

DEUTSCHE STRATEGIC MUNICIPAL INCOME TRUST  
Form N-CSRS  
August 04, 2016  
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

FORM N-CSRS

Investment Company Act file number: 811-05767

Deutsche Strategic Municipal Income Trust

(Exact Name of Registrant as Specified in Charter)

345 Park Avenue

New York, NY 10154-0004

(Address of Principal Executive Offices) (Zip Code)

Registrant's Telephone Number, including Area Code: (212) 250-3220

Paul Schubert

60 Wall Street

New York, NY 10005

(Name and Address of Agent for Service)

Date of fiscal year end: 11/30

Date of reporting period: 5/31/2016

## **ITEM 1. REPORT TO STOCKHOLDERS**

May 31, 2016

### **Semiannual Report to Shareholders**

#### **Deutsche Strategic Municipal Income Trust**

Ticker Symbol: KSM

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The fund's investment objective is to provide a high level of current income exempt from federal income tax.

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.

Bond investments are subject to interest-rate, credit, liquidity and market risks to varying degrees. When interest rates rise, bond prices generally fall. Credit risk refers to the ability of an issuer to make timely payments of principal and

interest. Investing in derivatives entails special risks relating to liquidity, leverage and credit that may reduce returns and/or increase volatility. Leverage results in additional risks and can magnify the effect of any gains or losses. Although the fund seeks income that is exempt from federal income taxes, a portion of the fund's distributions may be subject to federal, state and local taxes, including the alternative minimum tax.

Deutsche Asset Management represents the asset management activities conducted by Deutsche Bank AG or any of its subsidiaries.

NOT FDIC/NCUA INSURED NO BANK GUARANTEE MAY LOSE VALUE NOT A DEPOSIT NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY

**Performance Summary May 31, 2016 (Unaudited)**

**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 [deutschefunds.com](http://deutschefunds.com) for the Fund's most recent month-end performance.**

**Fund specific data and performance are provided for informational purposes only and are not intended for trading purposes.**

Average Annual Total Returns as of 5/31/16

| <b>Deutsche Strategic Municipal Income Trust</b>                          | <b>6-Month<sup>‡</sup> 1-Year 5-Year 10-Year</b> |              |              |              |
|---|--|--------------|--------------|--------------|
| <b>Based on Net Asset Value<sup>(a)</sup></b>                             | <b>5.53%</b>                                     | <b>8.06%</b> | <b>9.13%</b> | <b>7.98%</b> |
| <b>Based on Market Price<sup>(a)</sup></b>                                | <b>7.56%</b>                                     | <b>8.42%</b> | <b>9.21%</b> | <b>8.04%</b> |
| Barclays Municipal Bond Index <sup>(b)</sup>                              | 3.42%  | 5.87%        | 5.07%        | 4.93%        |
| Morningstar Closed-End High-Yield Municipal Funds Category <sup>(c)</sup> | 5.59%  | 8.88%        | 9.64%        | 6.22%        |

<sup>‡</sup>Total returns shown for periods less than one year are not annualized.

(a) Total return based on net asset value reflects changes in the Fund's net asset value during each period. Total return based on market price reflects changes in market price. 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 net asset value at which the Fund's shares traded during the period. Expenses of the Fund include management fee, interest expense and other fund expenses. Total returns shown take into account these fees and expenses. The expense ratio of the Fund for the six months ended May 31, 2016 was 1.76% (1.13% excluding interest expense).

(b) The unmanaged, unleveraged Barclays Municipal Bond Index covers the U.S. dollar-denominated long-term tax exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds and pre-refunded bonds. Index returns do not reflect any fees or expenses and it is not possible to invest directly into an index.

(c) Morningstar's Closed-End High-Yield Municipal Funds category represents high-yield muni portfolios that typically invest at least 50% of assets in high-income municipal securities that are not rated or that are rated by a major agency such as Standard & Poor's or Moody's at the level of BBB and below (considered part of the high-yield universe within the municipal industry). Morningstar figures represent the average of the total returns based on net asset value reported by all of the closed-end funds designated by Morningstar, Inc. as falling into the Closed-End High-Yield Municipal Funds category. Category returns assume reinvestment of all distributions. It is not possible to invest directly in a Morningstar category.

**Net Asset Value and Market Price**

**As of 5/31/16 As of 11/30/15**

Net Asset Value \$ 13.20 \$ 12.90

Market Price \$ 13.59 \$ 13.03

Prices and net asset value fluctuate and are not guaranteed.

**Distribution Information**

Six Months as of 5/31/16:

|  |          |
|--|----------|
|  | \$ .41   |
| Income Dividends (common shareholders)   |          |
| May Income Dividend (common shareholders)  | \$ .0650 |
| Current Annualized Distribution Rate (Based on Net Asset Value) as of 5/31/16 <sup>†</sup> | 5.91%    |
| Current Annualized Distribution Rate (Based on Market Price) as of 5/31/16 <sup>†</sup>    | 5.74%    |
| Tax Equivalent Distribution Rate (Based on Net Asset Value) as of 5/31/16 <sup>†</sup>     | 10.44%   |
| Tax Equivalent Distribution Rate (Based on Market Price) as of 5/31/16 <sup>†</sup>        | 10.14%   |

<sup>†</sup>Current annualized distribution rate is the latest monthly dividend shown as an annualized percentage of net asset value/market price on May 31, 2016. 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 43.4%. Distribution rates are historical, not guaranteed and will fluctuate. Distributions do not include return of capital or other non-income sources.

**Portfolio Management Team**

Ashton P. Goodfield, CFA, Managing Director

Co-Lead Portfolio Manager of the fund. Began managing the fund in 2014.

— Joined Deutsche Asset Management in 1986.

— Co-Head of Municipal Bonds.

— BA, Duke University.

Rebecca L. Flinn, Director

Co-Lead Portfolio Manager of the fund. Began managing the fund in 1998.

— Joined Deutsche Asset Management in 1986.

— BA, University of Redlands, California.

A. Gene Caponi, CFA, Managing Director

Portfolio Manager of the fund. Began managing the fund in 2014.

— Joined Deutsche Asset Management in 1998.

— BS, State University of New York, Oswego; MBA, State University of New York at Albany.

Carol L. Flynn, CFA, Managing Director

Portfolio Manager of the fund. Began managing the fund in 2014.

— Joined Deutsche Asset Management in 1994.

— Co-Head of Municipal Bonds.

— BS, Duke University; MBA, University of Connecticut.

### Portfolio Summary (Unaudited)

#### Investment Portfolio as of May 31, 2016 (Unaudited)

|   | Principal<br>Amount (\$) | Value (\$)       |
|---|--------------------------|------------------|
| <b>Municipal Bonds and Notes 139.6%</b>   |                          |                  |
| <b>Arizona 1.2%</b>   |                          |                  |
| Maricopa County, AZ, Pollution Control Corp. Revenue, El Paso Electric Co. Project, Series B, 7.25%, 4/1/2040                   | 1,570,000                | <b>1,822,927</b> |
| <b>California 16.0%</b>   |                          |                  |
| California, Golden State Tobacco Securitization Corp., Tobacco Settlement, Series A-1, 5.75%, 6/1/2047                          | 500,000                  | 505,795          |
| California, Health Facilities Financing Authority Revenue, Catholic Healthcare West, Series A, 6.0%, 7/1/2034                   | 1,000,000                | 1,147,810        |
| California, M-S-R Energy Authority, Series B, 7.0%, 11/1/2034, GTY: Citigroup, Inc.   | 1,310,000                | 1,965,498        |
| California, Morongo Band of Mission Indians, Enterprise Casino Revenue, Series B, 144A, 6.5%, 3/1/2028                          | 1,000,000                | 1,083,540        |
| California, South Bayside Waste Management Authority, Solid Waste Enterprise, Shoreway Environmental, Series A, 6.25%, 9/1/2029 | 1,425,000                | 1,658,301        |
| California, State General Obligation:   |                          |                  |
| 5.0%, 11/1/2043   | 1,500,000                | 1,795,005        |
| 5.25%, 4/1/2035   | 1,230,000                | 1,488,214        |
| 5.5%, 3/1/2040  | 1,000,000                | 1,166,810        |
| 5.75%, 4/1/2031   | 1,000,000                | 1,136,870        |
| 6.0%, 4/1/2038  | 1,000,000                | 1,142,040        |
| 6.5%, 4/1/2033  | 1,950,000                | 2,257,164        |
| California, State Public Works Board Lease Revenue, Capital Projects, Series I-1, 6.375%, 11/1/2034                             | 1,000,000                | 1,194,560        |
| California, State Public Works Board Lease Revenue, Riverside Campus Project, Series B, 6.125%, 4/1/2028                        | 2,000,000                | 2,299,880        |
| California, Statewide Communities Development Authority Revenue, Loma Linda University Medical Center:                          |                          |                  |
| Series A, 5.25%, 12/1/2044  | 195,000                  | 218,989          |
| Series A, 144A, 5.25%, 12/1/2056  | 735,000                  | 829,506          |
| Series A, 5.5%, 12/1/2054   | 195,000                  | 221,007          |
| Riverside County, CA, Transportation Commission Toll Revenue Senior Lien, Series A, 5.75%, 6/1/2048                             | 1,000,000                | 1,173,890        |

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|   |           |                   |
|---|-----------|-------------------|
| San Buenaventura, CA, Community Memorial Health Systems, 7.5%, 12/1/2041  | 500,000   | 618,300           |
| San Francisco City & County, CA, Airports Commission, International Airport Revenue, Series A, AMT, 5.0%, 5/1/2044                                | 1,000,000 | 1,142,250         |
| San Joaquin Hills, CA, Transportation Corridor Agency, Toll Road Revenue, Series A, 5.0%, 1/15/2050   | 445,000   | 501,350           |
|   |           | <b>23,546,779</b> |
| <b>Colorado 2.6%</b>  |           |                   |
| Colorado, Park Creek Metropolitan District Revenue, Senior Ltd. Property Tax Supported, Series A, 5.0%, 12/1/2045                                 | 235,000   | 268,382           |
| Colorado, Public Energy Authority, Natural Gas Purchased Revenue, 6.25%, 11/15/2028, GTY: Merrill Lynch & Co., Inc.                               | 635,000   | 820,509           |
| Colorado, State Health Facilities Authority Revenue, Covenant Retirement Communities:   |           |                   |
| Series A, 5.0%, 12/1/2033   | 440,000   | 488,189           |
| Series A, 5.0%, 12/1/2035   | 250,000   | 283,380           |
| Colorado, State Health Facilities Authority Revenue, School Health Systems, Series A, 5.5%, 1/1/2035  | 1,000,000 | 1,215,290         |
| Denver, CO, City & County Airport Revenue, Series A, AMT, 5.25%, 11/15/2043   | 600,000   | 683,988           |
|   |           | <b>3,759,738</b>  |
| <b>Connecticut 1.7%</b>   |           |                   |
| Connecticut, Harbor Point Infrastructure Improvement District, Special Obligation Revenue, Harbor Point Project, Series A, 7.875%, 4/1/2039       | 2,000,000 | 2,363,440         |
| Connecticut, Mashantucket Western Pequot Tribe Bond, 6.05%, 7/1/2031 (PIK)*   | 2,568,173 | 154,090           |
|   |           | <b>2,517,530</b>  |
| <b>District of Columbia 0.8%</b>  |           |                   |
| District of Columbia, Metropolitan Airport Authority Systems Revenue:   |           |                   |
| Series A, AMT, 5.0%, 10/1/2038  | 200,000   | 228,410           |
| Series A, AMT, 5.0%, 10/1/2043  | 850,000   | 960,534           |
|   |           | <b>1,188,944</b>  |
| <b>Florida 9.1%</b>   |           |                   |
| Collier County, FL, Industrial Development Authority, Continuing Care Community Revenue, Arlington of Naples Project, Series A, 8.125%, 5/15/2044 | 500,000   | 598,965           |
| Florida, Capital Region Community Development District, Capital Improvement Revenue, Series A, 7.0%, 5/1/2039                                     | 465,000   | 472,640           |
| Florida, Middle Village Community Development District, Special Assessment, Series A, 6.0%, 5/1/2035  | 930,000   | 802,804           |
| Florida, Tolomato Community Development District, Special Assessment:   |           |                   |
| Series A-2, Step-up Coupon, 0% to 5/1/2017, 6.61% to 5/1/2039   | 50,000    | 40,210            |
| Series 2015-1, Step-up Coupon, 0% to 11/1/2021, 6.61% to 5/1/2040   | 250,000   | 155,215           |
| Series 2015-2, Step-up Coupon, 0% to 11/1/2024, 6.61% to 5/1/2040   | 150,000   | 78,840            |
| Series A-3, Step-up Coupon, 0% to 5/1/2019, 6.61% to 5/1/2040   | 110,000   | 66,175            |
| Series A-4, Step-up Coupon, 0% to 5/1/2022, 6.61% to 5/1/2040   | 55,000    | 24,534            |
| 5.4%, 5/1/2037  | 1,480,000 | 1,481,510         |
| Series 1, 6.55%, 5/1/2027   | 10,000    | 10,194            |
| Series 3, 6.55%, 5/1/2027*  | 130,000   | 1                 |
| Series A-1, 6.55%, 5/1/2027   | 170,000   | 170,911           |
| Series 2015-3, 6.61%, 5/1/2040*   | 165,000   | 2                 |
| Florida, Village Community Development District No. 9, Special Assessment Revenue, 5.5%, 5/1/2042   | 150,000   | 173,019           |
| Martin County, FL, Health Facilities Authority, Martin Memorial Medical Center, 5.5%, 11/15/2042  | 335,000   | 378,382           |

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|   |           |                   |
|---|-----------|-------------------|
| Miami Beach, FL, Health Facilities Authority, Mount Sinai Medical Center, 5.0%,<br>11/15/2044   | 500,000   | 570,380           |
| Miami-Dade County, FL, Aviation Revenue:<br>Series A, AMT, 5.0%, 10/1/2031  | 30,000    | 34,655            |
| Series A, 5.5%, 10/1/2041   | 3,000,000 | 3,370,440         |
| Orlando & Orange County, FL, Expressway Authority Revenue, Series C, 5.0%,<br>7/1/2035  | 1,080,000 | 1,219,558         |
| Tallahassee, FL, Health Facilities Revenue, Memorial Healthcare, Inc. Project, Series A,<br>5.0%, 12/1/2055   | 150,000   | 170,979           |
| Tampa-Hillsborough County, FL, Expressway Authority:<br>Series A, 5.0%, 7/1/2031  | 1,500,000 | 1,752,780         |
| Series A, 5.0%, 7/1/2037  | 1,590,000 | 1,825,574         |
|   |           | <b>13,397,768</b> |
| <b>Georgia 6.2%</b>   |           |                   |
| Americus-Sumter County, GA, Hospital Authority, Magnolia Manor Obligated Group,<br>Series A, 6.25%, 5/15/2033   | 1,000,000 | 1,116,770         |
| Atlanta, GA, Airport Revenue, Series C, AMT, 5.0%, 1/1/2037   | 375,000   | 418,800           |
| Atlanta, GA, Tax Allocation, Beltline Project, Series B, 7.375%, 1/1/2031   | 1,000,000 | 1,135,730         |
| Atlanta, GA, Water & Wastewater Revenue, Series A, Prerefunded, 6.25%, 11/1/2034  | 2,000,000 | 2,354,860         |
| DeKalb County, GA, Water & Sewer Revenue, Series A, 5.25%, 10/1/2036  | 1,000,000 | 1,181,370         |
| Gainesville & Hall County, GA, Hospital Authority, Northeast Georgia Health System,<br>Inc. Project:<br>Series A, 5.25%, 8/15/2049                      | 100,000   | 119,140           |
| Series A, 5.5%, 8/15/2054   | 180,000   | 219,316           |
| Georgia, Main Street Natural Gas, Inc., Gas Project Revenue, Series A, 5.5%, 9/15/2024,<br>GTY: Merrill Lynch & Co., Inc.                               | 1,220,000 | 1,494,475         |
| Georgia, Medical Center Hospital Authority Revenue, Anticipation Certificates,<br>Columbus Regional Healthcare System, 6.5%, 8/1/2038, INS: AGC         | 1,000,000 | 1,105,270         |
|   |           | <b>9,145,731</b>  |
| <b>Guam 1.8%</b>  |           |                   |
| Guam, Government General Obligation, Series A, Prerefunded, 7.0%, 11/15/2039  | 1,000,000 | 1,205,850         |
| Guam, International Airport Authority Revenue, Series C, AMT, 6.375%, 10/1/2043   | 215,000   | 261,646           |
| Guam, Power Authority Revenue, Series A, 5.5%, 10/1/2030  | 1,000,000 | 1,127,930         |
|   |           | <b>2,595,426</b>  |
| <b>Hawaii 1.7%</b>  |           |                   |
| Gainesville & Hall County, GA, Development Authority Retirement Community<br>Revenue, ACTS Retirement Life Community, Series A-2, 6.625%, 11/15/2039    | 1,000,000 | 1,149,690         |
| Hawaii, State Airports Systems Revenue, Series A, AMT, 5.0%, 7/1/2041   | 695,000   | 802,391           |
| Hawaii, State Department of Budget & Finance, Special Purpose Revenue, Hawaiian<br>Electric Co., Inc., 6.5%, 7/1/2039, GTY: Hawaiian Electric Co., Inc. | 500,000   | 569,100           |
|   |           | <b>2,521,181</b>  |
| <b>Idaho 0.2%</b>   |           |                   |
| Idaho, Health Facilities Authority Revenue, St. Luke's Regional Medical Center, 6.75%,<br>11/1/2037   | 305,000   | <b>343,015</b>    |
| <b>Illinois 7.8%</b>  |           |                   |
| Chicago, IL, O'Hare International Airport Revenue:<br>Series C, AMT, 5.0%, 1/1/2046   | 1,000,000 | 1,131,730         |
| Series B, 6.0%, 1/1/2041  | 2,000,000 | 2,381,520         |
| Illinois, Finance Authority Revenue, Friendship Village of Schaumburg, Series A,<br>5.625%, 2/15/2037   | 2,000,000 | 2,000,480         |
|   | 1,000,000 | 1,156,660         |

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|  |           |                   |
|--|-----------|-------------------|
| Illinois, Finance Authority Revenue, The Admiral at Lake Project, Series A, 8.0%,<br>5/15/2040   |           |                   |
| Illinois, Finance Authority Revenue, Three Crowns Park Plaza, Series A, 5.875%,<br>2/15/2038   | 1,000,000 | 1,001,090         |
| Illinois, Metropolitan Pier & Exposition Authority Revenue, McCormick Place Project,<br>Series A, 5.0%, 6/15/2042                            | 300,000   | 320,760           |
| Illinois, Railsplitter Tobacco Settlement Authority, 6.0%, 6/1/2028  | 365,000   | 435,164           |
| Illinois, State Finance Authority Revenue, OSF Healthcare Systems, Series A, 5.0%,<br>11/15/2045   | 525,000   | 606,438           |
| Illinois, State Finance Authority Revenue, Park Place of Elmhurst Project:<br>Series C, 2.0%, 5/15/2055                                      | 150,000   | 18,732            |
| Series A, 6.24%, 5/15/2038   | 850,000   | 855,457           |
| Illinois, State Finance Authority Revenue, Trinity Health Corp., Series L, 5.0%,<br>12/1/2030  | 1,000,000 | 1,145,460         |
| Springfield, IL, Electric Revenue, Senior Lien, 5.0%, 3/1/2040, INS: AGMC  | 385,000   | 445,780           |
|  |           | <b>11,499,271</b> |
| <b>Indiana 4.1%</b>  |           |                   |
| Indiana, Finance Authority Hospital Revenue, Deaconess Hospital Obligation, Series A,<br>Prerefunded, 6.75%, 3/1/2039                        | 525,000   | 607,735           |
| Indiana, State Finance Authority Revenue, Community Foundation of Northwest<br>Indiana, 5.0%, 3/1/2041                                       | 1,000,000 | 1,105,140         |
| Indiana, State Finance Authority Revenue, Greencroft Obligation Group, Series A, 7.0%,<br>11/15/2043   | 460,000   | 541,061           |
| Indiana, State Finance Authority Revenue, I-69 Development Partners LLC, AMT,<br>5.25%, 9/1/2034   | 225,000   | 253,679           |
| Indiana, State Finance Authority Revenue, Stadium Project, Series A, 5.25%, 2/1/2037   | 1,330,000 | 1,590,600         |
| Valparaiso, IN, Exempt Facilities Revenue, Pratt Paper LLC Project, AMT, 7.0%,<br>1/1/2044, GTY: Pratt Industries (U.S.A.)                   | 780,000   | 966,872           |
| Vigo County, IN, Hospital Authority Revenue, Union Hospital, Inc., 144A, 5.7%,<br>9/1/2037   | 1,000,000 | 1,029,590         |
|  |           | <b>6,094,677</b>  |
| <b>Iowa 0.7%</b>   |           |                   |
| Iowa, Finance Authority Retirement Community Revenue, Edgewater LLC Project,<br>Prerefunded, 6.5%, 11/15/2027                                | 1,000,000 | <b>1,083,730</b>  |
| <b>Kansas 0.2%</b>   |           |                   |
| Lenexa, KS, Health Care Facility Revenue, Lakeview Village, Inc. Project, 7.25%,<br>5/15/2039  | 300,000   | <b>330,921</b>    |
| <b>Kentucky 5.3%</b>   |           |                   |
| Kentucky, Economic Development Finance Authority, Hospital Facilities Revenue,<br>Owensboro Medical Health Systems, Series A, 6.5%, 3/1/2045 | 2,000,000 | 2,314,700         |
| Kentucky, Economic Development Finance Authority, Louisville Arena Project<br>Revenue, Series A-1, 6.0%, 12/1/2033, INS: AGC                 | 365,000   | 394,047           |
| Kentucky, Public Transportation Infrastructure Authority Toll Revenue, 1st<br>Tier-Downtown Crossing, Series A, 6.0%, 7/1/2053               | 1,440,000 | 1,701,648         |
| Louisville & Jefferson County, KY, Metropolitan Government Health Systems Revenue,<br>Norton Healthcare, Inc., 5.0%, 10/1/2030               | 3,425,000 | 3,463,394         |
|  |           | <b>7,873,789</b>  |
| <b>Louisiana 1.5%</b>  |           |                   |
| Louisiana, Local Government Environmental Facilities, Community Development<br>Authority Revenue, 6.75%, 11/1/2032                           | 1,000,000 | 1,080,080         |
|  | 950,000   | 974,130           |

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| Louisiana, St. John Baptist Parish Revenue, Marathon Oil Corp., Series A, 5.125%,<br>6/1/2037  |           |                   |
| Louisiana, Tobacco Settlement Financing Corp. Revenue, Series A, 5.25%, 5/15/2035  | 180,000   | 206,224           |
|  |           | <b>2,260,434</b>  |
| <b>Maine 0.8%</b>  |           |                   |
| Maine, Health & Higher Educational Facilities Authority Revenue, Maine General<br>Medical Center, 6.75%, 7/1/2036                                | 1,000,000 | <b>1,140,120</b>  |
| <b>Maryland 4.1%</b>   |           |                   |
| Maryland, Economic Development Corp., Pollution Control Revenue, Potomac Electric<br>Power Co., 6.2%, 9/1/2022                                   | 1,500,000 | 1,705,560         |
| Maryland, State Health & Higher Educational Facilities Authority Revenue, Anne<br>Arundel Health Systems, Series A, Prerefunded, 6.75%, 7/1/2039 | 500,000   | 588,495           |
| Maryland, State Health & Higher Educational Facilities Authority Revenue, Meritus<br>Medical Center Obligated Group, 5.0%, 7/1/2040              | 1,000,000 | 1,150,670         |
| Maryland, State Health & Higher Educational Facilities Authority Revenue, Washington<br>County Hospital:<br>Prerefunded, 5.75%, 1/1/2033         | 1,000,000 | 1,078,460         |
| Prerefunded, 6.0%, 1/1/2028  | 1,385,000 | 1,499,110         |
|  |           | <b>6,022,295</b>  |
| <b>Massachusetts 2.0%</b>  |           |                   |
| Massachusetts, State Development Finance Agency Revenue, Linden Ponds, Inc.<br>Facility:<br>Series B, Zero Coupon, 11/15/2056                    | 505,485   | 2,871             |
| Series A-2, 5.5%, 11/15/2046   | 101,629   | 94,089            |
| Series A-1, 6.25%, 11/15/2039  | 1,903,948 | 1,923,083         |
| Massachusetts, State Health & Educational Facilities Authority Revenue, Milford<br>Regional Medical Center, Series E, 5.0%, 7/15/2037            | 950,000   | 976,144           |
|  |           | <b>2,996,187</b>  |
| <b>Michigan 6.9%</b>   |           |                   |
| Detroit, MI, Water & Sewerage Department, Sewerage Disposal System Revenue, Series<br>A, 5.25%, 7/1/2039   | 280,000   | 313,135           |
| Detroit, MI, Water Supply Systems Revenue, Series A, 5.75%, 7/1/2037   | 1,000,000 | 1,133,780         |
| Kalamazoo, MI, Economic Development Corp. Revenue, Limited Obligation, Heritage<br>Community, 5.5%, 5/15/2036                                    | 1,000,000 | 1,010,160         |
| Kentwood, MI, Economic Development, Limited Obligation, Holland Home, Series A,<br>5.375%, 11/15/2036  | 2,000,000 | 2,016,700         |
| Michigan, State Building Authority Revenue, Facilities Program:<br>Series I, 5.0%, 4/15/2038   | 775,000   | 919,592           |
| Series I-A, 5.5%, 10/15/2045   | 2,000,000 | 2,335,500         |
| Michigan, State Finance Authority Revenue, Detroit Water & Sewer, Series C-3, 5.0%,<br>7/1/2033, INS: AGMC                                       | 180,000   | 209,313           |
| Michigan, State Finance Authority Revenue, Detroit Water & Sewer Department, Series<br>C, 5.0%, 7/1/2035   | 90,000    | 104,139           |
| Royal Oak, MI, Hospital Finance Authority Revenue, William Beaumont Hospital,<br>Prerefunded, 8.25%, 9/1/2039                                    | 1,000,000 | 1,165,650         |
| Tawas City, MI, Hospital Finance Authority, St. Joseph Health Services, Series A, ETM,<br>5.75%, 2/15/2023                                       | 980,000   | 984,488           |
|  |           | <b>10,192,457</b> |
| <b>Minnesota 0.8%</b>  |           |                   |
| Minneapolis, MN, Health Care Systems Revenue, Fairview Health Services, Series A,<br>Prerefunded, 6.75%, 11/15/2032                              | 1,000,000 | <b>1,142,810</b>  |

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**Mississippi 1.0%**

|  |         |                  |
|--|---------|------------------|
| Lowndes County, MS, Solid Waste Disposal & Pollution Control Revenue, Weyerhaeuser Co. Project, Series A, 6.8%, 4/1/2022 | 250,000 | 312,237          |
| Mississippi, Business Finance Corp., Pollution Control Revenue, Systems Energy Resources, Inc. Project, 5.875%, 4/1/2022 | 620,000 | 639,803          |
| Warren County, MS, Gulf Opportunity Zone, International Paper Co., Series A, 6.5%, 9/1/2032                              | 435,000 | 485,460          |
|  |         | <b>1,437,500</b> |

**Missouri 2.1%**

|  |           |                  |
|--|-----------|------------------|
| Missouri, State Health & Educational Facilities Authority Revenue, Lutheran Senior Services, Series C, 5.0%, 2/1/2042  | 2,000,000 | 2,021,560        |
| Missouri, State Health & Educational Facilities Authority Revenue, Medical Research, Lutheran Senior Services, Series A, 5.0%, 2/1/2046                          | 65,000    | 73,820           |
| Missouri, State Health & Educational Facilities Authority, Health Facilities Revenue, Lester E Cox Medical Centers, Series A, 5.0%, 11/15/2048                   | 150,000   | 170,215          |
| St. Louis County, MO, Industrial Development Authority, Senior Living Facilities, St. Andrews Resources for Seniors Obligated Group, Series A, 5.125%, 12/1/2045 | 365,000   | 385,079          |
| St. Louis, MO, Lambert-St. Louis International Airport Revenue, Series A-1, 6.625%, 7/1/2034   | 415,000   | 475,532          |
|  |           | <b>3,126,206</b> |

**Nevada 3.7%**

|  |           |                  |
|--|-----------|------------------|
| Clark County, NV, School District, Series A, 5.0%, 6/15/2022, INS: NATL                          | 1,390,000 | 1,491,567        |
| Henderson, NV, Health Care Facility Revenue, Catholic Healthcare West, Series B, 5.25%, 7/1/2031 | 2,000,000 | 2,072,120        |
| Las Vegas Valley, NV, Water District, Series B, 5.0%, 6/1/2037                                   | 1,565,000 | 1,830,174        |
|  |           | <b>5,393,861</b> |

**New Jersey 6.6%**

|   |           |                  |
|---|-----------|------------------|
| New Jersey, Health Care Facilities Financing Authority Revenue, St. Joseph's Health Care System, 6.625%, 7/1/2038                                   | 715,000   | 783,440          |
| New Jersey, State Economic Development Authority, Continental Airlines, Inc. Project, AMT, 4.875%, 9/15/2019  | 620,000   | 658,223          |
| New Jersey, State Economic Development Authority, Special Facilities Revenue, Continental Airlines, Inc. Project, Series B, AMT, 5.625%, 11/15/2030 | 500,000   | 576,190          |
| New Jersey, State Health Care Facilities Financing Authority Revenue, University Hospital, Series A, 5.0%, 7/1/2046, INS: AGMC                      | 180,000   | 207,428          |
| New Jersey, State Transportation Trust Fund Authority, Series B, 5.5%, 6/15/2031  | 1,500,000 | 1,671,915        |
| New Jersey, State Turnpike Authority Revenue, Series E, 5.0%, 1/1/2045  | 1,015,000 | 1,185,145        |
| New Jersey, Tobacco Settlement Financing Corp.:   |           |                  |
| Series 1A, 4.75%, 6/1/2034  | 4,280,000 | 4,154,981        |
| Series 1A, 5.0%, 6/1/2041   | 500,000   | 486,915          |
|   |           | <b>9,724,237</b> |

**New York 9.2%**

|  |           |           |
|--|-----------|-----------|
| New York, General Obligation, Series A-4, 0.4%***, 8/1/2038, LOC: Bank of Tokyo-Mitsubishi UFJ             | 1,000,000 | 1,000,000 |
| New York, Metropolitan Transportation Authority Revenue:   |           |           |
| Series D, 5.0%, 11/15/2038   | 275,000   | 328,094   |
| Series E, 5.0%, 11/15/2042   | 305,000   | 358,939   |
| New York, State Liberty Development Corp. Revenue, World Trade Center Project, Class 1-3, 5.0%, 11/15/2044 | 500,000   | 563,445   |
| New York & New Jersey Port Authority, One Hundred Forty-Seventh, AMT, 5.0%, 10/15/2023, INS: NATL          | 8,260,000 | 8,538,445 |

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|   |           |                   |
|---|-----------|-------------------|
| New York & New Jersey Port Authority, Special Obligation Revenue, JFK International Air Terminal LLC, 6.0%, 12/1/2042   | 680,000   | 798,742           |
| New York City, NY, Industrial Development Agency, Special Facility Revenue, American Airlines, JFK International Airport, AMT, 8.0%, 8/1/2028, GTY: American Airlines Group | 2,000,000 | 2,044,420         |
|   |           | <b>13,632,085</b> |
| <b>North Carolina 1.0%</b>  |           |                   |
| North Carolina, Medical Care Commission, Health Care Facilities Revenue, University Health Systems, Series D, Prerefunded, 6.25%, 12/1/2033                                 | 1,000,000 | 1,133,650         |
| North Carolina, Medical Care Commission, Retirement Facilities Revenue, First Mortgage-Aldersgate, 5.0%, 7/1/2045   | 330,000   | 355,073           |
|   |           | <b>1,488,723</b>  |
| <b>Ohio 1.2%</b>  |           |                   |
| Ohio, American Municipal Power, Inc. Revenue, Fremont Energy Center Project, Series B, 5.0%, 2/15/2037  | 1,575,000 | <b>1,818,416</b>  |
| <b>Oregon 1.2%</b>  |           |                   |
| Port of Portland, OR, Portland International Airport Revenue, Series 23, 5.0%, 7/1/2038   | 1,500,000 | <b>1,781,550</b>  |
| <b>Pennsylvania 5.0%</b>  |           |                   |
| Butler County, PA, Hospital Authority Revenue, Butler Health Systems Project, Prerefunded, 7.25%, 7/1/2039  | 2,000,000 | 2,380,940         |
| Pennsylvania, Commonwealth Financing Authority, Series A, 5.0%, 6/1/2035  | 315,000   | 363,563           |
| Pennsylvania, State Economic Development Financing Authority Revenue, Bridges Finco LP, AMT, 5.0%, 12/31/2038   | 715,000   | 815,879           |
| Pennsylvania, State Economic Development Financing Authority, Exempt Facilities Revenue, PPL Energy Supply, Series A, 6.4%, 12/1/2038                                       | 185,000   | 182,314           |
| Pennsylvania, State Turnpike Commission Revenue:  |           |                   |
| Series A-1, 5.0%, 12/1/2040   | 2,500,000 | 2,917,575         |
| Series C, 5.0%, 12/1/2044   | 240,000   | 280,090           |
| Philadelphia, PA, Redevelopment Authority Revenue, First Lien Mortgage, Series A, 6.5%, 1/1/2029  | 470,000   | 471,274           |
|   |           | <b>7,411,635</b>  |
| <b>Puerto Rico 1.6%</b>   |           |                   |
| Puerto Rico, Public Buildings Authority Revenue, Series Q, 5.625%, 7/1/2039   | 1,000,000 | 521,210           |
| Puerto Rico, Sales Tax Financing Corp., Sales Tax Revenue:  |           |                   |
| Series A, 5.5%, 8/1/2042  | 750,000   | 300,645           |
| Series A, 6.0%, 8/1/2042  | 1,000,000 | 405,820           |
| Series A, 6.375%, 8/1/2039  | 950,000   | 389,054           |
| Puerto Rico, Sales Tax Financing Corp., Sales Tax Revenue, Convertible Capital Appreciation, Series A, Step-up Coupon, 0% to 8/1/2016, 6.75% to 8/1/2032                    | 2,000,000 | 763,980           |
|   |           | <b>2,380,709</b>  |
| <b>Rhode Island 0.1%</b>  |           |                   |
| Rhode Island, Tobacco Settlement Financing Corp., Series A, 5.0%, 6/1/2040  | 155,000   | <b>171,556</b>    |
| <b>South Carolina 3.1%</b>  |           |                   |
| Hardeeville, SC, Assessment Revenue, Anderson Tract Municipal Improvement District, Series A, 7.75%, 11/1/2039  | 894,000   | 928,249           |
| South Carolina, State Public Service Authority Revenue, Series E, 5.25%, 12/1/2055  | 2,070,000 | 2,452,515         |
| South Carolina, State Public Service Authority Revenue, Santee Cooper, Series A, 5.75%, 12/1/2043   | 890,000   | 1,100,414         |
|   |           | <b>4,481,178</b>  |
| <b>Tennessee 1.5%</b>   |           |                   |
| Clarksville, TN, Natural Gas Acquisition Corp., Gas Revenue:  |           |                   |

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|  |           |                  |
|--|-----------|------------------|
| 5.0%, 12/15/2017, GTY: Merrill Lynch & Co., Inc.   | 500,000   | 527,345          |
| 5.0%, 12/15/2018, GTY: Merrill Lynch & Co., Inc.   | 540,000   | 586,386          |
| Johnson City, TN, Health & Educational Facilities Board Hospital Revenue, Mountain States Health Alliance, Series A, 7.75%, 7/1/2038                               | 1,000,000 | 1,139,560        |
|  |           | <b>2,253,291</b> |
| <b>Texas 18.6%</b>   |           |                  |
| Brazos River, TX, Harbor Navigation District, Brazoria County Environmental Health, Dow Chemical Co. Project:  |           |                  |
| Series B-2, 4.95%, 5/15/2033   | 1,000,000 | 1,052,710        |
| Series A-3, AMT, 5.125%, 5/15/2033   | 1,000,000 | 1,049,440        |
| Central Texas, Regional Mobility Authority Revenue, Series A, 5.0%, 1/1/2043   | 1,500,000 | 1,676,070        |
| Central Texas, Regional Mobility Authority Revenue, Senior Lien:   |           |                  |
| Series A, 5.0%, 1/1/2040   | 230,000   | 267,722          |
| Prerefunded, 6.0%, 1/1/2041  | 545,000   | 661,183          |
| Dallas-Fort Worth, International Airport Revenue:  |           |                  |
| Series F, AMT, 5.0%, 11/1/2035   | 1,000,000 | 1,129,950        |
| Series D, AMT, 5.0%, 11/1/2038   | 2,000,000 | 2,259,360        |
| Houston, TX, Airport System Revenue, United Airlines, Inc., Terminal E Project, AMT, 4.75%, 7/1/2024   | 615,000   | 698,818          |
| Matagorda County, TX, Navigation District No. 1, Pollution Control Revenue, AEP Texas Central Co. Project, Series A, 4.4%, 5/1/2030, INS: AMBAC                    | 2,250,000 | 2,583,338        |
| Mission, TX, Economic Development Corp. Revenue, Senior Lien, Natgasoline Project, Series B, AMT, 144A, 5.75%, 10/1/2031   | 250,000   | 264,253          |
| North Texas, Tollway Authority Revenue, Series B, 5.0%, 1/1/2045   | 665,000   | 769,877          |
| North Texas, Tollway Authority Revenue, Toll Second Tier, Series F, Prerefunded, 5.75%, 1/1/2033   | 2,000,000 | 2,154,940        |
| Red River, TX, Health Facilities Development Corp., Retirement Facilities Revenue, MRC Crossings Project, Series A, 8.0%, 11/15/2049                               | 285,000   | 342,707          |
| San Antonio, TX, Convention Center Hotel Finance Corp., Contract Revenue, Empowerment Zone, Series A, AMT, 5.0%, 7/15/2039, INS: AMBAC                             | 1,000,000 | 1,003,550        |
| Tarrant County, TX, Cultural Education Facilities Finance Corp. Revenue, Trinity Terrace Project, The Cumberland Rest, Inc., Series A-1, 5.0%, 10/1/2044           | 175,000   | 196,445          |
| Tarrant County, TX, Cultural Education Facilities Finance Corp., Hospital Revenue, Scott & White Healthcare, 5.0%, 8/15/2043                                       | 2,100,000 | 2,418,717        |
| Tarrant County, TX, Cultural Education Facilities Finance Corp., Retirement Facility, Mirador Project, Series A, 8.25%, 11/15/2044                                 | 570,000   | 481,684          |
| Texas, Grand Parkway Transportation Corp., System Toll Revenue, Series B, 5.0%, 4/1/2053   | 500,000   | 568,540          |
| Texas, Love Field Airport Modernization Corp., Special Facilities Revenue, Southwest Airlines Co. Project, 5.25%, 11/1/2040  | 1,055,000 | 1,182,718        |
| Texas, SA Energy Acquisition Public Facility Corp., Gas Supply Revenue, 5.5%, 8/1/2020, GTY: The Goldman Sachs Group, Inc.   | 2,000,000 | 2,332,500        |
| Texas, State Municipal Gas Acquisition & Supply Corp. III Gas Supply Revenue:  |           |                  |
| 5.0%, 12/15/2030, GTY: Macquarie Group Ltd.  | 165,000   | 186,656          |
| 5.0%, 12/15/2031, GTY: Macquarie Group Ltd.  | 1,000,000 | 1,124,890        |
| 5.0%, 12/15/2032, GTY: Macquarie Group Ltd.  | 1,000,000 | 1,119,200        |
| Texas, State Private Activity Bond, Surface Transportation Corp. Revenue, Senior Lien, North Tarrant Express Mobility Partners Segments LLC, AMT, 6.75%, 6/30/2043 | 280,000   | 347,738          |
| Texas, State Transportation Commission, Turnpike Systems Revenue, Series C, 5.0%, 8/15/2034  | 825,000   | 966,438          |
|  | 510,000   | 585,388          |

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|  |           |                    |
|--|-----------|--------------------|
| Travis County, TX, Health Facilities Development Corp. Revenue, Westminster Manor Health, 7.125%, 11/1/2040  |           | <b>27,424,832</b>  |
| <b>Virgin Islands 1.1%</b>   |           |                    |
| Virgin Islands, Public Finance Authority Revenue, Gross Receipts Tax Loan Notes, Series A, 5.0%, 10/1/2032   | 1,500,000 | <b>1,628,520</b>   |
| <b>Virginia 1.1%</b>   |           |                    |
| Washington County, VA, Industrial Development Authority, Hospital Facility Revenue, Mountain States Health Alliance, Series C, 7.75%, 7/1/2038                 | 1,370,000 | <b>1,563,047</b>   |
| <b>Washington 3.4%</b>   |           |                    |
| Washington, State Health Care Facilities Authority Revenue, Series C, 5.375%, 8/15/2028, INS: AGC  | 595,000   | 617,902            |
| Washington, State Health Care Facilities Authority Revenue, Virginia Mason Medical Center, Series A, 6.125%, 8/15/2037   | 2,000,000 | 2,111,660          |
| Washington, State Health Care Facilities Authority, Catholic Health Initiatives, Series A, 5.0%, 2/1/2041  | 1,000,000 | 1,102,710          |
| Washington, State Housing Finance Commission, Rockwood Retirement Communities Project, Series A, 7.375%, 1/1/2044  | 1,000,000 | 1,167,890          |
|  |           | <b>5,000,162</b>   |
| <b>Wisconsin 2.6%</b>  |           |                    |
| Wisconsin, State Health & Educational Facilities Authority Revenue, Agnesian Healthcare, Inc., Series B, 5.0%, 7/1/2036  | 500,000   | 571,085            |
| Wisconsin, State Health & Educational Facilities Authority Revenue, Prohealth Care, Inc. Obligation Group, Prerefunded, 6.625%, 2/15/2039                      | 1,110,000 | 1,279,464          |
| Wisconsin, State Health & Educational Facilities Authority Revenue, Thedacare, Inc., Series A, 5.5%, 12/15/2038  | 1,765,000 | 1,958,426          |
|  |           | <b>3,808,975</b>   |
| <b>Total Municipal Bonds and Notes (Cost \$182,793,410)</b>  |           | <b>206,002,213</b> |
| <b>Underlying Municipal Bonds of Inverse Floaters (a) 16.4%</b>  |           |                    |
| <b>Florida 4.1%</b>  |           |                    |
| Orange County, FL, School Board, Certificates of Participation, Series C, 5.0%, 8/1/2034 (b)   | 5,000,000 | <b>6,021,250</b>   |
| <i>Trust: Orange County, FL, School Board, Series 2016-XM0183, 144A, 16.775, 8/1/2034, Leverage Factor at purchase date: 4 to 1</i>                            |           |                    |
| <b>Massachusetts 4.1%</b>  |           |                    |
| Massachusetts, State Development Finance Agency Revenue, Partners Healthcare System, Inc., Series Q, 5.0%, 7/1/2035 (b)  | 5,000,000 | <b>6,088,000</b>   |
| <i>Trust: Massachusetts, State Development Finance Agency Revenue, Series 2016-XM0136, 144A, 16.985%, 1/1/2024, Leverage Factor at purchase date: 4 to 1</i>   |           |                    |
| <b>New York 3.9%</b>   |           |                    |
| New York, State Dormitory Authority, State Personal Income Tax Revenue, Series A, 5.0%, 3/15/2023 (b)  | 5,535,000 | <b>5,725,189</b>   |
| <i>Trust: New York, State Dormitory Authority Revenue, Secondary Issues, Series 1955-2, 144A, 17.135%, 9/15/2016, Leverage Factor at purchase date: 4 to 1</i> |           |                    |
| <b>Tennessee 4.3%</b>  |           |                    |
| Nashville & Davidson County, TN, Metropolitan Government, 5.0%, 1/1/2024 (b)   | 5,918,585 | <b>6,313,227</b>   |
| <i>Trust: Nashville &amp; Davidson County, TN, Metropolitan Government, Series 2631-1, 144A, 17.146%, 7/1/2017, Leverage Factor at purchase date: 4 to 1</i>   |           |                    |
| <b>Total Underlying Municipal Bonds of Inverse Floaters (Cost \$23,318,159)</b>  |           | <b>24,147,666</b>  |

**% of Net Assets Value (\$)**

|   |        |                     |
|---|--------|---------------------|
| <b>Total Investment Portfolio</b> (Cost \$206,111,569) <sup>†</sup> | 156.0  | <b>230,149,879</b>  |
| <b>Floating Rate Notes (a)</b>                                      | (10.9) | <b>(16,088,378)</b> |
| <b>Series 2018 MTPS, at Liquidation Value</b>                       | (47.5) | <b>(70,000,000)</b> |
| <b>Other Assets and Liabilities, Net</b>                            | 2.4    | <b>3,455,714</b>    |
| <b>Net Assets Applicable to Common Shareholders</b>                 | 100.0  | <b>147,517,215</b>  |

The following represents bonds that are in default:

| <b>Security</b>  | <b>Coupon</b> | <b>Maturity Date</b> | <b>Principal Amount (\$)</b> | <b>Cost (\$)</b> | <b>Value (\$)</b> |
|--|---------------|----------------------|------------------------------|------------------|-------------------|
| Florida, Tolomato Community Development District, Special Assessment, Series 2015-3* | 6.61%         | 5/1/2040             | 165,000                      | 0                | 2                 |
| Florida, Tolomato Community Development District, Special Assessment, Series 3*      | 6.55%         | 5/1/2027             | 130,000                      | 1                | 1                 |
|  |               |                      |                              | <b>4,161</b>     | <b>10,197</b>     |

\* Non-income producing security.

\*\* 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 May 31, 2016.

<sup>†</sup>The cost for federal income tax purposes was \$188,496,148. At May 31, 2016, net unrealized appreciation for all securities based on tax cost was \$25,565,353. This consisted of aggregate gross unrealized appreciation for all securities in which there was an excess of value over tax cost of \$30,370,728 and aggregate gross unrealized depreciation for all securities in which there was an excess of tax cost over value of \$4,805,375.

(a) Securities represent the underlying municipal obligations of inverse floating rate obligations held by the Fund. The Floating Rate Notes represent leverage to the Fund and is the amount owed to the floating rate note holders.

(b) Security forms part of the below inverse floater. The Fund accounts for these inverse floaters as a form of secured borrowing, by reflecting the value of the underlying bond in the investments of the Fund and the amount owed to the floating rate note holder as a liability.

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.

AGC: Assured Guaranty Corp.

AGMC: Assured Guaranty Municipal Corp.

AMBAC: Ambac Financial Group, Inc.

AMT: Subject to alternative minimum tax.

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

GTY: Guaranty Agreement

INS: Insured

LOC: Letter of Credit

NATL: National Public Finance Guarantee Corp.

PIK: Denotes that all or a portion of the income is paid in-kind in the form of additional principal.

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

### Fair Value Measurements

Various inputs are used in determining the value of the Fund's investments. These inputs are summarized in three broad levels. Level 1 includes quoted prices in active markets for identical securities. Level 2 includes other significant observable inputs (including quoted prices for similar securities, interest rates, prepayment speeds and credit risk). Level 3 includes significant unobservable inputs (including the Fund's own assumptions in determining the fair value of investments). The level assigned to the securities valuations may not be an indication of the risk or liquidity associated with investing in those securities.

The following is a summary of the inputs used as of May 31, 2016 in valuing the Fund's investments. For information on the Fund's policy regarding the valuation of investments, please refer to the Security Valuation section of Note A in the accompanying Notes to Financial Statements.

| Assets                    | Level 1     | Level 2               | Level 3     | Total                 |
|---------------------------|-------------|-----------------------|-------------|-----------------------|
| Municipal Investments (c) | \$ —        | \$ 230,149,879        | \$ —        | \$ 230,149,879        |
| <b>Total</b>              | <b>\$ —</b> | <b>\$ 230,149,879</b> | <b>\$ —</b> | <b>\$ 230,149,879</b> |

There have been no transfers between fair value measurement levels during the period ended May 31, 2016.

(c) See Investment Portfolio for additional detailed categorizations.

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

### Statement of Assets and Liabilities

as of May 31, 2016 (Unaudited)

#### Assets

|  |                    |
|--|--------------------|
| Investments in securities, at value (cost \$206,111,569) | \$ 230,149,879     |
| Receivable for investments sold                          | 1,000,313          |
| Interest receivable                                      | 3,209,274          |
| Other assets   | 3,298              |
| Deferred offering costs                                  | 84,778             |
| <b>Total assets</b>                                      | <b>234,447,542</b> |

#### Liabilities

|   |            |
|---|------------|
| Cash overdraft  | 604,851    |
| Payable for floating rate notes issued                                | 16,088,378 |
| Accrued management fee  | 109,871    |
| Accrued Trustees' fees  | 8,046      |
| Other accrued expenses and payables                                   | 119,181    |
| Series 2018 MTPS, at liquidation value (see page 33 for more details) | 70,000,000 |

|   |                    |
|---|--------------------|
| Total liabilities   | 86,930,327         |
|   | \$                 |
| <b>Net assets applicable to common shareholders, at value</b>   | <b>147,517,215</b> |
| <b>Net Assets Applicable to Common Shareholders Consist of</b>  |                    |
| Undistributed net investment income   | 245,974            |
| Net unrealized appreciation (depreciation) on investments   | 24,038,310         |
| Accumulated net realized gain (loss)  | (3,608,981)        |
| Paid-in capital   | 126,841,912        |
|   | \$                 |
| <b>Net assets applicable to common shareholders, at value</b>   | <b>147,517,215</b> |
| <b>Net Asset Value</b>  |                    |
| <b>Net Asset Value</b> per common share (\$147,517,215 ÷ 11,178,158 outstanding shares of beneficial interest, \$.01 par value, unlimited number of common shares authorized) | <b>\$ 13.20</b>    |

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

### Statement of Operations

for the six months ended May 31, 2016 (Unaudited)

#### Investment Income

|  |                     |
|--|---------------------|
| Income:  |                     |
|  | \$ 5,849,565        |
| Interest   |                     |
| Expenses:  |                     |
|  | 647,638             |
| Management fee   |                     |
| Services to shareholders   | 6,003               |
| Custodian fee  | 3,416               |
| Professional fees  | 51,789              |
| Reports to shareholders  | 26,596              |
| Trustees' fees and expenses  | 7,198               |
| Interest expense   | 456,532             |
| Stock exchange listing fees  | 11,301              |
| Offering costs   | 28,528              |
| Other  | 42,923              |
| Total expenses   | 1,281,924           |
| <b>Net investment income</b>   | <b>4,567,641</b>    |
| <b>Realized and Unrealized Gain (Loss)</b>                             |                     |
| Net realized gain (loss) from investments                              | 1,512,973           |
| Change in net unrealized appreciation (depreciation) on investments    | 1,789,822           |
| <b>Net gain (loss)</b>   | <b>3,302,795</b>    |
| <b>Net increase (decrease) in net assets resulting from operations</b> | <b>\$ 7,870,436</b> |

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

### Statement of Cash Flows

for the six months ended May 31, 2016 (Unaudited)

#### Increase (Decrease) in Cash:

#### Cash Flows from Operating Activities

|   |              |
|---|--------------|
| Net increase (decrease) in net assets resulting from operations (excluding distributions to ARPS) | \$ 7,870,436 |
|   | (33,645,815) |

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Adjustments to reconcile net increase (decrease) in net assets resulting from operations to net cash provided (used) by operating activities:

|   |                    |
|---|--------------------|
| Purchases of long-term investments  |                    |
| Net amortization of premium/(accretion of discount)                               | 19,743             |
| Proceeds from sales and maturities of long-term investments                       | 25,844,168         |
| (Increase) decrease in interest receivable  | (101,014)          |
| (Increase) decrease in other assets   | 3,295              |
| (Increase) decrease in receivable for investments sold                            | (1,000,313)        |
| Increase (decrease) in payable for investments purchased — when-issued securities | (416,967)          |
| Increase (decrease) in other accrued expenses and payables                        | 58,160             |
| Change in net unrealized (appreciation) depreciation on investments               | (1,789,822)        |
| Net realized (gain) loss from investments   | (1,512,973)        |
| <b>Cash provided (used) by operating activities</b>                               | <b>(4,671,102)</b> |
| <b>Cash Flows from Financing Activities</b>                                       |                    |
| Net increase (decrease) in cash overdraft   | 604,851            |
| (Increase) decrease in deferred offering cost on Series 2018 MTPS                 | 27,443             |
| Distributions paid (net of reinvestment of distributions)                         | (4,378,580)        |
| Increase (decrease) in payable for floating rate notes issued                     | 7,500,000          |
| <b>Cash provided (used) by financing activities</b>                               | <b>3,753,714</b>   |
| <b>Increase (decrease) in cash</b>  | <b>(917,388)</b>   |
| Cash at beginning of period   | 917,388            |
| <b>Cash at end of period</b>  | <b>\$ —</b>        |
| <b>Supplemental Disclosure</b>  |                    |
| Reinvestment of distributions   | \$ 204,087         |
| Interest paid on preferred shares   | \$ (464,571)       |
| Interest expense and fees on floating rate notes issued                           | \$ (49,921)        |

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

**Statement of Changes in Net Assets**

|   | <b>Six Months Ended May<br/>31, 2016 (Unaudited)</b> | <b>Year Ended<br/>November 30, 2015</b> |
|---|--|---|
| <b>Increase (Decrease) in Net Assets</b>  |  |   |
| Operations:   |  |   |
|   | \$ 4,567,641   | \$ 9,245,393                            |
| Net investment income   |  |   |
| Net realized gain (loss)  | 1,512,973  | (1,262,645)                             |
| Change in net unrealized appreciation (depreciation)                                      | 1,789,822  | (2,003,349)                             |
| Net increase (decrease) in net assets resulting from operations                           | 7,870,436  | 5,979,399                               |
| Distributions to ARPS   | —  | (6,023)                                 |
| <b>Net increase (decrease) in net assets applicable to common shareholders</b>            | <b>7,870,436</b>                                     | <b>5,973,376</b>                        |
| Distributions to common shareholders from:  |  |   |
|   | (4,524,707)  | (9,993,116)                             |
| Net investment income   |  |   |
| Net realized gains  | —  | (115,536)                               |
| Total distributions   | (4,524,707)  | (10,108,652)                            |
| Fund share transactions:  |  |   |
|   | 204,087  | 315,593                                 |
| Net proceeds from shares issued to common shareholders from reinvestment of distributions |  |   |

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|  |                       |                       |
|--|-----------------------|-----------------------|
| Net increase (decrease) in net assets from Fund share transactions   | 204,087               | 315,593               |
| <b>Increase (decrease) in net assets</b>   | <b>3,549,816</b>      | <b>(3,819,683)</b>    |
| Net assets at beginning of period applicable to common shareholders  | 143,967,399           | 147,787,082           |
| Net assets at end of period applicable to common shareholders<br>(including undistributed net investment income of \$245,974 and<br>\$203,040, respectively) | <b>\$ 147,517,215</b> | <b>\$ 143,967,399</b> |

**Other Information**

|  |            |            |
|--|------------|------------|
| Common shares outstanding at beginning of period                           | 11,162,530 | 11,138,704 |
| Shares issued to common shareholders from reinvestment of<br>distributions | 15,628     | 23,826     |
| Common shares outstanding at end of period                                 | 11,178,158 | 11,162,530 |

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

**Financial Highlights**

**Six Months Ended 5/31/16 (Unaudited)**      **Years Ended November 30, 2015   2014   2013   2012   2011**  
**Selected Per Share Data Applicable to Common Shareholders**

**Net asset value at beginning of period**  
**\$ 12.90      \$ 13.27   \$ 12.52   \$ 14.46   \$ 12.49   \$ 12.40**

*Income (loss) from investment operations:*  
**.83      .87      .87      .95      1.01**

Net investment income<sup>a</sup>  
**and** **Net realized gain (loss)**  
**\$ 0      (.29)   .81      (1.89)   1.75   .08**

**Total from investment operations**  
**.54      1.68      (1.02)   2.70   1.09**

Distributions to ARPS from net investment income  
**(.00)\*\*\*   (.00)\*\*\*   (.00)\*\*\*   (.02)   (.02)**

|  |  |  |  |  |  |
|--|--|--|--|--|--|
| (common share equivalent)  |  |  |  |  |  |
| <b>Net increase (decrease) in net assets resulting from operations</b> |  |  |  |  |  |
| Less distributions to common shareholders                              |  |  |  |  |  |
| Net investment income  |  |  |  |  |  |
| Net realized gains   |  |  |  |  |  |
| <b>Total distributions</b>   |  |  |  |  |  |
| NAV accretion resulting from ARPS tendered at a discount <sup>a</sup>  |  |  |  |  |  |
| <b>Net asset value, end of period</b>                                  |  |  |  |  |  |
| <b>Market price, end of period</b>                                     |  |  |  |  |  |
| <b>Total Return</b>  |  |  |  |  |  |
| Based on net asset value (%) <sup>b</sup>                              |  |  |  |  |  |
|  |  |  |  |  |  |

  

|   |                 |                 |                 |                 |                 |
|---|-----------------|-----------------|-----------------|-----------------|-----------------|
|   | 2011            | 2012            | 2013            | 2014            | 2015            |
| Net increase (decrease) in net assets resulting from operations       | .54             | 1.68            | (1.02)          | 2.68            | 1.07            |
| Less distributions to common shareholders                             | (.90)           | (.92)           | (.92)           | (.93)           | (.92)           |
| Net investment income   |                 |                 |                 |                 |                 |
| Net realized gains  | (.01)           | (.01)           | —               | —               | (.06)           |
| <b>Total distributions</b>  | (.91)           | (.93)           | (.92)           | (.93)           | (.98)           |
| NAV accretion resulting from ARPS tendered at a discount <sup>a</sup> | —               | —               | —               | .22             | —               |
| <b>Net asset value, end of period</b>                                 | <b>\$ 13.20</b> | <b>\$ 12.90</b> | <b>\$ 13.27</b> | <b>\$ 12.52</b> | <b>\$ 14.46</b> |
| <b>Market price, end of period</b>                                    | <b>\$ 13.59</b> | <b>\$ 13.03</b> | <b>\$ 13.30</b> | <b>\$ 12.21</b> | <b>\$ 15.49</b> |
| <b>Total Return</b>   |                 |                 |                 |                 |                 |
| Based on net asset value (%) <sup>b</sup>                             |                 |                 |                 |                 |                 |
|   | 5.53**          | 4.15            | 13.80           | (7.31)          | 23.77           |
|   | 7.56**          | 4.97            | 16.96           | (15.62)         | 24.23           |
|   |                 |                 |                 |                 | 9.32            |
|   |                 |                 |                 |                 | 13.20           |

Based  
on  
market  
price (%)<sup>b</sup>

**Ratios to Average Net Assets Applicable to  
Common Shareholders and Supplemental Data**

|   |       |      |      |      |      |      |
|---|-------|------|------|------|------|------|
| Net<br>assets,<br>end<br>of                                 | 148   | 144  | 148  | 139  | 160  | 138  |
| period<br>(\$ millions)                                     |       |      |      |      |      |      |
| Ratio<br>of<br>expenses<br>(%) <sup>a</sup> ,76*            | 1.71  | 1.73 | 1.69 | 1.30 | 1.29 |      |
| (including<br>interest<br>expense) <sup>c,d</sup>           |       |      |      |      |      |      |
| Ratio<br>of<br>expenses<br>(%) <sup>a</sup> ,13*            | 1.19  | 1.20 | 1.16 | 1.23 | 1.23 |      |
| (excluding<br>interest<br>expense) <sup>c</sup>             |       |      |      |      |      |      |
| Ratio<br>of<br>net<br>investment<br>income (%) <sup>f</sup> | 6.26* | 6.33 | 6.69 | 6.43 | 7.06 | 8.40 |
| Portfolio<br>turnover<br>rate (%)                           | 24    | 19   | 34   | 41   | 26   |      |

**Financial Highlights** (continued)

**Six Months**

**Ended**            **Years Ended November 30,**  
**5/31/16**        **2015**   **2014**   **2013**   **2012**   **2011**  
**(Unaudited)**

**Senior Securities**

|   |   |    |    |    |    |
|---|---|----|----|----|----|
| Preferred<br>shares<br>information<br>at<br>end of period,<br>aggregate<br>amount | — | 10 | 10 | 10 | 70 |
|---|---|----|----|----|----|

outstanding:

ARPS

(\$ millions)

| Series MTPS<br>(\$ millions)                | 70     | 60     | 60     | 60     | —      |
|---|--------|--------|--------|--------|--------|
| Asset coverage per share (\$) <sup>g</sup>  | 77,685 | 76,417 | 77,781 | 74,663 | 82,268 |
| Liquidation and market price per share (\$) | 25,000 | 25,000 | 25,000 | 25,000 | 25,000 |

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

<sup>b</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 price reflects changes in market price. 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 net asset value at which the Fund's shares traded during the period.

<sup>c</sup> Interest expense represents interest and fees on short-term floating rate notes issued in conjunction with inverse floating rate securities and interest paid to shareholders of Series 2015 MTPS and Series 2018 MTPS.

<sup>d</sup> The ratio of expenses (based on net assets of common and Preferred Shares, including interest expense) were 1.19%, 1.16%, 1.17%, 1.15%, 0.89% and 0.85% for the periods ended May 31, 2016, November 30, 2015, 2014, 2013, 2012 and 2011, respectively.

<sup>e</sup> The ratio of expenses (based on net assets of common and Preferred Shares, excluding interest expense) were 0.76%, 0.80%, 0.81%, 0.79%, 0.85% and 0.81% for the periods ended May 31, 2016, November 30, 2015, 2014, 2013, 2012 and 2011, respectively.

<sup>f</sup> The ratio of net investment income after distributions paid to ARPS were 6.26%, 6.33%, 6.68%, 6.42%, 6.94% and 8.23% for the periods

ended May 31, 2016, November 30, 2015, 2014, 2013, 2012 and 2011, respectively.

‡ Asset coverage per share equals net assets of common shares plus the liquidation value of the preferred shares divided by the total number of preferred shares outstanding at the end of the period.

\* Annualized

\*\* Not annualized

\*\*\* Amount is less than \$.005.

## Notes to Financial Statements (Unaudited)

### A. Organization and Significant Accounting Policies

Deutsche 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.

Various inputs are used in determining the value of the Fund's investments. These inputs are summarized in three broad levels. Level 1 includes quoted prices in active markets for identical securities. Level 2 includes other significant observable inputs (including quoted prices for similar securities, interest rates, prepayment speeds and credit risk). Level 3 includes significant unobservable inputs (including the Fund's own assumptions in determining the fair value of investments). The level assigned to the securities valuations may not be an indication of the risk or liquidity associated with investing in those securities.

Municipal debt securities are valued at prices supplied by independent pricing services approved by the Fund's Board, whose valuations are intended to reflect the mean between the bid and asked prices. 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. If the pricing services are unable to provide valuations, the securities are valued at the mean of the most recent bid and asked quotations or evaluated prices, as applicable, obtained from one or more broker-dealers. These securities are generally categorized as Level 2.

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 Board and are generally categorized as Level 3. In accordance with the Fund's valuation procedures, factors considered in determining value may include, but are not limited to, the type of the security; the size of the holding; the initial cost of the security; the existence of any contractual restrictions on the security's disposition; the price and extent of public trading in similar securities of the

issuer or of comparable companies; quotations or evaluated prices from broker-dealers and/or pricing services; information obtained from the issuer, analysts, and/or the appropriate stock exchange (for exchange-traded securities); an analysis of the company's or issuer's financial statements; an evaluation of the forces that influence the issuer and the market(s) in which the security is purchased and sold; and with respect to debt securities, the maturity, coupon, creditworthiness, currency denomination and the movement of the market in which the security is normally traded. The value determined under these procedures may differ from published values for the same securities.

Disclosure about the classification of fair value measurements is included in a table following the Fund's Investment Portfolio.

**When Issued/Delayed Delivery Securities.** The Fund may purchase or sell securities with delivery or payment to occur at a later date beyond the normal settlement period. At the time the Fund enters into a commitment to purchase or sell a security, the transaction is recorded and the value of the transaction is reflected in the net asset value. The price of such security and the date when the security will be delivered and paid for are fixed at the time the transaction is negotiated. The value of the security may vary with market fluctuations. At the time the Fund enters into a purchase transaction it is required to segregate cash or other liquid assets at least equal to the amount of the commitment. Additionally, the Fund may be required to post securities and/or cash collateral in accordance with the terms of the commitment.

Certain risks may arise upon entering into when-issued or delayed delivery transactions from the potential inability of counterparties to meet the terms of their contracts or if the issuer does not issue the securities due to political, economic, or other factors. Additionally, losses may arise due to changes in the value of the underlying securities.

**Inverse Floaters.** The Fund invests in inverse floaters. Inverse floaters are debt instruments with a weekly floating rate of interest that bears an inverse relationship to changes in the short-term interest rate market. Inverse floaters are created by depositing a fixed-rate long-term municipal bond into a special purpose Tender Offer Bond trust (the "TOB Trust"). In turn the TOB Trust issues a short-term floating rate note and an inverse floater. The short-term floating rate note is issued in a face amount equal to some fraction of the underlying bond's par amount and is sold to a third party, usually a tax-exempt money market fund. The Fund receives the proceeds from the sale of the short-term floating rate note and uses the cash proceeds to make additional investments. The short-term floating rate note represents leverage to the Fund. The Fund, as the holder of the inverse floater, has full exposure to any increase or decrease in the value of the underlying bond. The income stream from the underlying bond in the TOB Trust is divided between the floating rate note and the inverse floater. The inverse floater earns all of the interest from the underlying long-term fixed-rate bond less the amount of interest paid on the floating rate note and the expenses of the TOB Trust. The floating rate notes issued by the TOB Trust are valued at cost, which approximates fair value.

By holding the inverse floater, the Fund has the right to collapse the TOB Trust by causing the holders of the floating rate instrument to tender their notes at par and have the broker transfer the underlying bond to the Fund. The floating rate note holder can also elect to tender the note for redemption at par at each reset date. The Fund accounts for these transactions as a form of secured borrowing, by reflecting the value of the underlying bond in the investments of the Fund and the amount owed to the floating rate note holder as a liability under the caption "Payable for floating rate notes issued" in the Statement of Assets and Liabilities. Income earned on the underlying bond is included in interest income, and interest paid on the floaters and the expenses of the TOB Trust are included in "Interest expense" in the Statement of Operations. For the six months ended May 31, 2016, interest expense related to floaters amounted to \$49,921. The weighted average outstanding daily balance of the floating rate notes issued during the six months ended May 31, 2016 was approximately \$11,990,000, with a weighted average interest rate of 0.83%.

The Fund may enter into shortfall and forbearance agreements by which the Fund agrees to reimburse the TOB Trust, in certain circumstances, for the difference between the liquidation value of the underlying bond held by the TOB Trust and the liquidation value of the floating rate notes plus any shortfalls in interest cash flows. This could potentially expose the Fund to losses in excess of the value of the Fund's inverse floater investments. In addition, the

value of inverse floaters may decrease significantly when interest rates increase. The market for inverse floaters may be more volatile and less liquid than other municipal bonds of comparable maturity. The TOB Trust could be terminated outside of the Fund's control, resulting in a reduction of leverage and disposal of portfolio investments at inopportune times and prices. Investments in inverse floaters generally involve greater risk than in an investment in fixed-rate bonds.

The final rules implementing Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Volcker Rule") preclude banking entities from sponsoring and/or providing services to TOB Trusts. In response to these rules, investment market participants have developed and are developing new TOB Trust structures that are designed to ensure that banking entities do not sponsor TOB Trusts in violation of the Volcker Rule. The Fund currently participates in a number of pre-2014 TOB Trusts (each, a "Legacy TOB Trust") that will need to be restructured to conform to Volcker Rule requirements by the applicable compliance date, currently expected to be July 17, 2017, or unwound. Any new TOB Trust structures must currently comply with the Volcker Rule. A Volcker-compliant TOB Trust structure is similar to traditional TOB Trust structures, with certain key differences. The basic features of the new Volcker-compliant TOB Trust structure currently intended to be implemented by the funds are as follows:

- Portfolio management continues to make certain basic investment determinations, such as which bonds are placed in the TOB Trust, the amount of leverage for any given transaction, whether the transaction is structured as non-recourse or recourse, etc.
- Similar to traditional TOB Trust structures, the fund continues to be the holder of the TOB Inverse Floater Residual Interests.
- Unlike traditional TOB Trust structures, a bank or financial institution no longer serves as the sponsor, depositor, or trust administrator nor does it have any discretionary decision making authority with respect to the TOB Trust.
- Consistent with traditional TOB Trust structures, a bank or financial institution serves as the trustee, liquidity provider, and remarketing agent.
- A third-party administrative agent retained by the fund performs certain of the roles and responsibilities historically provided by banking entities in traditional TOB Trust structures, including certain historical sponsor/administrative roles and responsibilities.

The ultimate impact of the new rules on the inverse floater market and the municipal market generally is not yet certain. Such changes could make early unwinds of TOB Trusts more likely in adverse market scenarios, may make the use of TOB Trusts more expensive, and may make it more difficult to use TOB Trusts in general. The new rules may also expose the Fund to additional risks, including, but not limited to, compliance, securities law and operational risks.

**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.

Under the Regulated Investment Company Modernization Act of 2010, net capital losses may be carried forward indefinitely, and their character is retained as short-term and/or long-term. Previously, net capital losses were carried forward for eight years and treated as short-term losses. As a transition rule, the Act requires that post-enactment net capital losses be used before pre-enactment net capital losses.

At November 30, 2015, the Fund had a net tax basis capital loss carryforward of approximately \$6,712,000, including \$367,000 of pre-enactment losses, which may be applied against any realized net taxable capital gains of each

succeeding year until fully utilized or November 30, 2019, the expiration date, whichever occurs first; and \$6,345,000 of post-enactment losses, which may be applied against realized net taxable capital gains indefinitely, including short-term losses (\$1,611,000) and long-term losses (\$4,734,000).

The Fund has reviewed the tax positions for the open tax years as of November 30, 2015 and has determined that no provision for income tax and/or uncertain tax provisions is required in the Fund's financial statements. The Fund's federal tax returns for the prior three fiscal years remain open subject to examination by the Internal Revenue Service.

**Distribution of Income and Gains.** Distributions from net investment income of the Fund are declared and 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 Fund may also make additional distributions for tax purposes if necessary.

The timing and characterization of certain income and capital gain 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, reclassification of distributions 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.

The tax character of current year distributions will be determined at the end of the current fiscal year.

**Preferred Shares.** At May 31, 2016, the Fund had issued and outstanding 2,800 Floating Rate Municipal Term Preferred Shares ("Series 2018 MTPS") in a private offering with an aggregate liquidation preference of \$70,000,000 (\$25,000.00 per share). The Series 2018 MTPS are floating rate preferred shares with a mandatory term redemption date of June 1, 2018, unless extended. Dividends on the Series 2018 MTPS are set weekly to a fixed spread (dependent on the then current rating of the Series 2018 MTPS) to the Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Index. The average annualized dividend rate on the MTPS for the period December 1, 2015 through May 31, 2016 was 1.16%. In the Fund's Statement of Assets and Liabilities, the Series 2018 MTPS' aggregate liquidation preference is shown as a liability since the series 2018 MTPS have a stated mandatory redemption date. Dividends paid on the Series 2018 MTPS are treated as interest expense and recorded as incurred. For the period December 1, 2015 through May 31, 2016, interest expense related to Series 2018 MTPS amounted to \$406,611. Costs directly related to the issuance of Series 2018 MTPS have been deferred and are being amortized over the life of the MTPS. The Series 2018 MTPS are senior in priority to the Fund's outstanding common shares as to payments of dividends and distributions upon liquidation. The Fund used a portion of the proceeds from the sale of its Series 2018 MTPS to fund the redemption on June 1, 2015 of all of its outstanding Floating Rate Municipal Term Preferred Shares ("Series 2015 MTPS"). The Fund used the remaining portion of its Series 2018 MTPS offering proceeds to fund the redemption of all of its outstanding Series T municipal auction rate cumulative preferred shares ("ARPS"). The redemption date for the Fund's ARPS was June 8, 2015. The ARPS were redeemed at their liquidation preference per share plus dividends owed to, but excluding, the redemption date.

As a result of its Series 2018 MTPS issuance and the redemption of the outstanding Series 2015 MTPS and ARPS, the Fund's leverage attributable to preferred shares remains unchanged.

Under the terms of a purchase agreement between the Fund and the initial purchaser of the Series 2018 MTPS, the Fund is subject to various investment restrictions that are substantially similar to those that were in place with respect to the Series 2015 MTPS. These investment restrictions are, in certain respects, more restrictive than those to which the Fund is otherwise subject in accordance with its investment objective and policies. Such restrictions may limit the investment flexibility that might otherwise be pursued by the Fund if the Series 2018 MTPS were not outstanding. In addition, the Fund is subject to certain restrictions on its investments imposed by guidelines of the rating agencies that

rate the Series 2018 MTPS, which guidelines may be changed by the applicable rating agency, in its sole discretion, from time to time. These guidelines may impose asset coverage or portfolio composition requirements that are more stringent than those imposed on the Fund by the 1940 Act. Moreover, the Fund is required to maintain various asset coverage ratios with respect to the Series 2018 MTPS in accordance with the Fund's charter documents and the 1940 Act.

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, each preferred share is entitled to one vote and preferred shareholders will vote together with common shareholders as a single class.

Leverage involves risks and special considerations for the Fund's common shareholders, including the likelihood of greater volatility of net asset value and market price of, and dividends on, the Fund's common shares than a comparable portfolio without leverage; the risk that fluctuations in interest rates will reduce the return to common shareholders; and the effect of leverage in a declining market, which is likely to cause a greater decline in the net asset value of the Fund's common shares than if the Fund were not leveraged, which may result in a greater decline in the market price of the Fund's common shares. Changes in the value of the Fund's portfolio will be borne entirely by the common shareholders. If there is a net decrease (or increase) in the value of the Fund's investment portfolio, leverage will decrease (or increase) the net asset value per share to a greater extent than if leverage were not used. It is also possible that the Fund will be required to sell assets at a time when it would otherwise not do so, possibly at a loss, in order to redeem preferred shares to comply with asset coverage or other restrictions imposed by the rating agencies that rate the preferred shares. There is no assurance that the Fund's leveraging strategy will be successful.

**Statement of Cash Flows.** Information on financial transactions which have been settled through the receipt and disbursement of cash is presented in the Statement of Cash Flows. The cash amount shown in the Statement of Cash Flows represents the cash position at the Fund's custodian bank at May 31, 2016.

**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 six months ended May 31, 2016, purchases and sales of investment securities (excluding short-term investments) aggregated \$33,645,815 and \$25,844,168, respectively.

## **C. Related Parties**

**Management Agreement.** Under the Investment Management Agreement with Deutsche Investment Management Americas Inc. ("DIMA" 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 Investment Management Agreement. The management fee payable under the Investment Management Agreement is equal to an annual rate of 0.60% of the Fund's average weekly net assets, computed and accrued daily and payable monthly. Average weekly net assets, for purposes of determining the management fee, means the average weekly value of the total assets of the Fund, minus the sum of accrued liabilities of the Fund (other than the liquidation value of the Series 2018 MTPS).

**Service Provider Fees.** Deutsche AM Service Company ("DSC"), an affiliate of the Advisor, is the transfer agent, dividend-paying agent and shareholder service agent for the Fund. Pursuant to a sub-transfer agency agreement between DSC and DST Systems, Inc. ("DST"), DSC has delegated certain transfer agent, dividend-paying agent and shareholder service agent functions to DST. DSC compensates DST out of the shareholder servicing fee it receives from the Fund. For the six months ended May 31, 2016, the amount charged to the Fund by DSC aggregated \$2,770, of which \$1,410 is unpaid.

**Typesetting and Filing Service Fees.** Under an agreement with DIMA, DIMA is compensated for providing typesetting and certain regulatory filing services to the Fund. For the six months ended May 31, 2016, the amount charged to the Fund by DIMA included in the Statement of Operations under "Reports to shareholders" aggregated \$7,076, of which \$7,070 is unpaid.

**Trustees' Fees and Expenses.** The Fund paid retainer fees to each Trustee not affiliated with the Advisor, plus specified amounts to the Board Chairperson and Vice Chairperson and to each committee Chairperson.

**Transactions with Affiliates.** The Fund may purchase securities from, or sell securities to, an affiliated fund provided the affiliation is solely due to having a common investment adviser, common officers or common trustees. During the period ended May 31, 2016, the Fund engaged in securities purchases of \$5,530,000 and securities sales of \$3,130,000 with an affiliated fund in compliance with Rule 17a-7 under the 1940 Act.

#### **D. Share Repurchases**

The Board has authorized the Fund to effect periodic repurchases of its outstanding shares in the open market from time to time when the Fund's shares trade at a discount to their net asset value. During the six months ended May 31, 2016 and the year ended November 30, 2015, the Fund did not repurchase shares in the open market.

On September 11, 2015, the Fund announced that the Fund's Board of Trustees extended the Fund's existing open market share repurchase program for an additional 12-month period. The Fund may continue to purchase outstanding shares of common stock in open-market transactions over the period from December 1, 2015 until November 30, 2016, when the Fund's shares trade at a discount to net asset value. The Board's authorization of the repurchase program extension follows the previous repurchase program, which commenced on August 1, 2014 and ran until November 30, 2015.

#### **Dividend Reinvestment and Cash Purchase Plan**

The Board of Trustees of the Fund has established a Dividend Reinvestment and Cash Purchase Plan (the "Plan") for shareholders that elect to have all dividends and distributions automatically reinvested in shares of the Fund (each a "Participant"). DST Systems, Inc. (the "Plan Agent") has been appointed by the Fund's Board of Trustees to act as agent for each Participant.

A summary of the Plan is set forth below. Shareholders may obtain a copy of the entire Dividend Reinvestment and Cash Purchase Plan by visiting the Fund's Web site at [deutschefunds.com](http://deutschefunds.com) or by calling (800) 294-4366.

If you wish to participate in the Plan and your shares are held in your own name, contact Deutsche AM Service Company (the "Transfer Agent") at P.O. Box 219066, Kansas City, Missouri 64121-9066 or (800) 294-4366 for the

appropriate form. Current shareholders may join the Plan by either enrolling their shares with the Transfer Agent or making an initial cash deposit of at least \$250 with the Transfer Agent. First-time investors in the Fund may join the Plan by making an initial cash deposit of at least \$250 with the Transfer Agent. Initial cash deposits will be invested within approximately 30 days. If your shares are held in the name of a broker or other nominee, you should contact the broker or nominee in whose name your shares are held to determine whether and how you may participate in the Plan.

The Transfer Agent will establish a Dividend Investment Account (the "Account") for each Participant in the Plan. The Transfer Agent will credit to the Account of each Participant any cash dividends and capital gains distributions (collectively, "Distributions") paid on shares of the Fund (the "Shares") and any voluntary cash contributions made pursuant to the Plan. Shares in a Participant's Account are transferable upon proper written instructions to the Transfer Agent.

If, on the valuation date for a Distribution, Shares are trading at a discount from net asset value per Share, the Plan Agent shall apply the amount of such Distribution payable to a Participant (less a Participant's pro rata share of brokerage commissions incurred with respect to open-market purchases in connection with the reinvestment of such Distribution) to the purchase on the open market of Shares for a Participant's Account. If, on the valuation date for a Distribution, 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 valuation date to the Transfer Agent in the aggregate amount of the funds credited to a Participant's Account. 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 valuation date if the net asset value per Share of the Shares on the valuation date is less than 95% of the fair market value of the Shares on the valuation date. The valuation date will be the payment date for Distributions. Open-market purchases will be made on or shortly after the valuation date for Distributions, and in no event more than 30 days after such date except where temporary curtailment or suspension of purchase is necessary to comply with applicable provisions of federal securities law.

A Participant may from time to time make voluntary cash contributions to his or her Account in a minimum amount of \$100 in any month (with a \$36,000 annual limit) for the purchase on the open market of Shares for the Participant's Account. Such voluntary contributions will be invested by the Plan Agent on or shortly after the 15th of each month and in no event more than 30 days after such dates, except where temporary curtailment or suspension of purchase is necessary to comply with applicable provisions of federal securities law. Voluntary cash contributions received from a Participant on or prior to the fifth day preceding the 15th of each month will be applied by the Plan Agent to the purchase of additional Shares as of that investment date. No interest will be paid on voluntary cash contributions held until investment. Consequently, Participants are strongly urged to ensure that their payments are received by the Transfer Agent on or prior to the fifth day preceding the 15th of any month. Voluntary cash contributions should be made in U.S. dollars and be sent by first-class mail, postage prepaid only to the following address (deliveries to any other address do not constitute valid delivery):

Deutsche Strategic Municipal Income Trust  
Dividend Reinvestment and Cash Purchase Plan  
c/o Deutsche AM Service Company  
P.O. Box 219066  
Kansas City, MO 64121-9066  
(800) 294-4366

Participants may withdraw their entire voluntary cash contribution by written notice received by the Transfer Agent not less than 48 hours before such payment is to be invested.

The cost of Shares acquired for each Participant's Account in connection with the Plan shall be determined by the average cost per Share, including brokerage commissions, of the Shares acquired. 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 open market purchases.

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The reinvestment of Distributions does not relieve the Participant of any tax that may be payable on the Distributions. The Transfer Agent will report to each Participant the taxable amount of Distributions credited to his or her Account. Participants will be treated for federal income tax purposes as receiving the amount of the Distributions made by the Fund, which amount generally will be either equal to the amount of the cash distribution the Participant would have received if the Participant had elected to receive cash or, for Shares issued by the Fund, the fair market value of the Shares issued to the Participant.

The Fund may amend the Plan at any time or times but, only by mailing to each Participant appropriate written notice at least 90 days prior to the effective date thereof except when 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 Plan also may be terminated by the Fund.

Shareholders may withdraw from the Plan at any time by giving the Transfer Agent a written notice. A notice of withdrawal will be effective immediately following receipt of the notice by the Transfer Agent provided the notice is received by the Transfer Agent at least ten calendar days prior to the record date for the Distribution; otherwise such withdrawal will be effective after the investment of the current Distribution. When a Participant withdraws from the Plan, or when the Plan is terminated by the Fund, 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 the Plan Agent to sell his or her Shares in the Plan and send the proceeds to the Participant, less brokerage commissions.

All correspondence and inquiries concerning the Plan, and requests for additional information about the Plan, should be directed to Deutsche AM Service Company at P.O. Box 219066, Kansas City, Missouri 64121-9066 or (800) 294-4366.

### **Additional Information**

#### **Automated Information Line**

#### **Deutsche AM Closed-End Fund Info Line**

**(800) 349-4281**  
**deutschefunds.com**

#### **Web Site**

Obtain fact sheets, financial reports, press releases and webcasts when available.

#### **Deutsche Asset Management**

#### **Written Correspondence**

Attn: Secretary of the  
Deutsche Funds

One Beacon Street

Boston, MA 02108  
**Vedder Price P.C.**

#### **Legal Counsel**

222 North LaSalle Street  
  
Chicago, IL 60601

**DST Systems, Inc.**

**Dividend Reinvestment Plan Agent**

333 W. 11th Street, 5th Floor

Kansas City, MO 64105  
**Deutsche AM Service  
Company**

**Shareholder Service Agent and Transfer Agent**

P.O. Box 219066

Kansas City, MO  
64121-9066

**(800) 294-4366  
State Street Bank and  
Trust Company**

**Custodian**

State Street Financial Center

One Lincoln Street

Boston, MA 02111  
**Ernst & Young LLP**

**Independent Registered Public Accounting Firm** 200 Clarendon Street

Boston, MA 02116  
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 are available on our Web site —[deutschefunds.com](http://deutschefunds.com) (click on "proxy voting" at the bottom of the page) — or on the SEC's Web site — [sec.gov](http://sec.gov). To obtain a written copy of the fund's policies and procedures without charge, upon request, call us toll free at (800) 728-3337.

**Proxy Voting**

**Portfolio Holdings**

Following the fund's fiscal first and third quarter-end, a complete portfolio holdings listing is filed with the SEC on Form N-Q. This form will be available on the SEC's Web site at [sec.gov](http://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. The fund's portfolio holdings as of the month-end are posted on [deutschefunds.com](http://deutschefunds.com) on or after the last day of the following month. More frequent posting of portfolio holdings information may be made from time to time on [deutschefunds.com](http://deutschefunds.com).

## **Investment Management**

Deutsche Investment Management Americas Inc. ("DIMA" or the "Advisor"), which is part of Deutsche Asset Management, is the investment advisor for the fund. DIMA and its predecessors have more than 80 years of experience managing mutual funds and DIMA provides a full range of investment advisory services to both institutional and retail clients.

DIMA is an indirect, wholly owned subsidiary of Deutsche Bank AG. Deutsche Bank AG is a major global banking institution engaged in a wide variety of financial services, including investment management, retail, private and commercial banking, investment banking and insurance.

Deutsche Asset Management is the retail brand name in the U.S. for the asset management activities of Deutsche Bank AG and



services to you

**For joint marketing with other financial companies** No

We do not share

**For our affiliates' everyday business purposes —**

information about your transactions and experiences

We do not share

**For our affiliates' everyday business purposes —**

information about your creditworthiness

We do not share

**For non-affiliates to market to you** No

We do not share

**Questions?** Call (800) 728-3337 or e-mail us at [service@db.com](mailto:service@db.com)

**Who we are**

**Who is providing this notice?**

Deutsche AM Distributors, Inc.; Deutsche Investment Management Americas Inc.; Deutsche AM Trust Company; the Deutsche Funds

**What we do**

**How does Deutsche Asset Management protect my personal information?**

To protect your personal information from unauthorized access and use, we use security measures that comply with federal law. These measures include computer safeguards and secured files and buildings.

We collect your personal information, for example. When you:

— open an account

**How does Deutsche Asset Management collect my personal information?**

— give us your contact information

— provide bank account information for ACH or wire transactions

— tell us where to send money

— seek advice about your investments

**Why can't I limit all sharing?**

Federal law gives you the right to limit only

— sharing for affiliates' everyday business purposes — information about your creditworthiness

— affiliates from using your information to market to you

— sharing for non-affiliates to market to you

State laws and individual companies may give you additional rights to limit sharing.

**Definitions**

**Affiliates**

Companies related by common ownership or control. They can be financial or non-financial companies. Our affiliates include financial companies with the DWS or Deutsche Bank ("DB") name, such as DB AG Frankfurt and DB Alex Brown. Companies not related by common ownership or control. They can be financial and non-financial companies.

**Non-affiliates**

Non-affiliates we share with include account service providers, service quality monitoring services, mailing service providers and verification services to help in the fight against money laundering and fraud.

**Joint marketing**

A formal agreement between non-affiliated financial companies that together market financial products or services to you. Deutsche Asset Management does not jointly market.

Rev. 08/2015

**Notes**

**Notes**

**Notes**

**Notes**

**Notes**

**ITEM 2. CODE OF ETHICS**

Not applicable.

**ITEM 3. AUDIT COMMITTEE FINANCIAL EXPERT**

Not applicable

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

Not applicable

**ITEM 5. AUDIT COMMITTEE OF LISTED REGISTRANTS**

Not applicable

**ITEM 6. SCHEDULE OF INVESTMENTS**

Not applicable

**ITEM 7. DISCLOSURE OF PROXY VOTING POLICIES AND PROCEDURES FOR CLOSED-END MANAGEMENT INVESTMENT COMPANIES**

Not applicable

**ITEM 8. PORTFOLIO MANAGERS OF CLOSED-END MANAGEMENT INVESTMENT COMPANIES**

Not applicable

**ITEM 9. PURCHASES OF EQUITY SECURITIES BY CLOSED-END MANAGEMENT INVESTMENT COMPANY AND AFFILIATED PURCHASERS**

| Period                         | (a)<br>Total Number of<br>Shares Purchased | (b)<br>Average Price<br>Paid<br>per Share | (c)<br>Total Number of<br>Shares Purchased as<br>Part of Publicly<br>Announced<br>Plans or Programs | (d)<br>Maximum Number of<br>Shares that May Yet<br>Be<br>Purchased Under the<br>Plans or Programs |
|--------------------------------|--|---|---|---|
| December 1 through December 31 | -  | n/a                                       | n/a   | n/a   |
| January 1 through January 31   | -  | n/a                                       | n/a   | n/a   |
| February 1 through February 28 | -  | n/a                                       | n/a   | n/a   |
| March 1 through March 31       | -  | n/a                                       | n/a   | n/a   |
| April 1 through April 30       | -  | n/a                                       | n/a   | n/a   |
| May 1 through May 31           | -  | n/a                                       | n/a   | n/a   |
| Total                          | -  | n/a                                       | n/a   | n/a   |

The Fund may from time to time repurchase shares in the open market.

**ITEM 10. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

There were no material changes to the procedures by which shareholders may recommend nominees to the Fund's Board. The primary function of the Nominating and Governance Committee is to identify and recommend individuals for membership on the Board and oversee the administration of the Board Governance Guidelines. Shareholders may recommend candidates for Board positions by forwarding their correspondence by U.S. mail or courier service to Kenneth C. Froewiss, Independent Chairman, Deutsche Mutual Funds, P.O. Box 390601, Cambridge, MA 02139.

**ITEM 11. CONTROLS AND PROCEDURES**

- The Chief Executive and Financial Officers concluded that the Registrant's Disclosure Controls and Procedures are effective based on the evaluation of the Disclosure Controls and Procedures as of a date within 90 days of the filing date of this report.
- (a)

- There have been no changes in the registrant's internal control over financial reporting that occurred during the second fiscal quarter of the period covered by this report that has materially affected, or is reasonably likely to materially affect, the registrant's internal controls over financial reporting.
- (b)

**ITEM 12. EXHIBITS**

(a)(1) Not applicable

(a)(2) Certification pursuant to Rule 30a-2(a) under the Investment Company Act of 1940 (17 CFR 270.30a-2(a)) is filed and attached hereto as Exhibit 99.CERT.

(b) Certification pursuant to Rule 30a-2(b) under the Investment Company Act of 1940 (17 CFR 270.30a-2(b)) is furnished and attached hereto as Exhibit 99.906CERT.

**SIGNATURES**

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

Registrant: Deutsche Strategic Municipal Income Trust

/s/Brian E. Binder

By: Brian E. Binder

President

Date: 7/29/2016

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

/s/Brian E. Binder

By: Brian E. Binder

President

Date: 7/29/2016

/s/Paul Schubert

By: Paul Schubert

Chief Financial Officer and Treasurer

Date: 7/29/2016