was above the median of the peer universe, such expenses were within an acceptable range of the peer group and peer universe, respectively, and consistent with reasonable expectations in light of the nature, quality and extent of services provided by the Advisor.

**Profitability.** The Board reviewed detailed information regarding revenues received by the Advisor under the Agreement. The Board considered the estimated costs and pre-tax profits realized by the Advisor from advising the Scudder Funds, as well as estimates of the pre-tax profits attributable to managing the Fund in particular. The Board also received information regarding the estimated enterprise-wide profitability of the Scudder organization with respect to all fund services in totality and by fund. The Board reviewed DeIM's methodology in allocating its costs to the management of the Fund. Although the Board noted the inherently subjective nature of any allocation methodology, the Board received an attestation report from an accounting firm affirming that the allocation methods were consistently applied and were based upon practices commonly used in the investment management industry. Based on the information provided, the Board concluded that the pre-tax profits realized by DeIM in connection with the management of the Fund were not unreasonable.

**Economies of Scale.** The Board considered whether there are economies of scale with respect to the management of the Fund and whether the Fund benefits from any economies of scale. The Board considered whether the management fee rate under the Agreement is reasonable in relation to the asset size of the Fund. The Board concluded that the management fee schedule reflects an appropriate level of sharing of any economies of scale.

**Other Benefits to DeIM and Its Affiliates.** The Board also considered the character and amount of other incidental benefits received by DeIM and its affiliates, including fees received by the Advisor for administrative services provided to the Fund. The Board also considered benefits to DeIM related to brokerage and soft-dollar allocations, which pertain primarily to funds investing in equity securities. The Board considered that, during the past year, the Advisor agreed to cease allocating brokerage to acquire research services from third-party service providers. The Board concluded that management fees were reasonable in light of these fallout benefits.

**Regulatory Matters.** The Board also considered information regarding ongoing inquiries of the Advisor regarding market timing, late trading and other matters by federal and state regulators and private lawsuits on related topics. Among other matters, the Board considered the Advisor's commitment to indemnify the Scudder Funds against regulatory actions or lawsuits arising from such inquiries. The Board also considered management's representation that such actions will not materially impact the Advisor's ability to perform under the Agreement or materially impact the Fund.

Based on all of the information considered and the conclusions reached, the Board (including a majority of the Independent Trustees) determined that the terms of the Agreement continue to be fair and reasonable and that the continuation of the Agreement is in the best interests of the Fund. No single factor was determinative in the Board's analysis.

## Trustees and Officers

The following table presents certain information regarding the Trustees and Officers of the fund as of November 30, 2005. Each individual's year of birth is set forth in parentheses after his or her name. Unless otherwise noted, (i) each individual has engaged in the principal occupation(s) noted in the table for at least the most recent five years, although not necessarily in the same capacity, and (ii) the address of each individual is c/o Deutsche Asset Management, 222 South Riverside Plaza, Chicago, Illinois 60606. Each Trustee's term of office extends until the next shareholders' meeting called for the purpose of electing Trustees and until the election and qualification of a successor, or until such Trustee sooner dies, retires, resigns or is removed as provided in the governing documents of the fund.

| Independent Trustees                       |  |                         |
|--|--|-------------------------|
| Name, Year of Birth, Position(s) Held with | Principal Occupation(s) During Past 5 Years and Other Directorships Held | Number of Funds in Fund |

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| the Fund and Length of Time Served <sup>1</sup>  |   | Complex Overseen |
|--|---|------------------|
| Shirley D. Peterson (1941)<br><br>Chairperson, 2004-present<br><br>Trustee, 1995-present | Retired; formerly, President, Hood College (1995-2000); prior thereto, Partner, Steptoe & Johnson (law firm); Commissioner, Internal Revenue Service; Assistant Attorney General (Tax), US Department of Justice. Directorships: Federal Mogul Corp. (supplier of automotive components and subsystems); AK Steel (steel production); Goodyear Tire & Rubber Co. (April 2004-present) ; Champion Enterprises, Inc. (manufactured home building); Wolverine World Wide, Inc. (designer, manufacturer and marketer of footwear) (April 2005-present); Trustee, Bryn Mawr College. Former Directorship: Bethlehem Steel Corp.  | 71               |
| John W. Ballantine (1946)<br><br>Trustee, 1999-present                                   | Retired; formerly, Executive Vice President and Chief Risk Management Officer, First Chicago NBD Corporation/The First National Bank of Chicago (1996-1998); Executive Vice President and Head of International Banking (1995-1996). Directorships: First Oak Brook Bancshares, Inc.; Oak Brook Bank; American Healthways, Inc. (provider of disease and care management services); Portland General Electric (utility company)   | 71               |
| Donald L. Dunaway (1937)<br><br>Trustee, 1980-present                                    | Retired; formerly, Executive Vice President, A.O. Smith Corporation (diversified manufacturer) (1963-1994)  | 71               |
| James R. Edgar (1946)<br><br>Trustee, 1999-present                                       | Distinguished Fellow, University of Illinois, Institute of Government and Public Affairs (1999-present); formerly, Governor, State of Illinois (1991-1999). Directorships: Kemper Insurance Companies; John B. Sanfilippo & Son, Inc. (processor/packager/marketer of nuts, snacks and candy products); Horizon Group Properties, Inc.; Youbet.com (online wagering platform); Alberto-Culver Company (manufactures, distributes and markets health and beauty care products)   | 71               |
| Paul K. Freeman (1950)<br><br>Trustee, 2002-present                                      | President, Cook Street Holdings (consulting); Senior Visiting Research Scholar, Graduate School of International Studies, University of Denver; Consultant, World Bank/Inter-American Development Bank; formerly, Project Leader, International Institute for Applied Systems Analysis (1998-2001); Chief Executive Officer, The Eric Group, Inc. (environmental insurance) (1986-1998)   | 71               |
| Robert B. Hoffman (1936)<br><br>Trustee, 1981-present                                    | Retired; formerly, Chairman, Harnischfeger Industries, Inc. (machinery for the mining and paper industries) (1999-2000); prior thereto, Vice Chairman and Chief Financial Officer, Monsanto Company (agricultural, pharmaceutical and nutritional/food products) (1994-1999). Directorships: RCP Advisors, LLC (a private equity investment advisory firm)  | 71               |
| William McClayton (1944)<br><br>Trustee, 2004-present                                    | Managing Director of Finance and Administration, DiamondCluster International, Inc. (global management consulting firm) (2001-present); formerly, Partner, Arthur Andersen LLP (1986-2001). Formerly: Trustee, Ravinia Festival; Board of Managers, YMCA of Metropolitan Chicago  | 71               |
| Robert H. Wadsworth (1940)<br><br>Trustee, 2004-present                                  | President, Robert H. Wadsworth Associates, Inc. (consulting firm) (1983-present). Director, The European Equity Fund, Inc. (since 1986), The New Germany Fund, Inc. (since 1992), The Central Europe and Russia Fund, Inc. (since 1990). Formerly, Trustee of New York Board Scudder Funds; President and Trustee, Trust for Investment Managers (registered investment company) (1999-2002). President, Investment Company Administration, L.L.C. (1992*-2001); President, Treasurer and Director, First Fund Distributors, Inc. (June 1990-January 2002); Vice President, Professionally Managed Portfolios (May 1991-January 2002) and Advisors Series Trust (October 1996-January 2002) (registered investment companies) | 74               |

\* Inception date of the corporation which was the predecessor to the L.L.C.

**Interested Trustee and Officers<sup>2</sup>**

| Name, Year of Birth, Position(s) Held with the Fund and Length of Time Served <sup>1</sup> | Principal Occupation(s) During Past 5 Years and Other Directorships Held   | Number of Funds in Fund Complex Overseen |
|--|--|--|
| William N. Shiebler <sup>4</sup> (1942)<br><br>Trustee, 2004-present                       | Vice Chairman, Deutsche Asset Management ("DeAM") and a member of the DeAM Global Executive Committee (since 2002); Vice Chairman of Putnam Investments, Inc. (1999); Director and Senior Managing Director of Putnam Investments, Inc. and President, Chief Executive Officer, and Director of Putnam Mutual Funds Inc. (1990-1999)   | 120                                      |
| Vincent J. Esposito <sup>4</sup> (1956)<br><br>President, 2005-present                     | Managing Director <sup>3</sup> , Deutsche Asset Management (since 2003); President and Chief Executive Officer of The Central Europe and Russia Fund, Inc., The European Equity Fund, Inc., The New Germany Fund, Inc. (since 2003) (registered investment companies); Vice Chairman and Director of The Brazil Fund, Inc. (2004-present); formerly, Managing Director, Putnam Investments (1991-2002) | n/a                                      |
| Philip J. Collora (1945)<br><br>Vice President and Assistant Secretary, 1986-present       | Director <sup>3</sup> , Deutsche Asset Management  | n/a                                      |
| Paul H. Schubert <sup>4</sup> (1963)<br><br>Chief Financial Officer, 2004-present          | Managing Director <sup>3</sup> , Deutsche Asset Management (since July 2004); formerly, Executive Director, Head of Mutual Fund Services and Treasurer for UBS Family of Funds (1998-2004); Vice President and Director of Mutual Fund Finance at UBS Global Asset Management (1994-1998)  | n/a                                      |



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|  |  |     |
|--|--|-----|
| Treasurer, 2005-present                                |  |     |
| John Millette <sup>5</sup> (1962)                      | Director <sup>3</sup> , Deutsche Asset Management  | n/a |
| Secretary, 2001-present                                |  |     |
| Patricia DeFilippis <sup>4</sup> (1963)                | Vice President, Deutsche Asset Management (since June 2005); Counsel, New York Life Investment Management LLC (2003-2005); legal associate, Lord, Abbett & Co. LLC (1998-2003)   | n/a |
| Assistant Secretary, 2005-present                      |  |     |
| Daniel O. Hirsch <sup>6</sup> (1954)                   | Consultant. Formerly, Managing Director, Deutsche Asset Management (2002-2005); Director, Deutsche Asset Management (1999-2002), Principal, BT Alex. Brown Incorporated (now Deutsche Bank Securities Inc.) (1998-1999); Assistant General Counsel, United States Securities and Exchange Commission (1993-1998); Director, Deutsche Global Funds Ltd. (2002-2004) | n/a |
| Assistant Secretary, 2002-present                      |  |     |
| Elisa D. Metzger <sup>4</sup> (1962)                   | Director <sup>3</sup> , Deutsche Asset Management (since September 2005); Counsel, Morrison and Foerster LLP (1999-2005)   | n/a |
| Assistant Secretary 2005-present                       |  |     |
| Caroline Pearson <sup>5</sup> (1962)                   | Managing Director <sup>3</sup> , Deutsche Asset Management   | n/a |
| Assistant Secretary, 1998-present                      |  |     |
| Scott M. McHugh <sup>5</sup> (1971)                    | Director <sup>3</sup> , Deutsche Asset Management  | n/a |
| Assistant Treasurer, 2005-present                      |  |     |
| Kathleen Sullivan D'Eramo <sup>5</sup> (1957)          | Director <sup>3</sup> , Deutsche Asset Management  | n/a |
| Assistant Treasurer, 2003-present                      |  |     |
| John Robbins <sup>4</sup> (1966)                       | Managing Director <sup>3</sup> , Deutsche Asset Management (since 2005); formerly, Chief Compliance Officer and Anti-Money Laundering Compliance Officer for GE Asset Management (1999-2005)   | n/a |
| Anti-Money Laundering Compliance Officer, 2005-present |  |     |
| Philip Gallo <sup>4</sup> (1962)                       | Managing Director <sup>3</sup> , Deutsche Asset Management (2003-present); formerly, Co-Head of Goldman Sachs Asset Management Legal (1994-2003)   | n/a |
| Chief Compliance Officer, 2004-present                 |  |     |

<sup>1</sup> Length of time served represents the date that each Trustee was first elected to the common board of Trustees which oversees a number of investment companies, including the fund, managed by the Advisor. For the Officers of the fund, the length of time served represents the date that each officer was first elected to serve as an officer of any fund overseen by the aforementioned common board of Trustees.

<sup>2</sup> As a result of their respective positions held with the Advisor, these individuals are considered "interested persons" of the Advisor within the meaning of the 1940 Act. Interested persons receive no compensation from the fund.

<sup>3</sup> Executive title, not a board directorship

<sup>4</sup> Address: 345 Park Avenue, New York, New York 10154

<sup>5</sup> Address: Two International Place, Boston, Massachusetts 02110

<sup>6</sup> Address: One South Street, Baltimore, Maryland 21202. Effective December 31, 2005, Mr. Hirsch resigned as an officer of the Fund.

|                               |
|-------------------------------|
| <b>Additional Information</b> |
|                               |

## Changes in Trustees and Officers

On July 19, 2005, the Board of Trustees appointed Paul H. Schubert as Treasurer of the fund.

On September 23, 2005, the Board of Trustees appointed Patricia DeFilippis as Assistant Secretary of the fund, John Robbins as the Anti-Money Laundering Compliance Officer of the fund and Vincent J. Esposito as President of the fund.

On November 16, 2005, the Board of Trustees appointed Elisa Metzger as Assistant Secretary of the fund.

## Certifications

The fund's chief executive officer has certified to the New York Stock Exchange that, as of September 1, 2005, he was not aware of any violation by the fund of applicable NYSE corporate governance listing standards. The fund's reports to the Securities and Exchange Commission on Forms N-CSR and N-Q contain certifications by the fund's chief executive officer and chief financial officer that relate to the fund's disclosure in such reports and that are required by the rule 30a-2(a) under the Investment Company Act.

## Changes Effective February 6, 2006

Scudder Investments will change its name to DWS Scudder and the Scudder funds will be renamed the DWS funds.

Scudder Strategic Municipal Income Trust will change its name to DWS Strategic Municipal Income Trust and the cusip number for the fund's common stock will change to 23338T101 and the cusip number for the fund's preferred stock will change to 23338T200.

The Shareholder Service Agent will change its name to DWS Scudder Investments Service Company.

The web site address will change from [www.scudder.com](http://www.scudder.com) and [www.cef.scudder.com](http://www.cef.scudder.com) to [www.dws-scudder.com](http://www.dws-scudder.com).

| <b>Additional Information (continued)</b> |   |
|---|---|
| <b>Automated Information Lines</b>        | <b>Scudder Closed-End Fund Info Line</b><br><br>(800) 349-4281  |
| <b>Web Sites</b>                          | <a href="http://www.scudder.com">www.scudder.com</a><br><br>or visit our Direct Link:<br><br><a href="http://www.cef.scudder.com">www.cef.scudder.com</a><br><br>Obtain monthly fact sheets, financial reports, press releases and webcasts when available.   |
| <b>Written Correspondence</b>             | <b>Deutsche Investment Management Americas Inc.</b><br><br>222 South Riverside<br><br>Chicago, IL 60606   |
| <b>Proxy Voting</b>                       | A description of the fund's policies and procedures for voting proxies for portfolio securities and information about how the fund voted proxies related to its portfolio securities during the 12-month period ended June 30 is available on our Web site <a href="http://scudder.com">scudder.com</a> (type "proxy voting" in the search field) or on the SEC's Web site <a href="http://www.sec.gov">www.sec.gov</a> . To obtain a written copy of the fund's policies and procedures without charge, upon request, call us toll free at (800) 621-1048. |

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|  |  |
|--|--|
| <b>Legal Counsel</b>                                 | <b>Vedder, Price, Kaufman &amp; Kammholz, P.C.</b><br><br>222 North LaSalle Street<br><br>Chicago, IL 60601                      |
| <b>Dividend Reinvestment Plan Agent</b>              | <b>UMB Bank</b><br><br>P.O. Box 410064<br><br>Kansas City, MO 64141-0064   |
| <b>Shareholder Service Agent</b>                     | <b>Scudder Investments Service Company</b><br><br>P.O. Box 219066<br><br>Kansas City, MO 64121-9066<br><br><b>(800) 294-4366</b> |
| <b>Custodian and Transfer Agent</b>                  | <b>State Street Bank and Trust Company</b><br><br>225 Franklin Street<br><br>Boston, MA 02110                                    |
| <b>Independent Registered Public Accounting Firm</b> | <b>Ernst &amp; Young LLP</b><br><br>200 Clarendon Street<br><br>Boston, MA 02116   |
| <b>NYSE Symbol</b>                                   | KSM  |
| <b>CUSIP Number</b>                                  | 811234-103   |

**Notes**

ITEM 2. CODE OF ETHICS.

As of the end of the period, November 30, 2005, Scudder Strategic Municipal Income Trust has adopted a code of ethics, as defined in Item 2 of Form N-CSR, that applies to its Principal Executive Officer and Principal Financial Officer.

There have been no amendments to, or waivers from, a provision of the code of ethics during the period covered by this report that would require disclosure under Item 2.

A copy of the code of ethics is filed as an exhibit to this Form N-CSR.

ITEM 3. AUDIT COMMITTEE FINANCIAL EXPERT.

The Fund's Board of Directors/Trustees has determined that the Fund has at least one "audit committee financial expert" serving on its audit committee: Mr. Donald L. Dunaway. This audit committee member is "independent," meaning that he is not an "interested person" of the Fund (as that term is defined in Section 2(a)(19) of the Investment Company Act of 1940) and he does not accept any consulting, advisory, or other compensatory fee from the Fund (except in the capacity as a Board or committee member).

An "audit committee financial expert" is not an "expert" for any purpose, including for purposes of Section 11 of the Securities Act of 1933, as a result

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of being designated as an "audit committee financial expert." Further, the designation of a person as an "audit committee financial expert" does not mean that the person has any greater duties, obligations, or liability than those imposed on the person without the "audit committee financial expert" designation. Similarly, the designation of a person as an "audit committee financial expert" does not affect the duties, obligations, or liability of any other member of the audit committee or board of directors.

### ITEM 4. PRINCIPAL ACCOUNTANT FEES AND SERVICES.

#### SCUDDER STRATEGIC MUNICIPAL INCOME TRUST FORM N-CSR DISCLOSURE RE: AUDIT FEES

The following table shows the amount of fees that Ernst & Young, LLP ("E&Y"), the Fund's auditor, billed to the Fund during the Fund's last two fiscal years. The Audit Committee approved in advance all audit services and non-audit services that E&Y provided to the Fund.

The Audit Committee has delegated certain pre-approval responsibilities to its Chairman (or, in his absence, any other member of the Audit Committee).

#### Services that the Fund's Auditor Billed to the Fund

| Fiscal<br>Year<br>Ended<br>November 30 | Audit<br>Fees<br>Billed<br>to Fund | Audit-<br>Related<br>Fees Billed<br>to Fund | Tax Fees<br>Billed<br>to Fund | All<br>Other Fees<br>Billed<br>to Fund |
|--|------------------------------------|---|-------------------------------|--|
| 2005                                   | \$45,248                           | \$0   | \$6,170                       | \$0                                    |
| 2004                                   | \$41,478                           | \$0   | \$7,320                       | \$0                                    |

The above "Tax Fees" were billed for professional services rendered for tax compliance and tax return preparation.

#### Services that the Fund's Auditor Billed to the Adviser and Affiliated Fund Service Providers

The following table shows the amount of fees billed by E&Y to Deutsche Investment Management Americas, Inc. ("DeIM" or the "Adviser"), and any entity controlling, controlled by or under common control with DeIM ("Control Affiliate") that provides ongoing services to the Fund ("Affiliated Fund Service Provider"), for engagements directly related to the Fund's operations and financial reporting, during the Fund's last two fiscal years.

| Fiscal<br>Year<br>Ended<br>November 30 | Audit-Related<br>Fees Billed<br>to Adviser<br>and Affiliated<br>Fund Service<br>Providers | Tax Fees<br>Billed to<br>Adviser and<br>Affiliated<br>Fund<br>Service<br>Providers | All Other<br>Fees Billed<br>to Adviser<br>and Affiliated<br>Fund Service<br>Providers |
|--|---|--|---|
| 2005                                   | \$406,000   | \$70,570   | \$0   |
| 2004                                   | \$281,500   | \$0  | \$0   |

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The "Audit-Related Fees" were billed for services in connection with the assessment of internal controls, agreed upon procedures and additional related procedures and the above "Tax Fees" were billed in connection with consultation services and agreed upon procedures.