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Highland Credit Strategies Fund
Form N-CSR
March 09, 2007

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

FORM N-CSR

CERTIFIED SHAREHOLDER REPORT OF REGISTERED MANAGEMENT INVESTMENT COMPANIES

Investment Company Act file number 811-21869

HIGHLAND CREDIT STRATEGIES FUND

(Exact name of registrant as specified in charter)

Two Galleria Tower
13455 Noel Road, Suite 800
DALLAS, TEXAS 75240

(Address of principal executive offices) (Zip code)

James D. Dondero, President
Highland Credit Strategies Fund
Two Galleria Tower
13455 Noel Road, Suite 800
DALLAS, TEXAS 75240

(Name and address of agent for service)

registrant's telephone number, including area code: (877) 665-1287

Date of fiscal year end: DECEMBER 31

Date of reporting period: DECEMBER 31, 2006

Form N-CSR is to be used by management investment companies to file reports with the Commission not later than 10 days after the transmission to stockholders of any report that is required to be transmitted to stockholders under Rule 30e-1 under the Investment Company Act of 1940 (17 CFR 270.30e-1). The Commission may use the information provided on Form N-CSR in its regulatory, disclosure review, inspection, and policymaking roles.

A registrant is required to disclose the information specified by Form N-CSR, and the Commission will make this information public. A registrant is not required to respond to the collection of information contained in Form N-CSR unless the Form displays a currently valid Office of Management and Budget ("OMB") control number. Please direct comments concerning the accuracy of the information collection burden estimate and any suggestions for reducing the burden to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549. The OMB has reviewed this collection of information under the clearance requirements of 44 U.S.C. ss. 3507.

ITEM 1. REPORTS TO STOCKHOLDERS.

The Report to Shareholders is attached herewith.

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HIGHLAND FUNDS

[GRAPHIC OMITTED]

SHIELD ART

MANAGED BY HIGHLND CAPITAL MANAGEMENT, L.P.

HIGHLAND CREDIT STRATEGIES FUND

ANNUAL REPORT

DECEMBER 31, 2006

[GRAPHIC OMITTED]

HIGHLAND CREDIT STRATEGIES FUND

[GRAPHIC OMITTED]

SHIELD ART

SHIELD ART

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Economic and market conditions change frequently. There is no assurance that the trends described in this report will continue or commence.

PORTFOLIO MANAGERS' LETTER

HIGHLAND CREDIT STRATEGIES FUND

Dear Shareholders:

We are pleased to provide you with our first annual shareholder report for Highland Credit Strategies Fund (the "Fund"), for the period ended December 31, 2006. The Fund commenced investment operations on June 29, 2006. On December 29, 2006 (the last day the New York Stock Exchange was open for trading prior to the end of the calendar year), the net asset value of the Fund was \$20.08 per share, as compared to \$19.06 on June 29, 2006. On December 29, 2006, the closing market price of the Fund's shares on the New York Stock Exchange was \$21.16 per share, as compared to \$20.18 on June 29, 2006. During the period ended December 31, 2006, the Fund distributed to common shareholders \$0.60 per share.

THE FUND'S INVESTMENTS:

The total return on the Fund's per share market price, assuming reinvestment of dividends, for the period ended December 31, 2006 was 9.06%. The total return on the Fund's net assets was 8.60% for the period ended December 31, 2006. The

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variation in total returns is attributable to the increase in the market price of the Fund's shares of 5.80% relative to an increase in the net asset value of the Fund's shares of 5.35% during the period.

DIVIDEND DECLARATION:

On February 13, 2007, the Board of Directors declared a dividend of \$0.15 per common share, payable on the last day of business for the month of February 2007.

Respectfully submitted,

/S/ JAMES DONDERO
JAMES DONDERO
President

/S/ MARK OKADA
MARK OKADA
Executive Vice President

/S/ KURT PLUMER
KURT PLUMER
Portfolio Manager

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FUND PROFILE

HIGHLAND CREDIT STRATEGIES FUND

Objective

Highland Credit Strategies Fund (the "Fund") seeks to provide both current income and capital appreciation.

Total Net Assets of Common Shares as of December 31, 2006

\$693.0 million

Portfolio Data as of December 31, 2006

The information below provides a snapshot of the Fund at the end of the reporting period. The Fund is actively managed and the composition of its portfolio will change over time.

QUALITY BREAKDOWN AS OF 12/31/06 (%)*

Ba	11.4
B	45.2
Caa	17.5
Ca	1.8
NR	24.1

TOP 5 SECTORS AS OF 12/31/06 (%)*

Retail	10.6
Healthcare -- Acute Care	9.8
Transportation -- Auto	6.7

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Information Technology	6.6
Utilities	6.4

TOP 10 HOLDINGS AS OF 12/31/06 (%)*

Movie Gallery, Inc.	2.7
Ford Motor Co.	2.2
Delphi Corp.	2.0
Paramount Resources Ltd. (Canada)	2.0
HCA, Inc. (Senior Loan Notes)	1.9
Alliance Imaging, Inc.	1.8
SunCom Wireless Holdings, Inc.	1.8
HCA, Inc. (Corporate Notes and Bonds)	1.7
Burlington Coat Factory Warehouse Corp.	1.7
Metro-Goldwyn-Mayer Holdings II, Inc./LOC Acquisition Co.	1.5

* Quality is calculated as a percentage of total notes and bonds. Sectors and holdings are calculated as a percentage of net assets applicable to common shareholders.

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FINANCIAL STATEMENTS

DECEMBER 31, 2006

HIGHLAND CREDIT STRATEGIES FUND

A GUIDE TO UNDERSTANDING THE FUND'S FINANCIAL STATEMENTS

INVESTMENT PORTFOLIO

The Investment Portfolio details all of the Fund's holdings and their market value as of the last day of the reporting period. Portfolio holdings are organized by type of asset and industry to demonstrate areas of concentration and diversification.

STATEMENT OF ASSETS AND LIABILITIES

This statement details the Fund's assets, liabilities, net assets and common share price as of the last day of the reporting period. Net assets are calculated by subtracting all the Fund's liabilities (including any unpaid expenses) from the total of the Fund's investment and non-investment assets. The net asset value per common share is calculated by dividing net assets by the number of common shares outstanding as of the last day of the reporting period.

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STATEMENT OF OPERATIONS

This statement reports income earned by the Fund and the expenses accrued by the Fund during the reporting period. The Statement of Operations also shows any net gain or loss the Fund realized on the sales of its holdings during the period as well as any unrealized gains or losses recognized over the period. The total of these results represents the Fund's net increase or decrease in net assets from operations applicable to common shareholders.

STATEMENT OF CHANGES IN NET ASSETS

This statement details how the Fund's net assets were affected by its operating results, distributions to common shareholders and shareholder transactions from common shares (e.g., subscriptions, redemptions and dividend reinvestments) during the reporting period. The Statement of Changes in Net Assets also details changes in the number of common shares outstanding.

STATEMENT OF CASH FLOWS

This statement reports net cash and foreign currency provided or used by operating, investing and financing activities and the net effect of those flows on cash and foreign currency during the period.

FINANCIAL HIGHLIGHTS

The Financial Highlights demonstrate how the Fund's net asset value per common share was affected by the Fund's operating results. The Financial Highlights also disclose the performance and certain key ratios (e.g., net expenses and net investment income as a percentage of average net assets).

NOTES TO FINANCIAL STATEMENTS

These notes disclose the organizational background of the Fund, its significant accounting policies (including those surrounding security valuation, income recognition and distributions to shareholders), federal tax information, fees and compensation paid to affiliates and significant risks and contingencies.

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INVESTMENT PORTFOLIO

DECEMBER 31, 2006

HIGHLAND CREDIT STRATEGIES FUND

PRINCIPAL AMOUNT (\$)	VALUE (\$)
SENIOR LOAN NOTES (A) - 96.6%	
AEROSPACE - AEROSPACE/DEFENSE - 0.9%	
2,441,463	AWAS Capital, Inc. Second Priority Term Loan, 11.36%, 03/15/13
	2,478,084
3,634,004	TDS Investor Corp. (Travelport) Dollar Term Loan, 8.37%, 08/23/13
356,888	Synthetic Letter of Credit, 8.37%, 08/23/13
	358,522

	6,484,420

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AEROSPACE - AIRLINES - 3.2%		
	Delta Airlines, Inc.	
3,750,000	12/12/07 (b)	2,428,125
10,000,000	Term Loan Equipment Notes, 8.00%, 09/29/12	10,012,500
7,000,000	Northwest Airlines, Inc. Term Loan DIP, 7.85%, 08/21/08	7,049,840
3,000,000	U S Airways, Inc. Term Loan, 8.87%, 03/31/11	3,025,320

		22,515,785

AUTOMOBILE - 2.2%		
15,000,000	Ford Motor Co.Term Loan, 8.36%, 12/15/13	15,048,000

BROADCASTING - 1.9%		
9,135,579	Millennium Digital Media Systems, LLC Term Facility, 8.99%, 06/30/11	9,135,579
2,000,000	Persona Communications Corp. (Canada) Second Lien Term Loan, 11.37%, 04/12/14	2,010,000
2,000,000	Revolution Studios Tranche B Term Loan, 12/21/14 (b)	1,990,000

		13,135,579

CABLE - INTERNATIONAL CABLE - 0.1%		
845,000	San Juan Cable, LLC (Puerto Rico) Second Lien Term Loan, 10.87%, 10/31/13	855,563

CABLE - US CABLE - 3.0%		
6,000,000	Century Cable Holdings LLC Revolver, 9.25%, 03/31/09	5,805,000
9,000,000	Cequel Communications, LLC NC Term Facility, 10.36%, 10/30/07	9,011,250
2,400,000	WideOpenWest Finance LLC First Lien Term Loan, 7.73%, 05/01/13	2,407,008
3,250,000	Second Lien Term Loan, 10.37%, 05/01/14	3,289,098

		20,512,356

PRINCIPAL AMOUNT (\$)		VALUE (\$)
-----		-----
CHEMICALS - COMMODITY & FERTILIZER - 0.2%		
1,388,889	Ferro Corp.Term Loan, 8.57%, 06/06/12 (c)	1,387,153

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CHEMICALS - SPECIALTY CHEMICALS - 0.8%		
5,729,500	Solutia Inc. New Term Loan B DIP, 8.96%, 03/31/07	5,765,309 -----
CONSUMER DURABLES - 0.4%		
2,862,201	Rexair LLC First Lien Term Loan, 9.62%, 06/30/10	2,869,357 -----
CONSUMER NON-DURABLES - 2.0%		
1,512,000	Camelbak Products LLC First Lien Term Loan, 9.45%, 08/04/11	1,477,980
2,000,000	DS Waters Enterprises, Inc. Term Loan B, 7.82%, 10/27/12	1,978,760
1,000,000	GTM Holding, Inc. (GoldToe) First Lien Term Loan, 8.13%, 10/30/13	1,007,190
5,077,650	Spectrum BrandsU. S. Dollar Term Loan B, 8.62%, 02/07/12	5,106,745
3,990,000	VNU Inc./Nielsen Finance LLC Dollar Term Loan, 8.19%, 08/09/13	4,024,314 -----
		13,594,989 -----
DIVERSIFIED MEDIA - 3.3%		
3,000,000	Endurance Business Media, Inc. Second Lien Term Loan, 12.60%, 01/24/14	3,022,500
2,853,659	Metro-Goldwyn-Mayer Holdings II, Inc./LOC Acquisition Co. Tranche A Term Loan, 8.61%, 04/08/11	2,823,638
10,441,169	Tranche B Term Loan, 8.61%, 04/08/12	10,346,572
3,500,000	North American Membership Group, Inc. Revolver, 05/19/10 (b)	3,436,300
500,000	Panavision, Inc. Second Lien Term Loan, 12.38%, 03/30/12	508,440
3,000,000	PBI Media, Inc. Second Lien Term Loan, 11.38%, 09/30/13	3,015,000 -----
		23,152,450 -----
ENERGY - EXPLORATION & PRODUCTION - 3.7%		
3,970,050	ATP Oil & Gas Corp. First Additional Term Loan, 8.92%, 04/14/10	4,007,289
7,980,000	First Lien Term Loan, 8.95%, 04/14/10	8,054,852
14,000,000	Paramount Resources Ltd. (Canada) Term Loan, 9.86%, 08/28/12	13,842,500

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25,904,641

4 | See accompanying Notes to Financial Statements.

INVESTMENT PORTFOLIO (CONTINUED)

DECEMBER 31, 2006

HIGHLAND CREDIT STRATEGIES FUND

PRINCIPAL AMOUNT (\$)		VALUE (\$)
-----		-----
SENIOR LOAN NOTES (CONTINUED)		
ENERGY - OTHER ENERGY - 1.7%		
	Alon USA Energy, Inc.	
221,667	Edington Facility, 7.63%, 06/22/13	222,637
1,768,889	Paramount Facility, 7.66%, 06/22/13	1,776,637
3,000,000	Endeavour International Holding B.V. (Netherlands) Second Lien Term Loan, 12.37%, 11/01/11	3,075,000
4,000,000	MEG Energy Corp. (Canada) Interim Loan, 10.12%, 09/29/13	3,952,480
3,000,000	Willbros USA, Inc. Syndicate Term Loan, 5.25%, 10/27/09	3,000,000
		----- 12,026,754 -----
ENERGY - REFINING - 0.3%		
2,000,000	J Ray McDermott, SA (Panama) Synthetic Facility, 5.27%, 06/06/12	2,010,000
FINANCIAL - 1.3%		
750,000	Arrowhead General Insurance Agency, Inc. Second Lien Term Loan, 02/08/13 (b)	761,250
994,987	Checksmart Financial Co. First Lien Tranche B Term Loan, 8.06%, 05/01/12	996,858
5,000,000	Concord Re Ltd. (Bermuda) Term Loan, 9.57%, 02/29/12	5,075,000
997,500	First American Payment Systems, L.P. Term Loan, 8.63%, 10/06/13	1,002,487
995,000	Transfirst Holdings, Inc. First Lien Term Loan, 7.87%, 08/15/12	1,001,219
		----- 8,836,814 -----

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FOOD AND DRUG - 1.7%		
2,092,645	Duloxetine Royalty Sub (Cayman Island) Term Loan, 10/18/13 (b)	2,108,340
7,855,816	Jean Coutu Group, Inc. Term Loan B, 7.94%, 07/30/11	7,878,441
1,984,962	Roundy's Supermarkets, Inc. Term Loan, 8.40%, 11/03/11	2,005,308
		11,992,089
FOOD/TOBACCO - BEVERAGES & BOTTLING - 0.3%		
1,995,000	PBM Holdings, Inc. Term Loan, 8.10%, 09/29/12	2,009,963
FOOD/TOBACCO - FOOD/TOBACCO PRODUCERS - 1.3%		
8,902,101	Merisant Co.Tranche B Term Loan, 8.63%, 01/11/10	8,913,229
	PRINCIPAL AMOUNT (\$)	VALUE (\$)
	-----	-----
FOOD/TOBACCO - RESTAURANTS - 0.8%		
3,328,797	Garden Fresh Restaurant Corp. First Lien Term Loan B, 8.62%, 06/22/11	3,341,281
1,995,000	Restaurant Co., The Term Loan, 8.12%, 05/03/13	2,011,199
		5,352,480
GAMING/LEISURE - GAMING - 0.8%		
5,690,614	Drake Hotel Acquisition B Note 1, 8.25%, 04/01/07 (c)	5,690,614
GAMING/LEISURE - OTHER LEISURE - 1.9%		
3,980,000	Cedar Fair L.P. (Canada) US Term Loan, 7.87%, 08/30/12	4,024,775
1,979,898	Kerasotes Showplace Theatres LLC Term B1 Loan, 7.94%, 10/28/11	1,987,739
5,984,887	Kuilima Resort Co. First Lien Term Loan, 8.07%, 09/30/10	5,917,556
987,635	Pivotal Group Promontory First Lien Term Loan, 8.07%, 08/31/10	970,845
		12,900,915
HEALTHCARE - ACUTE CARE - 7.4%		
12,526,875	Alliance Imaging, Inc. Tranche C Term Loan, 7.92%, 12/29/11	12,599,280
1,466,250	ComPsych Investments Corp. Term Loan, 8.12%, 04/11/12	1,473,581
3,015,000	Cornerstone Healthcare	

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	Group Holding, Inc. Senior Subordinated Unsecured Notes, 14.00%, 07/15/12 (d)	2,185,875
10,000,000	HCA, Inc. Second Lien Bridge Loan, 09/15/07 (b)	10,000,000
13,000,000	Tranche B Term Loan, 7.86%, 11/17/13	13,155,870
2,434,028	MultiPlan, Inc. Term C Loan, 7.85%, 04/12/13	2,434,807
230,000	National Mentor Holdings, Inc. Institutional Line of Credit Facility, 5.84%, 06/29/13	230,862
3,751,150	Tranche B Term Loan, 7.87%, 06/29/13	3,764,054
293,040	Sheridan Healthcare, Inc. Delayed Draw Term Loan, 8.37%, 11/09/11	294,872
1,701,960	First Lien Term C Loan, 8.37%, 11/09/11	1,712,597
1,500,000	Second Lien Term Loan, 12.37%, 11/09/12	1,525,320
2,000,000	Triumph Healthcare Second Holdings LLC Second Lien Term Loan, 13.48%, 07/28/14	2,000,000

		51,377,118

See accompanying Notes to Financial Statements. | 5

INVESTMENT PORTFOLIO (CONTINUED)

DECEMBER 31, 2006

HIGHLAND CREDIT STRATEGIES FUND

PRINCIPAL AMOUNT (\$)

VALUE (\$)

SENIOR LOAN NOTES (CONTINUED)

HEALTHCARE - ALTERNATE SITE SERVICES - 1.0%

6,000,000	InSight Health Services Corp. Tranche B Term Loan, 7.61%, 04/06/14	6,043,140
995,274	Renal Advantage Inc. Tranche B Term Loan, 7.89%, 10/06/12	1,003,355

		7,046,495

HEALTHCARE - MEDICAL PRODUCTS - 4.6%

9,952,259	CCS Medical, Inc. (Chronic Care) First Lien Term Loan, 8.62%, 09/30/12	9,735,598
4,000,000	Golden Gate National Senior Care LLC Second Lien Term Loan, 13.12%, 09/14/11	4,070,000
6,965,000	HealthSouth Corp. Term Loan B, 8.62%, 03/10/13	7,013,825

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	MMM Holding, Inc./NAMM Holdings, Inc./PHMC (Puerto Rico)	
2,700,994	NAMM New Term Loan, 7.62%, 08/22/11	2,694,241
352,689	NAMM New Term Loan, 7.62%, 08/22/11	351,807
635,528	NAMM Original Term Loan, 7.62%, 08/22/11	633,939
61,487	NAMM PHMC Acquisition Term Loan, 7.62%, 08/22/11	61,333
2,213,526	PHMC Acquisition Term Loan, 7.62%, 08/10/11	2,207,992
	Warner Chilcott Co., Inc. (Puerto Rico)	
125,031	Dovobet Delayed Draw Term Loan, 7.87%, 01/18/12 (b)	125,446
1,287,985	Dovonex Delayed Draw Term Loan, 7.87%, 01/18/12 (b)	1,291,204
2,817,491	Tranche B Acquisition Date Term Loan, 7.92%, 01/18/12 (b)	2,832,086
432,286	Tranche C Acquisition Date Term Loan, 01/18/12 (b)	434,716
579,978	Warner Chilcott Corp. Tranche C Acquisition Date Term Loan, 7.87%, 01/18/12	583,237

		32,035,424

HOUSING - BUILDING MATERIALS - 1.8%		
2,404,588	Atrium Cos., Inc. Closing Date Term Facility, 8.13%, 05/31/12	2,348,994
5,961,208	Custom Building Products, Inc. First Lien Term Loan, 7.61%, 10/20/11	5,976,111
3,990,000	Roofing Supply Group LLC First Lien Term Loan, 8.61%, 08/31/13	3,960,075

		12,285,180

	PRINCIPAL AMOUNT (\$)	VALUE (\$)
	-----	-----
HOUSING- REAL ESTATE DEVELOPMENT - 5.5%		
1,217,162	DESA LLC Term Loan, 11.12%, 11/26/11	1,150,218
	Flag Luxury Properties Holdings, LLC	
1,496,241	First Lien Term Loan, 8.64%, 03/21/11	1,473,797
1,496,118	First Lien Term Loan, 9.10%, 03/21/11	1,502,671
	Ginn LA Conduit Lender, Inc.	
1,257,683	First Lien Tranche A Credit Linked Deposit, 8.37%, 06/08/11 (b)	1,210,520
2,732,032	First Lien Tranche B Term Loan, 8.37%, 06/08/11 (b)	2,629,581

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994,975	LBREP/L-Suncal Master I LLC First Lien, 8.63%, 01/19/10	975,075
10,000,000	LNR Property Corp. Initial Tranche B Term Loan, 8.12%, 07/12/11	10,043,800
2,500,000	November 2005 Land Investors, LLC Second Lien Term Loan, 12.50%, 04/24/12	2,475,000
7,500,000	Rubicon GSA II LLC (Australia) Term Loan, 8.10%, 08/30/08	7,500,000
7,334,691	Westgate Investments LLC Senior Secured Loan, 13.00%, 07/15/10 (d)	7,334,691
1,504,033	Senior Unsecured Loan, 18.00%, 08/03/12	1,507,793
		----- 37,803,146 -----

INFORMATION TECHNOLOGY - 5.5%

2,000,000	Data Transmission Network Corp. Second Lien Term Loan, 13.39%, 09/10/13	2,010,000
5,000,000	Infor Enterprise Solutions Holdings, Inc. (Luxembourg) Stage One U.S. Bridge Facility, 11.50%, 07/29/13	5,062,500
2,736,000	Infor Enterprise Solutions Holdings, Inc. (Luxembourg) Delayed Draw Term Loan, 9.12%, 07/28/12	2,770,200
5,244,000	Initial US Term Facility, 9.08%, 07/28/12	5,283,330
8,000,000	NameMedia, Inc. Term Loan, 11.33%, 08/31/08	8,040,000
2,619,063	ON Semiconductor Corp. Term Loan H, 7.62%, 12/15/11	2,635,432
4,858,156	Open Solutions Inc. First Lien Term Loan, 7.87%, 09/03/11	4,864,229
997,500	Open Text Corp. (Canada) Term Loan, 7.90%, 10/02/13	1,003,734
2,500,000	Secure Computing Corp. Term Loan, 8.58%, 08/31/13	2,518,750
2,000,000	Serena Software, Inc. Term Loan, 7.62%, 03/11/13	2,004,160
2,000,000	Spansion LLC Term Loan B, 8.38%, 11/01/12	2,007,500
		----- 38,199,835 -----

6 | See accompanying Notes to Financial Statements.

INVESTMENT PORTFOLIO (CONTINUED)

DECEMBER 31, 2006

HIGHLAND CREDIT STRATEGIES FUND

PRINCIPAL AMOUNT (\$)

VALUE (\$)

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SENIOR LOAN NOTES (CONTINUED)

MANUFACTURING - 4.2%

7,000,000	Acument Global Technologies, Inc. (TFS Acquisition Corp.) Term Loan, 8.92%, 08/11/13	7,052,500
2,992,500	CST Industries, Inc. Term Loan, 8.55%, 08/09/13	2,987,712
947,826	FR X Ohmstede Acquisitions Co. Term B Loan, 8.44%, 08/09/13	960,262
4,975,000	Global Petroleum, Inc. (SPI Petroleum) Term Loan, 9.88%, 07/26/13	4,999,875
	Matinvest 2 SAS (Deutsche Connector)	
2,250,000	B-2 Facility, 7.90%, 06/22/14	2,271,105
2,250,000	C-2 Facility, 8.08%, 06/22/15	2,282,355
1,011,458	Matinvest 2 SAS (Deutsche Connector) (France) Mezz A USD Facility, 13.54%, 06/22/16	1,039,273
	Prysmian Power Cables & Systems, Inc.	
1,525,200	B3b Term Loan, 7.88%, 08/25/13	1,531,880
381,300	C5b Term Loan, 8.38%, 08/25/13	383,923
	Quantum Corp.	
2,916,667	First Lien Term Loan, 9.44%, 08/22/12	2,920,313
1,000,000	Second Lien Term Loan, 13.69%, 08/22/13	1,002,500
2,000,000	Ray Acquisition SCA (Rexel) (France) Term Loan B3-A US, 7.61%, 08/02/14	2,012,500
		29,444,198

METALS/MINERALS - OTHER METALS/MINERALS - 2.8%

1,326,316	Euramax International Holdings B.V. Second Lien European Loan, 12.49%, 06/29/13	1,299,789
	Euramax International, Inc.	
2,884,136	First Lien Domestic Term Loan, 8.06%, 06/29/12	2,878,368
2,673,684	Second Lien Domestic Term Loan, 12.49%, 06/29/13	2,596,816
5,633,333	James River Coal Co. Credit Linked Certificate of Deposit, 8.85%, 11/30/11	5,633,333
1,600,000	Oglebay Norton Co. Tranche B Term Loan, 7.87%, 07/31/12	1,616,000
1,989,950	PinnOak Resources, LLC Term Loan, 8.78%, 11/23/12	1,960,101
1,736,875	United Central Industrial Supply Co., L.L.C. Term Loan, 8.61%, 03/31/12	1,747,731
1,488,750	Universal Buildings Products, Inc. Term Loan, 8.74%, 04/28/12	1,481,306

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		19,213,444

	PRINCIPAL AMOUNT (\$)	VALUE (\$)
	-----	-----
RETAIL- 8.2%		
3,467,443	Blockbuster Entertainment Corp. Tranche B Term Loan, 8.97%, 08/20/11	3,484,087
11,833,160	Burlington Coat Factory Warehouse Corp. Term Loan, 7.53%, 05/28/13	11,695,186
3,000,000	CSK Auto, Inc. Term Loan, 8.38%, 06/30/12	3,007,500
994,565	Eddie Bauer, Inc. Term Loan, 9.57%, 06/21/11	994,565
7,223,706	Home Interiors & Gifts, Inc. Initial Term Loan, 10.43%, 03/31/11	5,300,395
1,336,494	Movie Gallery, Inc. Term Loan A, 10.37%, 04/27/11	1,316,928
18,707,710	Term Loan B, 04/27/11 (b)	18,413,624
4,443,038	Neiman Marcus Group, Inc. (The) Term Loan, 7.60%, 04/06/13	4,479,915
1,990,000	Sports Authority, Inc., The Term Loan B, 7.61%, 05/03/13	1,984,189
6,000,000	Toys "R" Us Tranche B Term Loan, 9.63%, 07/19/12	6,183,720

		56,860,109

SERVICE - ENVIRONMENTAL SERVICES - 1.3%		
953,191	Alliance Laundry Systems LLC Term Loan, 7.63%, 01/27/12	961,532
6,237,288	Safety-Kleen JPMP SK Holdings Ltd. GBP Term Loan B1, 7.88%, 08/02/13	6,252,881
1,762,712	Safety-Kleen Systems, Inc. Synthetic Letter of Credit, 7.88%, 08/02/13	1,767,119

		8,981,532

SERVICE - OTHER SERVICES - 3.9%		
2,992,500	Education Management Corp. Tranche B Term Loan, 7.88%, 06/01/13	3,016,081
2,000,000	Koosharem Corp. Second Lien Term Loan, 15.75%, 06/30/13	1,975,000
6,483,750	La Petite Academy, Inc. Closing Date First Lien Term Loan, 8.32%, 08/16/12	6,491,855
4,000,000	Second Lien Term Loan, 12.57%, 02/16/13	4,040,000
9,000,000	NES Rentals Second Lien Term Loan, 12.13%, 07/20/13	9,084,420
1,458,815	Survey Sampling International, LLC	

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	Term Loan, 8.75%, 05/06/11	1,459,719
747,500	Vanguard Car Rental USA Holding, Inc. Term Loan, 8.36%, 06/14/13	753,188
		26,820,263

See accompanying Notes to Financial Statements. | 7

INVESTMENT PORTFOLIO (CONTINUED)

DECEMBER 31, 2006

HIGHLAND CREDIT STRATEGIES FUND

	PRINCIPAL AMOUNT (\$)	VALUE (\$)
	-----	-----
SENIOR LOAN NOTES (CONTINUED)		
TELECOMMUNICATIONS - 3.7%		
992,506	Gabriel Communications Finance Co. Term Loan B, 10.41%, 05/12/12	993,747
933,333	Madison River Capital Term B-1, 7.62%, 07/29/12	936,105
8,000,000	PaeTec Communications, Inc. Second Lien Term Loan, 12.88%, 06/12/13	8,167,520
2,000,000	Sorenson Communications, Inc. Revolver, 08/16/12 (b)	1,994,840
5,000,000	Second Lien Term Loan, 12.39%, 02/16/14	5,062,500
5,985,000	Tranche B Term Loan, 8.36%, 08/16/13	6,018,636
1,250,000	Stratos Global Corp./Stratos Funding LP (Canada) Term B Facility, 8.10%, 02/13/12	1,252,350
1,000,000	Time Warner Telecom Holdings Inc. Term Loan B, 7.60%, 01/07/13	1,007,500
		25,433,198

TRANSPORTATION - AUTO - 6.7%		
3,949,495	Carey International, Inc. First Lien Term Loan, 9.19%, 05/10/11	3,910,000
2,596,191	Second Lien Term Loan, 17.28%, 05/10/12	2,550,758
4,222,507	Conseco, Inc. Term Loan, 8.63%, 12/15/08	4,243,619
380,167	Cooper-Standard Automotive Canada Ltd. (Canada) Tranche B Term Loan, 7.88%, 12/23/11	380,882
994,975	Cooper-Standard Automotive Inc Term Loan D, 7.88%, 12/23/11	996,218
84,453	Tranche C Term Loan, 7.88%, 12/23/11	84,585
3,000,000	Dana Corp. DIP Term Loan, 7.55%, 04/13/08	3,002,160
2,000,000	Dayco Products LLC - (Mark IV)	

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	Second Lien Term Loan, 11.28%, 12/31/11	2,008,320
8,495,000	Delphi Corp.Term Loan, 13.75%, 06/14/11	8,731,246
485,083	Environmental Systems Products Holdings Inc.Term Loan, 8.93%, 12/12/08	487,509
1,000,000	Key Plastics LLC Term Loan B, 8.86%, 06/24/10	1,008,750
3,459,900	Term Loan C, 11.60%, 06/29/11	3,494,499
	Keystone Automotive Operations, Inc. Term Loan B, 7.91%, 10/30/09	89,690
89,661	Term Loan C, 7.85%, 10/30/10	2,047,574
2,046,919	Lear Corp. First Lien Term Loan B, 7.96%, 04/25/12	4,984,202
4,985,000	Motor Coach Industries International, Inc. Second Lien Term Loan, 14.12%, 12/01/08	3,694,820
	PRINCIPAL AMOUNT (\$)	VALUE (\$)
	-----	-----
TRANSPORTATION - AUTO (CONTINUED)		
	Navistar International Corp. Delay Draw Term Loan, 10.32%, 02/22/09	659,442
650,094	Delay Draw Term Loan, 10.37%, 02/22/09	3,736,205
3,683,240		-----
		46,110,479

TRANSPORTATION - LAND - 1.2%		
2,000,000	New Century Transportation, Inc. Term Loan B, 8.63%, 08/14/12	2,006,240
7,147,900	SIRVA Worldwide, Inc. Tranche B Term Loan, 11.62%, 12/01/10	6,641,543

		8,647,783

UTILITIES - 6.4%		
5,000,000	ANP Funding I, LLC Tranche A Term Loan, 07/29/10 (b)	5,035,000
	Calpine Corp. Second Lien Term Loan, 07/16/07 (e)	1,139,250
1,000,000	Second Priority DIP Term Loan, 9.50%, 12/20/07	1,015,620
1,000,000	Coletto Creek Power, LP Second Lien Term Loan, 9.37%, 06/28/13	4,701,375
4,975,000	Synthetic Facility, 5.27%, 06/28/13	381,332
382,166	Term Loan, 8.12%, 06/28/13	5,582,758
5,589,745	GBGH, LLC (U S Energy) First Lien Term Loan, 10.94%, 08/07/13	5,012,500
5,000,000	Second Lien Term Loan,	
5,000,000		

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	7.94%, 08/07/14	5,012,500
	Magnolia Energy LP	
30,043	Additional PCLC Facility, 12/14/11 (b)	24,535
465,044	Facility A, 12/14/11 (b)	378,234
4,504,913	Facility B, 12/14/11 (b)	3,679,028
1,000,000	NE Energy, Inc.	
	Second Lien Term Loan,	
	11.75%, 05/01/14	1,017,080
	Plum Point Energy Associates, LLC	
607,134	First Lien Term Loan,	
	5.37%, 03/14/14	611,687
2,093,334	Funded Letter of Credit,	
	8.62%, 03/14/14	2,114,267
	Reliant Energy, Inc.	
571,429	New Term Loan, 7.73%, 12/01/10	575,537
428,571	Pre-Funded Letter of Credit,	
	5.22%, 12/01/10	428,571
	TECO Panda Generating Co.	
	- Gila River Power Station	
598,071	Project Letter of Credit,	
	06/01/12 (b)	892,621
1,319,117	Tranche A Term Loan,	
	06/01/12 (b)	1,968,782
1,272,560	Tranche B Term Loan,	
	06/01/20 (b)	1,967,695
38,585	Working Capital, 06/01/12 (b)	57,588

8 | See accompanying Notes to Financial Statements.

INVESTMENT PORTFOLIO (CONTINUED)

DECEMBER 31, 2006

HIGHLAND CREDIT STRATEGIES FUND

PRINCIPAL AMOUNT (\$)	VALUE (\$)
-----	-----

SENIOR LOAN NOTES (CONTINUED)

UTILITIES (CONTINUED)

	TECO Panda Generating Co.	
	- Union Power Partners, L.P.	
173,633	Letter of Credit, 06/01/12 (b) (e)	259,148
775,951	Tranche A Term Loan,	
	06/01/12 (b) (e)	1,158,107
744,913	Tranche B Term Loan,	
	06/01/20 (b) (e)	1,151,822
77,170	Working Capital, 06/01/12 (b) (e)	115,177

		44,280,214

WIRELESS - CELLULAR/PCS - 0.6%

1,990,000	Cricket Communications, Inc.	
	Term B Facility, 8.25%, 06/16/13	2,006,378
2,000,000	Insight Midwest Holdings, LLC	
	B Delayed Draw Term Loan,	
	7.61%, 04/06/14	2,011,880

		4,018,258

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	Total Senior Loan Notes	669,515,136
	(Cost \$665,087,602)	669,515,136
FOREIGN DENOMINATED SENIOR LOAN NOTES - 7.7%		
CANADA - 0.9%		
CAD		
	Persona Communications Corp.	
5,965,455	First Lien CDN Delayed-Draw	
	Term Loan, 10/12/13 (b)	5,164,729
1,232,727	First Lien CDN Tranche B	
	Term Loan, 7.43%, 10/12/13	1,067,262
		6,231,991
		6,231,991
FRANCE - 2.7%		
EUR		
	Ypso Holding SA	
2,680,552	Eur B (Acq) 1 Facility,	
	5.87%, 06/15/14	3,511,033
4,373,530	Eur B (Acq) 2 Facility,	
	5.87%, 06/15/14	5,728,526
6,945,918	Eur B (Recap) 1 Facility,	
	5.87%, 06/15/14	9,111,348
		18,350,907
		18,350,907
GERMANY - 1.3%		
EUR		
5,000,000	P7S1 Holding II S.a.r.L - GMP	
	Facility B, 7.09%, 07/08/11	6,612,514
2,000,000	Iesy Hessen/ISH NRW	
	GMBH/Arena Sport	
	Euro Senior Secured Term Loan,	
	6.63%, 10/15/11	2,643,898
		9,256,412
		9,256,412
ITALY - 0.6%		
EUR		
3,000,000	H3G S.p.A.Euro	
	Term Loan A1, 12/30/11 (b)	3,896,618
		3,896,618
		3,896,618
	PRINCIPAL AMOUNT (\$)	VALUE (\$)
	-----	-----
UNITED KINGDOM - 2.2%		
GBP		
420,286	Eggborough Power Ltd.Term Loan,	
	03/31/22 (b) (d) (e)	2,681,539
	Mobileserv Ltd. (Phones 4U)	
3,250,000	Facility B , 7.65%, 09/22/14	6,380,547
3,250,000	Facility C, 8.15%, 09/22/15	6,388,562
		15,450,648
		15,450,648

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	15,450,648

Total Foreign Denominated	
Senior Loan Notes	
(Cost \$51,360,643)	53,186,576

CORPORATE NOTES AND BONDS - 26.6%	
AUTOMOTIVE - 0.5%	
3,332,000 Ford Motor Credit Co.	
8.11%, 01/13/12 (f)	3,305,794

CABLE - US CABLE - 1.1%	
4,500,000 CCH I LLC11.00%, 10/01/15	4,640,625
2,000,000 Charter Communications Inc.	
5.88%, 11/16/09	2,855,000

	7,495,625

CHEMICALS - SPECIALTY CHEMICALS - 1.9%	
Solutia Inc.	
8,000,000 10/15/27 (e)	7,830,000
5,500,000 10/15/37 (e)	5,383,125

	13,213,125

CONSUMER NON-DURABLES - 1.1%	
3,000,000 Ames True Temper	
9.37%, 01/15/12 (f)	3,060,000
3,100,000 Remington Arms Co., Inc.	
10.50%, 02/01/11	2,952,750
1,875,000 Solo Cup Co.	
8.50%, 02/15/14	1,631,250

	7,644,000

DIVERSIFIED MEDIA - 0.8%	
4,500,000 Network Communications, Inc.	
10.75%, 12/01/13	4,567,500
1,000,000 PRIMEDIA, Inc.	
10.75%, 05/15/10 (f)	1,045,000

	5,612,500

ENERGY - EXPLORATION & PRODUCTION - 0.3%	
1,750,000 Opti Canada, Inc.	
8.25%, 12/15/14 (g)	1,806,875

FINANCIAL - 0.3%	
2,000,000 Penhall International, Corp.	
12.00%, 08/01/14 (g) (h)	2,170,000

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FOOD AND DRUG - 0.1%		
496,383	Cinacalcet Royalty	
	8.00%, 03/30/17	565,876

See accompanying Notes to Financial Statements. | 9

INVESTMENT PORTFOLIO (CONTINUED)

DECEMBER 31, 2006

HIGHLAND CREDIT STRATEGIES FUND

PRINCIPAL AMOUNT (\$)	VALUE (\$)
-----	-----

CORPORATE NOTES AND BONDS (CONTINUED)

FOOD/TOBACCO-FOOD/TOBACCO PRODUCERS - 2.2%

Chiquita Brands International, Inc.		
3,000,000	7.50%, 11/01/14	2,760,000
5,000,000	8.88%, 12/01/15	4,812,500
10,000,000	Swift & Co., PIK Holdco Notes, 8.00%, 03/19/10	7,500,000

		15,072,500

FOREST PRODUCTS - PAPER - 0.9%

4,000,000	Graphic Packaging International, Inc. 9.50%, 08/15/13 (h)	4,240,000
1,500,000	Impress Metal Packaging Holdings BV (Netherlands) 8.51%, 09/15/13 (f) (g)	1,511,250
500,000	Newpage Corp. 12.00%, 05/01/13	531,250

		6,282,500

GAMING/LEISURE - OTHER LEISURE - 1.9%

4,500,000	Six Flags, Inc. 8.88%, 02/01/10	4,376,250
1,000,000	True Temper Sports, Inc. 8.38%, 09/15/11	875,000
8,000,000	Trump Entertainment Resorts Holdings LP 8.50%, 06/01/15	8,000,000

		13,251,250

HEALTHCARE - ACUTE CARE - 2.4%

HCA, Inc.		
2,100,000	6.30%, 10/01/12	1,926,750
3,000,000	8.36%, 04/15/24	2,654,472
11,000,000	9.63%, 11/15/16 (g)	11,852,500

		16,433,722

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HEALTHCARE - MEDICAL PRODUCTS - 0.9%		
250,000	Medquest, Inc., Series B 11.88%, 08/15/12	207,500
6,125,000	Rotech Healthcare, Inc. 9.50%, 04/01/12	6,033,125
		6,240,625
HOUSING - BUILDING MATERIALS - 0.1%		
1,000,000	Builders FirstSource, Inc. 9.62%, 02/15/12 (f)	988,750
INFORMATION TECHNOLOGY - 1.0%		
6,000,000	MagnaChip Semiconductor 8.61%, 12/15/11 (f)	5,190,000
2,000,000	NXP BV/NXP Funding LLC (Netherlands) 8.12%, 10/15/13 (f) (g)	2,040,000
		7,230,000
		7,230,000
	PRINCIPAL AMOUNT (\$)	VALUE (\$)
	-----	-----
MANUFACTURING - 0.5%		
1,000,000	Polypore, Inc. 8.75%, 05/15/12	1,000,000
2,150,000	TFS Acquisition Corp 12.87%, 08/01/14 (f) (g)	2,203,750
		3,203,750
METALS/MINERALS - 0.1%		
350,000	Doe Run Resources Corp. 11.75%, 11/01/08 (i)	346,500
RETAIL - 2.3%		
9,500,000	Blockbuster Inc. 9.00%, 09/01/12	9,238,750
2,000,000	Gregg Appliances, Inc. 9.00%, 02/01/13	1,920,000
2,000,000	Linens `n Things, Inc. 11.00%, 01/15/14 (f)	1,950,000
4,000,000	Movie Gallery Inc. 11.00%, 05/01/12	3,100,000
		16,208,750
SERVICE - OTHER SERVICES - 1.1%		
7,550,000	HydroChem Industrial Services, Inc. 9.25%, 02/15/13 (g)	7,625,500
TRANSPORTATION - 3.8%		
5,000,000	American Tire Distributors Holdings, Inc.	

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	11.62%, 04/01/12 (f)	4,800,000
	Delphi Corp.	
4,000,000	06/15/06 (e)	4,470,000
5,700,000	05/01/29 (e)	6,327,000
	Federal-Mogul Corp.	
12,000,000	01/15/09 (e)	8,940,000
1,000,000	07/01/06 (e)	742,500
1,350,000	General Motors Accept Corp.	
	6.75%, 12/01/14	1,388,744

		26,668,244

UTILITIES - 0.1%		
1,000,000	Enron Corp.11/15/05 (e) (k)	340,000

WIRELESS - CELLULAR/PCS - 0.5%		
3,500,000	Cricket Communications Corp.	
	9.38%, 11/01/14 (g)	3,710,000

WIRELESS COMMUNICATIONS - 2.7%		
250,000	Clearwire Corp.11.00%, 08/15/10	251,875
	SunCom Wireless Holdings, Inc.	
5,000,000	8.50%, 06/01/13	4,812,500
1,500,000	8.75%, 11/15/11	1,402,500
12,735,000	9.38%, 02/01/11 (h)	12,034,575

		18,501,450

	Total Corporate Notes and Bonds	
	(Cost \$167,189,188)	183,917,336

10 | See accompanying Notes to Financial Statements.

INVESTMENT PORTFOLIO (CONTINUED)

DECEMBER 31, 2006

HIGHLAND CREDIT STRATEGIES FUND

SHARES (\$)	VALUE (\$)	
-----	-----	
COMMON STOCKS - 9.0%		
21,670	ATP Oil & Gas Corp. (j)	857,482
82,500	Caremark Rx, Inc.	4,711,575
33,333	Chesapeake Energy Corp.	968,324
3,653,116	Delphi Corp. (j)	13,954,903
28,534	Diamond Offshore Drilling	2,281,008
18,300	Ferro Corp.	378,627
47,500	GlobalSantaFe Corp.	2,792,050
552,008	Graphic Packaging Corp. (j)	2,390,195
121,072	Gray Television, Inc., Class A	995,212
357,343	GrayTelevision, Inc.	2,619,324
225,000	ICO Global Communications	
	Holding Ltd. (j)	1,028,250
100,067	Louisiana-Pacific Corp.	2,154,442
85,816	Newpark Resources, Inc. (j)	618,733
46,500	Noble Corp.	3,540,975

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29,800	NRG Energy, Inc. (j)	1,669,098
177,509	Owens Corning, Inc. (h) (j)	5,307,507
95,550	Owens Illinois (j)	1,762,897
136,990	Safety-Kleen Systems, Inc. (j)	3,082,275
41,970	Sprint Nextel Corp.	792,813
51,500	Triad Hospitals, Inc. (j)	2,154,245
1,049	Trump Entertainment Resorts, Inc. (j)	19,134
282,085	United Rentals, Inc. (j)	7,173,422
8	Westgate Investments LLC (j)	25,000
47,150	Williams Cos., Inc.	1,231,558

	Total Common Stocks	
	(Cost \$58,823,283)	62,509,049

WARRANTS - 0.0%		
20,000	Clearwire Corp., expires 08/15/10	
	08/15/10 (j)	24,200
5,031	OpBiz LLC08/31/10 (j)	0
10	OpBiz LLC08/31/10 (j)	0

	Total Warrants	
	(Cost \$0)	24,200

	TOTAL INVESTMENTS - 139.9%	969,152,297

	(cost of \$942,460,716) (1)	
	OTHER ASSETS & LIABILITIES, NET - (39.9)%	(276,188,460)

	NET ASSETS APPLICABLE TO	
	COMMON SHAREHOLDERS - 100.0%	692,963,837
		=====

Investments sold short outstanding as of December 31, 2006:

Equity Securities	Shares	Value
Imperial Sugar Co.	124,162	\$ 3,005,961
RadioShack Corp.	70,075	1,175,858
Sharper Image Corp.	84,567	782,244
Superior Industries International, Inc.	114,720	2,210,654

Total Investments sold short		
(Proceeds \$7,248,112)		\$ 7,174,717
		=====

- (a) Senior loans in which the Fund invests generally pay interest at rates which are periodically predetermined by reference to a base lending rate plus a premium. (Unless otherwise identified by footnote (d), all senior loans carry a variable rate interest.) These base lending rates are generally (i) the Prime Rate offered by one or more major U.S. banks, (ii) the lending rate offered by one or more European banks such as the London Inter-Bank Offered Rate ("LIBOR") or (iii) the Certificate of Deposit rate. Rate shown represents the weighted average rate at December 31, 2006. Senior loans, while exempt from registration under the Security Act of 1933, as amended (the "1933 Act"), contain certain restrictions on resale and cannot be sold publicly. Senior secured floating rate loans often

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require prepayments from excess cash flow or permit the borrower to repay at its election. The degree to which borrowers repay, whether as a contractual requirement or at their election, cannot be predicted with accuracy. As a result, the actual remaining maturity may be substantially less than the stated maturities shown.

- (b) All or a portion of this position has not settled. Contract rates do not take effect until settlement date.
- (c) Senior loan notes have additional unfunded loan commitments. See Note 9.
- (d) Fixed rate senior loan.
- (e) The issuer is in default of certain debt covenants. Income is not being accrued.
- (f) Floating rate note. The interest rate shown reflects the rate in effect at December 31, 2006.
- (g) Securities exempt from registration pursuant to Rule 144A under the 1933 Act. These securities may only be resold, in transactions exempt from registration, to qualified institutional buyers. At December 31, 2006, the value of these securities amounted to \$32,919,875 or 4.8% of net assets. These securities have been determined by the Investment Adviser to be liquid securities.
- (h) Securities (or a portion of securities) on loan as of December 31, 2006. See Note 8.
- (i) Restricted security, e.g., security not registered under the 1933 Act excluding Rule 144A securities. At December 31, 2006, the value of this restricted security amounted to \$346,500 or 0.1% of net assets. Additional information about the restricted security is as follows:

Acquisition Security	Acquisition Date	Cost
Doe Run Resources Corp.	08/16/06	\$345,188

- (j) Non-income producing security.
 - (k) This issue is under the protection of the Federal Bankruptcy Court.
 - (l) Cost for federal income tax purposes is \$942,470,524.
- DIP Debtor in Possession
PIK Payment in Kind

FOREIGN DENOMINATED SENIOR LOAN NOTES INDUSTRY CONCENTRATION TABLE (% of Total Net Assets)

Cable - International Cable	3.6%
Retail	1.8%
Broadcasting	1.0%
Telecommunications	0.9%
Utilities	0.4%

Total	7.7%
	=====

See accompanying Notes to Financial Statements. | 11

STATEMENT OF ASSETS AND LIABILITIES

DECEMBER 31, 2006

HIGHLAND CREDIT STRATEGIES FUND

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ASSETS:

Investments, at value (Cost \$942,460,716)
Foreign currency (Cost \$10,303,463)
Cash
Restricted cash (Note 2)
Cash held as collateral for securities loaned (Note 8)
Net discount and unrealized appreciation on unfunded transactions (Note 9)
Receivable for:
 Investments sold
 Dividend and interest receivable
Other assets

Total assets

LIABILITIES:

Notes payable (Note 7)
Securities sold short, at value (Proceeds \$7,248,112)
Payable upon receipt of securities loaned (Note 8)
Payables for:
 Payable for investments purchased
 Investment advisory fee payable (Note 4)
 Administration fee (Note 4)
 Trustees' fees (Note 4)
 Interest expense (Note 7)
 Accrued expenses and other liabilities

Total liabilities

NET ASSETS APPLICABLE TO COMMON SHARES

COMPOSITION OF NET ASSETS:

Par value of common shares (Note 1)
Paid-in capital
Undistributed net investment income
Accumulated net realized gain/(loss) from investments and foreign currency transactions
Net unrealized appreciation/(depreciation) on investments, unfunded transactions,
 short positions and translation of assets and liabilities denominated in foreign currency ..

NET ASSETS APPLICABLE TO COMMON SHARES AT VALUE

COMMON SHARES:

Net assets
Shares outstanding (unlimited authorization)
Net asset value per share (Net assets/shares outstanding)

12 | See accompanying Notes to Financial Statements.

STATEMENT OF OPERATIONS

FOR THE PERIOD ENDED DECEMBER 31, 2006 (A)

HIGHLAND CREDIT STRATEGIES FUND

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INVESTMENT INCOME:

Interest
Dividends
Securities lending income

Total investment income

EXPENSES:

Investment advisory fee (Note 4)
Administration fee (Note 4)
Accounting service fee
Transfer agent fee
Professional fees
Trustees' fees (Note 4)
Custodian fees
Reports to shareholders
Other expense

Net operating expenses

Interest expense (Note 7)

Net expenses

Net investment income

NET REALIZED AND UNREALIZED GAIN/(LOSS) ON INVESTMENTS:

Net realized gain/(loss) on investments
Net realized gain/(loss) on foreign currency transactions
Net change in unrealized appreciation/(depreciation) on investments
Net change in unrealized appreciation/(depreciation) on unfunded transactions (Note 9)
Net change in unrealized appreciation/(depreciation) on short positions
Net change in unrealized appreciation/(depreciation) on translation of assets and
liabilities denominated in foreign currency

Net realized and unrealized gain/(loss) on investments

Net increase in net assets, applicable to common shareholders

See accompanying Notes to Financial Statements. | 13

STATEMENT OF CHANGES IN NET ASSETS

HIGHLAND CREDIT STRATEGIES FUND

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2006

INCREASE IN NET ASSETS:

FROM OPERATIONS:

Net investment income	2
Net realized gain/(loss) on investments and foreign currency transactions	
Net change in unrealized appreciation/(depreciation) on investments, unfunded transactions, short positions and translation of assets and liabilities denominated in foreign currency	2
Net increase in net assets from operations	5

DISTRIBUTIONS DECLARED TO COMMON SHAREHOLDERS

From net investment income	(2)
----------------------------------	-----

SHARE TRANSACTIONS FROM COMMON SHARES

Subscriptions	65
Distributions reinvested	

Net increase from share transactions	65
--	----

Total increase in net assets from common shares	69
---	----

NET ASSETS APPLICABLE TO COMMON SHARES

Beginning of period	
---------------------------	--

End of period (including undistributed net investment income of \$3,769,657).	69
---	----

CHANGE IN COMMON SHARES

Subscriptions	3
Issued for distributions reinvested	

Net increase	3
--------------------	---

14 | See accompanying Notes to Financial Statements.

STATEMENT OF CASH FLOWS

FOR THE PERIOD ENDED DECEMBER 31, 2006 (A) HIGHLAND CREDIT STRATEGIES FUND

CASH FLOWS USED FOR OPERATING ACTIVITIES

Net investment income	
-----------------------------	--

ADJUSTMENTS TO RECONCILE NET INVESTMENT INCOME TO NET CASH AND FOREIGN CURRENCY

USED FOR OPERATING ACTIVITIES

Purchase of investment securities	
Increase in restricted cash	
Proceeds from disposition of investment securities	
Increase in cash held as collateral for securities loaned	
Increase in interest and fees receivable	
Increase in other assets	

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Increase in receivable for investments sold
 Increase in securities sold short
 Increase in payable upon receipt of securities loaned
 Increase in payable for investments purchased
 Net amortization/(accretion) of premium/(discount)
 Decrease in market to market on realized and unrealized gain/(loss) on foreign currency
 Increase in unrealized appreciation/(depreciation) on securities sold short
 Increase in payables to related parties
 Increase in other expenses and liabilities

Net cash and foreign currency flow from operating activities

CASH FLOWS PROVIDED BY FINANCING ACTIVITIES

Increase in notes payable
 Increase in interest payable
 Proceeds from shares sold
 Distributions paid in cash

Net cash flow provided by financing activities

Net increase in cash and foreign currency

CASH AND FOREIGN CURRENCY

Beginning of the period
 End of the period

See accompanying Notes to Financial Statements. | 15

FINANCIAL HIGHLIGHTS

 HIGHLAND CREDIT STRATEGIES FUND

SELECTED DATA FOR A SHARE OUTSTANDING THROUGHOUT EACH PERIOD IS AS FOLLOWS:

COMMON SHARES PER SHARE OPERATING PERFORMANCE:	FOR THE PERIOD ENDED 12/30/0
NET ASSET VALUE, BEGINNING OF PERIOD	\$ 19

INCOME FROM INVESTMENT OPERATIONS:	
Net investment income	0
Net realized and unrealized gain on investments	0
Total from investment operations, applicable to common shareholders	1
LESS DISTRIBUTIONS DECLARED TO COMMON SHAREHOLDERS:	
From net investment income	(0)

NET ASSET VALUE, END OF PERIOD	\$ 20
MARKET VALUE, END OF PERIOD	\$ 21
Market Value Total Return (c)	9

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RATIOS TO AVERAGE NET ASSETS/SUPPLEMENTAL DATA:

COMMON SHARE INFORMATION AT END OF PERIOD:

Ratios based on net assets of common shares

Net assets, end of period (in 000's)	\$	692,
Net operating expenses		1
Interest expenses		0
Net expenses		2
Net investment income		6
Portfolio turnover rate		45

16 | See accompanying Notes to Financial Statements.

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2006

HIGHLAND CREDIT STRATEGIES FUND

NOTE 1. ORGANIZATION

Highland Credit Strategies Fund (the "Fund") is a Delaware statutory trust registered under the Investment Company Act of 1940, as amended (the "1940 Act"), as a nondiversified, closed-end management investment company. The Fund may issue an unlimited number of common shares, par value \$0.001 per share ("Common Shares").

INVESTMENT GOAL

The Fund seeks to provide both current income and capital appreciation.

NOTE 2. SIGNIFICANT ACCOUNTING POLICIES

USE OF ESTIMATES

The preparation of financial statements in conformity with U.S. generally accepted accounting principles ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

The following is a summary of significant accounting policies consistently followed by the Fund in the preparation of its financial statements.

FUND VALUATION

The net asset value of the Fund's Common Shares is calculated daily on each day that the New York Stock Exchange is open for business as of the close of the regular trading session on the New York Stock Exchange. The net asset value is calculated by dividing the value of the Fund's net assets attributable to Common Shares by the number of Common Shares outstanding.

SECURITY VALUATION

In computing the Fund's net assets attributable to Common Shares, securities with readily available market quotations use those quotations for valuation. When portfolio securities are traded on the relevant day of valuation, the valuation will be the last reported sale price on that day. If there are no such sales on that day, the security will be valued at the mean between the most recently quoted bid and asked prices provided by the principal market makers. If there is more than one such principal market maker, the value shall be the average of such means. Securities without a sale price or quotations from

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principal market makers on the valuation day will be valued by an independent pricing service. If securities do not have readily available market quotations or pricing service prices, including circumstances under which such are determined not to be accurate or current (including when events materially affect the value of securities occurring between the time when market price is determined and calculation of the Fund's net asset value), such securities are valued at their fair value, as determined by Highland Capital Management, L.P. ("Highland" or the "Investment Adviser") in good faith in accordance with procedures approved by the Fund's Board of Trustees. In these cases, the Fund's net asset value will reflect the affected portfolio securities' value as determined in the judgment of the Board of Trustees or its designee instead of being determined by the market. Using a fair value pricing methodology to value securities may result in a value that is different from a security's most recent sale price and from the prices used by other investment companies to calculate their net asset values. There can be no assurance that the Fund's valuation of a security will not differ from the amount that it realizes upon the sale of such security. Short-term investments, that is, those with a remaining maturity of 60 days or less, are valued at amortized cost. Repurchase agreements are valued at cost plus accrued interest. Foreign price quotations are converted to U.S. dollar equivalents using the 4 PM London Time Spot Rate.

SECURITY TRANSACTIONS

Security transactions are accounted for on the trade date. Cost is determined and gains (losses) are based upon the specific identification method for both financial statement and federal income tax purposes.

FOREIGN CURRENCY

Foreign currencies, investments and other assets and liabilities are translated into U.S. dollars at the exchange rates using the current 4:00 PM London Time Spot Rate. Fluctuations in the value of the foreign currencies and other assets and liabilities resulting from changes in exchange rates between trade and settlement dates on security transactions and between the accrual and payment dates on dividends, interest income and foreign withholding taxes are recorded as unrealized foreign currency gains (losses). Realized gains (losses) and unrealized appreciation (depreciation) on investment securities and income and expenses are translated on the respective dates of such transactions. The effect of changes in foreign currency exchange rates on investments in securities are not segregated in the Statement of Operations from the effects of changes in market prices of those securities, but are included with the net realized and unrealized gain or loss on investment securities.

SHORT SALES

A short sale is a transaction in which the Trust sells a security it does not own in anticipation that the market price of that security will decline. When the Trust makes a short

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NOTES TO FINANCIAL STATEMENTS (CONTINUED)

DECEMBER 31, 2006

HIGHLAND CREDIT STRATEGIES FUND

sale, it must borrow the security sold short from a broker-dealer and deliver it to the buyer upon conclusion of the sale. The Trust may have to pay a fee to borrow particular securities and is often obligated to pay over any payments received on such borrowed securities. Cash held as collateral for short sales is classified as restricted cash on the Statement of Assets and Liabilities.

The Trust intends to attempt to limit exposure to a possible market decline in the value of its portfolio securities through short sales of securities that

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Highland believes possess volatility characteristics similar to those being hedged. In addition, the Trust intends to use short sales for non-hedging purposes to pursue its investment objectives. Subject to the requirements of the 1940 Act and the Internal Revenue Code of 1986, as amended (the "Code"), the Trust will not make a short sale if, after giving effect to such sale, the market value of all securities sold short by the Trust exceeds 25% of the value of its total assets.

INCOME RECOGNITION

Interest income is recorded on the accrual basis and includes accretion of discounts and amortization of premiums. Dividend income is recorded on the ex-dividend date.

FEDERAL INCOME TAX STATUS

The Fund intends to qualify each year as a "regulated investment company" under Subchapter M of the Code, and will distribute substantially all of its taxable income and gains, if any, for its tax year, and as such will not be subject to federal income taxes. In addition, the Fund intends to distribute, in each calendar year, all of its net investment income, capital gains and certain other amounts, if any, such that the Fund should not be subject to federal excise tax. Therefore, no federal income or excise tax provisions are recorded.

DIVIDENDS AND DISTRIBUTIONS

The Fund plans to pay dividend distributions monthly and capital gain distributions annually to common shareholders. To permit the Fund to maintain more stable monthly dividends and annual distributions, the Fund may from time to time distribute less than the entire amount of income and gains earned in the relevant month or year, respectively. The undistributed income and gains would be available to supplement future distributions. Shareholders of the Fund will automatically have all dividends and distributions reinvested in Common Shares of the Fund issued by the Fund or purchased in the open market in accordance with the Fund's Dividend Reinvestment Plan (the "Plan") unless an election is made to receive cash. Each participant in the Plan will pay a pro rata share of brokerage commissions incurred in connection with open market purchases, and participants requesting a sale of securities through the plan agent of the Plan are subject to a sales fee and a brokerage commission.

STATEMENT OF CASH FLOWS

Information on financial transactions which have been settled through the receipt or disbursement of cash is presented in the Statement of Cash Flows. The cash and foreign currency amount shown in the Statement of Cash Flows is the amount included within the Fund's Statement of Assets and Liabilities and includes cash and foreign currency on hand at its custodian bank.

ADDITIONAL ACCOUNTING STANDARDS

On July 13, 2006, the Financial Accounting Standards Board (FASB) released FASB Interpretation No. 48 (FIN 48) "Accounting for Uncertainty in Income Taxes". FIN 48 provides guidance for how uncertain tax positions should be recognized, measured, presented and disclosed in the financial statements. FIN 48 requires the evaluation of tax positions taken in the course of preparing the Fund's tax returns to determine whether the tax positions are "more-likely-than-not" of being sustained by the applicable tax authority. Tax benefits of positions not deemed to meet the more-likely-than-not threshold would be booked as a tax expense in the current year and would be recognized as: a liability for unrecognized tax benefits; a reduction of an income tax refund receivable; a reduction of deferred tax asset; an increase in deferred tax liability; or a combination thereof. Adoption of FIN 48 is required for fiscal years beginning after December 15, 2006.

In addition, in September 2006, Statement of Financial Accounting Standards No. 157 FAIR VALUE MEASUREMENTS ("SFAS 157") was issued and is effective for fiscal years beginning after November 15, 2007. SFAS 157 defines fair value,

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establishes a framework for measuring fair value and expands disclosures about fair value measurements.

At this time, management is evaluating the implications of FIN 48 and SFAS 157 and their impact on the financial statements have not yet been determined.

NOTE 3. FEDERAL TAX INFORMATION

The timing and character of income and capital gain distributions are determined in accordance with income tax regulations, which may differ from GAAP. 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.

Reclassifications are made to the Fund's capital accounts for permanent tax differences to reflect income and gains available for distribution (or available capital loss carryforwards) under income tax regulations.

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NOTES TO FINANCIAL STATEMENTS (CONTINUED)

DECEMBER 31, 2006

HIGHLAND CREDIT STRATEGIES FUND

For the year ended December 31, 2006, permanent differences resulting primarily from section 988 gain/(loss) reclass were identified and reclassified among the components of the Fund's net assets as follows:

Overdistributed Net Investment Income	Accumulated Net Realized Loss
\$ (96,257)	\$96,257

Net investment income and net realized gains (losses), as disclosed on the Statement of Operations, and net assets were not affected by these reclassifications.

The tax character of distributions paid during the year ended December 31, 2006 was as follows:

Distributions paid from:	2006
Ordinary income*	\$20,704,560
Long-term capital gains	--

*For tax purposes, short-term capital gains distributions, if any, are considered ordinary income distributions.

As of December 31, 2006, the components of distributable earnings on a tax basis were as follows:

Undistributed Ordinary Income	Undistributed Long-Term Capital Gains	Net Unrealized Depreciation*
\$ 8,780,938	\$--	\$ 26,392,552

*Any differences between book-basis and tax-basis net unrealized appreciation/depreciation are primarily due to deferral of losses from wash sales.

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Unrealized appreciation and depreciation at December 31, 2006, based on cost of investments for federal income tax purposes and excluding any unrealized appreciation and depreciation from changes in the value of other assets and liabilities resulting from changes in exchange rates, was:

Unrealized appreciation	\$ 29,689,165
Unrealized depreciation	(3,007,392)

Net unrealized appreciation	\$ 26,681,773
	=====

NOTE 4. INVESTMENT ADVISER, ADMINISTRATION, AND TRUSTEE FEES

INVESTMENT ADVISER FEE

Highland Capital Management, L.P is the investment adviser to the Fund and receives an annual fee, paid monthly, in an amount equal to 1.00% of the average weekly value of the Fund's Managed Assets. The Fund's "Managed Assets" is an amount equal to the total assets of the Fund, including any form of leverage, minus all accrued expenses incurred in the normal course of operations, but not excluding any liabilities or obligations attributable to investment leverage obtained through (i) indebtedness of any type (including, without limitation, borrowing through a credit facility or the issuance of debt securities), (ii) the issuance of preferred stock or other preference securities, (iii) the reinvestment of collateral received for securities loaned in accordance with the Fund's investment objectives and policies, and/or (iv) any other means.

ADMINISTRATION FEE

Highland provides administrative services to the Fund. For its services, Highland receives an annual fee, payable monthly, in an amount equal to 0.20% of the average weekly value of the Fund's Managed Assets. Under a separate sub-administration agreement, Highland has delegated certain administrative functions to PFPC Inc. ("PFPC"). Highland pays PFPC directly for these sub-administration services.

FEES PAID TO TRUSTEES

The Fund pays no compensation to its Trustee and Officers who are interested persons (as defined in the 1940 Act) of the Fund and employees of Highland. The Fund pays each Trustee who is not an interested person (as defined in the 1940 Act) of the Fund an annual retainer of \$7,500 per year for services provided as a Trustee of the Fund.

NOTE 5. PORTFOLIO INFORMATION

For the period ended December 31, 2006, the cost of purchases and proceeds from sales of securities, excluding short-term obligations, were \$1,317,754,996 and \$381,326,418, respectively.

NOTE 6. SENIOR LOAN PARTICIPATION COMMITMENTS

The Fund may invest its assets (plus any borrowings for investment purposes) in adjustable rate senior loans ("Senior Loans") the interest rates of which float or vary periodically based upon a benchmark indicator of prevailing interest rates to domestic or foreign corporations, partnerships and other entities ("Borrowers"). If the lead lender in a typical lending syndicate becomes insolvent, enters FDIC receivership or, if not FDIC, insured enters into bankruptcy, the Fund may incur certain costs and delays in receiving payment or may suffer a loss of principal and/or interest. When the Fund purchases a participation of a Senior Loan interest, the Fund typically enters into a contractual agreement with the lender or other third party selling the participation (the "Selling Participant"), not with the Borrower directly. As such, the Fund assumes the credit risk of the Borrower, Selling Participant or other persons interpositioned between the Fund and the Borrower. The ability of Borrowers to meet their obligations may be affected by eco-

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

DECEMBER 31, 2006

HIGHLAND CREDIT STRATEGIES FUND

conomic developments in a specific industry. At December 31, 2006, there were no Senior Loans purchased by the Fund on a participation basis.

NOTE 7. LOAN AGREEMENT

Effective August 3, 2006, the Fund entered into a \$300,000,000 secured loan agreement with Scotia Capital ("Scotia").

At December 31, 2006, the Fund had a term loan outstanding with Scotia, totaling \$285,000,000. The interest rate charged on this loan at December 31, 2006 was 5.37%. The average daily loan balance was \$183,771,186 at weighted average interest rate of 5.34%. The Fund was required to maintain certain asset coverage with respect to the loan. Interest expense of \$3,436,058 is included on the Statement of Operations.

The Fund is required to maintain 300% asset coverage with respect to amounts outstanding under the agreement. The loan agreement asset coverage is calculated by subtracting the Fund's total liabilities, not including any bank loans and senior securities, from the Fund's total net assets and dividing such amount by the principal amount of the debt outstanding and is as follows:

Date	Total Amount Outstanding	Asset Coverage per \$1,000 of Indebtness
12/31/2006	\$285,000,000	\$3,429

NOTE 8. SECURITIES LOANS

The Fund may make secured loans of its portfolio securities amounting to not more than one-third of the value of its total assets, thereby realizing additional income. The risks in lending portfolio securities, as with other extensions of credit, consist of possible delays in recovery of the securities or possible loss of rights in the collateral should the borrower fail financially. As a matter of policy, securities loans are made to unaffiliated broker-dealers pursuant to agreements requiring that loans be continuously secured by collateral in cash or short-term debt obligations at least equal at all times to the value of the securities subject to the loan. The borrower pays to the Fund an amount equal to any interest or dividends received on securities subject to the loan. The Fund retains all or a portion of the interest received on investment of the cash collateral or receives a fee from the borrower. As of December 31, 2006, the value of securities loaned by the Fund was \$2,793,238. The loans were secured with cash collateral of \$2,861,357.

9. UNFUNDED LOAN COMMITMENTS

As of December 31, 2006, the Fund had unfunded loan commitments of \$11,326,092, which could be extended at the option of the borrower, pursuant to the following loan agreements:

Borrower	Unfunded Loan Commitment
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Ammsterdamse Beheer - En

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Consultingmaatschappu BV (Cassena)	\$ 6,500,000
Drake Hotel Acquisition	1,309,386
Ferro Corp.	1,111,111
Millennium Digial Media Systems, LLC	1,238,322
Oglebay Norton Co.	400,000
Persona Communications Corp.	767,273

	\$ 11,326,092
	=====

NOTE 10. DISCLOSURE OF SIGNIFICANT RISKS AND CONTINGENCIES

INDUSTRY FOCUS

The Fund may focus its investments in instruments of only a few companies. The concentration of the Fund's portfolio in any one obligor would subject the Fund to a greater degree of risk with respect to defaults by such obligor, and the concentration of the portfolio in any one industry would subject the Fund to a greater degree of risk with respect to economic downturns relating to such industry.

NON-PAYMENT RISK

Corporate debt obligations, including Senior Loans, are subject to the risk of non-payment of scheduled interest and/or principal. Non-payment would result in a reduction of income to the Fund, a reduction in the value of the Senior Loan experiencing non-payment, and a potential decrease in the net asset value of the Fund.

CREDIT RISK

Investments rated below investment grade are commonly referred to as high-yield, high risk or "junk debt." They are regarded as predominantly speculative with respect to the issuing company's continuing ability to meet principal and/or interest payments. Investments in high yield Senior Loans may result in greater net asset value fluctuation than if the Fund did not make such investments.

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NOTES TO FINANCIAL STATEMENTS (CONTINUED)

DECEMBER 31, 2006

HIGHLAND CREDIT STRATEGIES FUND

ILLIQUIDITY OF INVESTMENTS

The investments made by the Fund may be illiquid, and consequently the Fund may not be able to sell such investments at prices that reflect the Investment Adviser's assessment of their value or the amount originally paid for such investments by the Fund. Illiquidity may result from the absence of an established market for the investments as well as legal, contractual or other restrictions on their resale and other factors. Furthermore, the nature of the Fund's investments, especially those in financially distressed companies, may require a long holding period prior to profitability.

TROUBLED, DISTRESSED OR BANKRUPT COMPANIES

The Fund invests in companies that are troubled, in distress, or bankrupt. As such, they are subject to a multitude of legal, industry, market, environment and governmental forces that make analysis of these companies inherently risky. Further, the Investment Adviser relies on company management, outside experts, market participants, and personal experience to analyze potential investments for the Fund. There can be no assurance that any of these sources will prove credible, or that the resulting analysis will produce accurate conclusions.

LEVERAGE RISK

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The Fund intends to use leverage through the issuance of preferred shares, borrowings from a credit facility, or both. The use of leverage, which can be described as exposure to changes in price at a ratio greater than the amount of equity invested, either through the issuance of preferred shares, borrowing or other forms of market exposure, magnifies both the favorable and unfavorable effects of price movements in the investments made by the Fund. Insofar as the Fund employs leverage in its investment operations, the Fund will be subject to substantial risks of loss.

FOREIGN SECURITIES

Investments in foreign securities involve certain factors not typically associated with investing in U.S. securities, such as risks relating to (i) currency exchange matters, including fluctuations in the rate of exchange between the U.S. dollar (the currency in which the books of the Fund are maintained) and the various foreign currencies in which the Fund's portfolio securities will be denominated and costs associated with conversion of investment principal and income from one currency into another; (ii) differences between the U.S. and foreign securities markets, including the absence of uniform accounting, auditing and financial reporting standards and practices and disclosure requirements, and less government supervision and regulation; (iii) political, social or economic instability; and (iv) the extension of credit, especially in the case of sovereign debt.

EMERGING MARKETS RISK

Investing in securities of issuers based in underdeveloped emerging markets entails all of the risks of investing in foreign securities to a heightened degree. These heightened risks include: (i) greater risks of expropriation, confiscatory taxation, nationalization, and less social political and economic stability; (ii) the smaller size of the markets for such securities and a lower volume of trading, resulting in lack of liquidity and in price volatility; and (iii) certain national policies which may restrict the Fund's investment opportunities including restrictions on investing in issuers or industries deemed sensitive to relevant national interest.

DERIVATIVES RISK

Derivative transactions in which the Fund may engage for hedging and speculative purposes or to enhance total return, including engaging in transactions such as options, futures, swaps, foreign currency transactions including forward foreign currency contracts, currency swaps or options on currency and currency futures and other derivative transactions, involve certain risks and considerations. These risks include the imperfect correlation between the value of such instruments and the underlying assets, the possible default of the other party to the transaction or illiquidity of the derivative instruments. Furthermore, the ability to successfully use derivative transactions depends on the Investment Adviser's ability to predict pertinent market movements, which can not be assured. Thus, the use of derivative transactions may result in losses greater than if they had not been used, may require the Fund to sell or purchase portfolio securities at inopportune times or for prices other than current market value, may limit the amount of appreciation the Fund can realize on an investment or may cause the Fund to hold a security that it might otherwise sell.

SHORT SALES RISK

Short selling involves selling securities which may or may not be owned and borrowing the same securities for delivery to the purchaser, with an obligation to replace the borrowed securities at a later date. The Fund will profit from declines in the market prices to the extent such decline exceeds the transaction costs and the costs of borrowing the securities. However, since the borrowed securities must be replaced by purchases at market prices in order to close out the short position, any appreciation in the price of the borrowed securities would result in a loss. There can be no assurance that the securities necessary to cover a short position will be available for purchase.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

TO THE BOARD OF TRUSTEES AND SHAREHOLDERS OF HIGHLAND CREDIT STRATEGIES FUND:

In our opinion, the accompanying statement of assets and liabilities, including the investment portfolio, and the related statements of operations and of changes in net assets and of cash flows and the financial highlights present fairly, in all material respects, the financial position of Highland Credit Strategies Fund (the "Fund") at December 31, 2006, and the results of its operations, the changes in its net assets and cash flows and the financial highlights for the period from June 29, 2006 (commencement of operations) through December 31, 2006 in conformity with accounting principles generally accepted in the United States of America. These financial statements and financial highlights (hereafter referred to as "financial statements") are the responsibility of the Fund's management; our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit of these financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit, which included confirmation of investments at December 31, 2006 by correspondence with the custodian and the banks with whom the Fund owns participations in loans, provides a reasonable basis for our opinion.

PricewaterhouseCoopers LLP
Dallas, Texas
February 26, 2007

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ADDITIONAL INFORMATION (UNAUDITED)

DIVIDEND REINVESTMENT PLAN

HIGHLAND CREDIT STRATEGIES FUND

Unless the registered owner of Common Shares elects to receive cash by contacting the Plan Agent, all dividends declared for your Common Shares of the Trust will be automatically reinvested by PFPC, Inc. (the "Plan Agent"), agent for shareholders in administering the Trust's Dividend Reinvestment Plan (the "Plan"), in additional Common Shares of the Trust. If a registered owner of Common Shares elects not to participate in the Plan, you will receive all dividends in cash paid by check mailed directly to you (or, if the shares are held in street or other nominee name, then to such nominee) by PFPC, Inc., as dividend disbursing agent. You may elect not to participate in the Plan and to receive all dividends in cash by sending written instructions or by contacting PFPC, Inc., as dividend disbursing agent, at the address set forth below. Participation in the Plan is completely voluntary and may be terminated or resumed at any time without penalty by contacting the Plan Agent before the dividend record date; otherwise such termination or resumption will be effective with respect to any subsequently declared dividend or other distribution. Some

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brokers may automatically elect to receive cash on your behalf and may re-invest that cash in additional Common Shares of the Trust for you.

The Plan Agent will open an account for each common shareholder under the Plan in the same name in which such Common Shareholder's Common Shares are registered. Whenever the Trust declares a dividend or other distribution (together, a "dividend") payable in cash, non-participants in the Plan will receive cash and participants in the Plan will receive the equivalent in Common Shares. The Common Shares will be acquired by the Plan Agent for the participants' accounts, depending upon the circumstances described below, either (i) through receipt of additional unissued but authorized Common Shares from the Trust ("newly issued Common Shares") or (ii) by purchase of outstanding Common Shares on the open market ("open-market purchases") on the New York Stock Exchange or elsewhere.

If, on the payment date for any dividend, the market price per Common Share plus estimated brokerage commissions is greater than the net asset value per Common Share (such condition being referred to herein as "market premium"), the Plan Agent will invest the dividend amount in newly issued Common Shares, including fractions, on behalf of the participants. The number of newly issued Common Shares to be credited to each participant's account will be determined by dividing the dollar amount of the dividend by the net asset value per Common Share on the payment date; provided that, if the net asset value per Common Share is less than 95% of the market price per Common Share on the payment date, the dollar amount of the dividend will be divided by 95% of the market price per Common Share on the payment date.

If, on the payment date for any dividend, the net asset value per Common Share is greater than the market value per Common Share plus estimated brokerage commissions (such condition being referred to herein as "market discount"), the Plan Agent will invest the dividend amount in Common Shares acquired on behalf of the participants in open-market purchases.

In the event of a market discount on the payment date for any dividend, the Plan Agent will have until the last business day before the next date on which the Common Shares trade on an "ex-dividend" basis or 120 days after the payment date for such dividend, whichever is sooner (the "last purchase date"), to invest the dividend amount in Common Shares acquired in open-market purchases. It is contemplated that the Trust will pay monthly dividends. Therefore, the period during which open-market purchases can be made will exist only from the payment date of each dividend through the date before the "ex-dividend" date of the third month of the quarter. If, before the Plan Agent has completed its open-market purchases, the market price of a Common Share exceeds the net asset value per Common Share, the average per Common Share purchase price paid by the Plan Agent may exceed the net asset value of the Common Shares, resulting in the acquisition of fewer Common Shares than if the dividend had been paid in newly issued Common Shares on the dividend payment date. Because of the foregoing difficulty with respect to open market purchases, if the Plan Agent is unable to invest the full dividend amount in open market purchases during the purchase period or if the market discount shifts to a market premium during the purchase period, the Plan Agent may cease making open-market purchases and may invest the uninvested portion of the dividend amount in newly issued Common Shares at the net asset value per Common Share at the close of business on the last purchase date; provided that, if the net asset value per Common Share is less than 95% of the market price per Common Share on the payment date, the dollar amount of the dividend will be divided by 95% of the market price per Common Share on the payment date.

The Plan Agent maintains all shareholders' accounts in the Plan and furnishes written confirmation of all transactions in the accounts, including information needed by shareholders for tax records. Common Shares in the account of each Plan participant will be held by the Plan Agent on behalf of the Plan

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participant, and each shareholder proxy will include those shares purchased or received pursuant to the Plan. The Plan Agent will forward all proxy solicitation materials to participants and vote proxies for shares held under the Plan in accordance with the instructions of the participants.

In the case of shareholders such as banks, brokers or nominees which hold shares for others who are the beneficial owners, the Plan Agent will administer the Plan on the basis of the number of Common Shares certified from time to time by the record shareholder's name and held for the account of beneficial owners who participate in the Plan.

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ADDITIONAL INFORMATION (UNAUDITED) (CONTINUED)

DIVIDEND REINVESTMENT PLAN (CONTINUED)

HIGHLAND CREDIT STRATEGIES FUND

There will be no brokerage charges with respect to Common Shares issued directly by the Trust. However, each participant will pay a pro rata share of brokerage commissions incurred in connection with open-market purchases. The automatic reinvestment of dividends will not relieve participants of any federal, state or local income tax that may be payable (or required to be withheld) on such dividends. Accordingly, any taxable dividend received by a participant that is reinvested in additional Common Shares will be subject to federal (and possibly state and local) income tax even though such participant will not receive a corresponding amount of cash with which to pay such taxes. See "Tax Matters." Participants who request a sale of shares through the Plan Agent are subject to a \$2.50 sales fee and pay a brokerage commission of \$0.05 per share sold.

The Trust reserves the right to amend or terminate the Plan. There is no direct service charge to participants in the Plan; however, the Trust reserves the right to amend the Plan to include a service charge payable by the participants.

All correspondence concerning the Plan should be directed to the Plan Agent at PFPC, Inc., 301 Bellevue Parkway, Wilmington, Delaware 19809; telephone (877) 665-1287.

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ADDITIONAL INFORMATION (UNAUDITED) (CONTINUED)

FEBRUARY 26, 2007

HIGHLAND CREDIT STRATEGIES FUND

TRUSTEES AND OFFICERS

The Trustees and officers serve terms of indefinite duration. The names and ages of the Trustees and officers of the Fund, the year each was first elected or appointed to office, their principal business occupations during at least the last five years, the number of portfolios overseen by each Trustee and other directorships they hold are shown below. Each officer listed below serves as an officer of each Fund in the Highland Fund Complex. The business address of the Trustees and officers is c/o Highland Capital Management, L.P. Two Galleria Tower, 13455 Noel Road, Suite 800, Dallas, TX 75240.

YEAR FIRST

PRINCIPAL

NUMBER

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NAME AND AGE	POSITION WITH FUND	ELECTED OR APPOINTED TO OFFICE 1	OCCUPATION(S) DURING PAST FIVE YEARS	IN COMP BY
INDEPENDENT TRUSTEES				
Timothy K. Hui (Age 58)	Trustee	2006	Dean of Educational Resources since July 2006; Assistant Provost for Graduate Education since July 2004; Assistant Provost for Educational Resources, July 2001 to June 2004, Philadelphia Biblical University.	
Scott F. Kavanaugh (Age 46)	Trustee	2006	Private Investor since February 2004; Sales Representative at Round Hill Securities, March 2003 to January 2004; Executive at Provident Funding Mortgage Corporation, February 2003 to July 2003; Executive Vice President, Director and Treasurer, Commercial Capital Bank, January 2000 to February 2003; Managing Principal and Chief Operating Officer, Financial Institutional Partners Mortgage Company and the Managing Principal and President of Financial Institutional Partners, LLC (an investment banking firm), April 1998 to February 2003.	
James F. Leary (Age 76)	Trustee	2006	Managing Director, Benefit Capital Southwest, Inc. (a financial consulting firm) since January 1999.	
Bryan A. Ward (Age 52)	Trustee	2006	Senior Manager, Accenture, LLP (a consulting firm) since January 2002.	

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ADDITIONAL INFORMATION (UNAUDITED) (CONTINUED)

FEBRUARY 26, 2007

HIGHLAND CREDIT STRATEGIES FUND

TRUSTEES AND OFFICERS

POSITION	YEAR FIRST ELECTED OR APPOINTED	PRINCIPAL OCCUPATION(S) DURING PAST	NUMBER IN COMP
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NAME AND AGE	WITH FUND	TO OFFICE 1	FIVE YEARS	BY
INTERESTED TRUSTEE 3				
R. Joseph Dougherty (Age 36)	Trustee and Chairman of the Board	2006	Senior Portfolio Manager of the Investment Adviser since 2000. Trustee and Senior Vice President of the funds in the Highland Fund Complex.	
OFFICERS 4				
James D. Dondero (Age 44)	Chief Executive Officer and President	2006	President and Director of Strand Advisors, Inc., ("Strand") the General Partner of the Investment Adviser. President of the funds in the Highland Fund Complex.	
R. Joseph Dougherty (Age 36)	Senior Vice President	2006	Senior Portfolio Manager of the Investment Adviser since 2000.	
Mark Okada (Age 44)	Executive Vice President	2006	Executive Vice President of Strand and the funds in the Highland Fund Complex; Chief Investment Officer of the Investment Adviser.	
M. Jason Blackburn (Age 30)	Chief Financial Officer (Principal Accounting Officer), Treasurer and Secretary	2006	Assistant Controller of the Investment Adviser since November 2001. Treasurer and Secretary of the funds in the Highland Fund Complex.	
Michael S. Mincez (Age 32)	Chief Compliance Officer	2006	Chief Compliance Officer of the Investment Adviser and the funds in the Highland Fund Complex since August 2004; Associate, Akin Gump Strauss Hauer & Feld LLP (law firm), October 2003 to August 2004; Associate, Skadden, Arps, Slate, Meagher & Flom LLP (law firm), October 2000 to March 2003.	

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IMPORTANT INFORMATION ABOUT THIS REPORT

TRANSFER AGENT
PFPC Inc.
101 Sabin Street
Pawtucket, RI 02860

INVESTMENT ADVISER
Highland Capital Management, L.P.

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13455 Noel Road, Suite 800
Dallas, TX 75240

INDEPENDENT REGISTERED PUBLIC
ACCOUNTING FIRM
PricewaterhouseCoopers LLP
2001 Rose Avenue, Suite 1800
Dallas, TX 75201

CUSTODIAN
PFPC Trust Company
8800 Tinicum Boulevard
Philadelphia, PA 19153

The Fund mails one shareholder report to each shareholder address. If you would like more than one report, please call shareholder services at 1-877-665-1287 and additional reports will be sent to you.

This report has been prepared for shareholders of Highland Credit Strategies Fund.

A description of the policies and procedures that the Fund uses to determine how to vote proxies relating to its portfolio securities, and the Fund's proxy voting record for the most recent 12-month period ended June 30, are available (i) without charge, upon request, by calling 1-877-665-1287 and (ii) on the Securities and Exchange Commission's website at <http://www.sec.gov>.

The Fund files its complete schedule of portfolio holdings with the Securities and Exchange Commission for the first and third quarters of each fiscal year on Form N-Q. The Fund's Forms N-Q are available on the Commission's website at <http://www.sec.gov> and also may be reviewed and copied at the Commission's Public Reference Room in Washington, DC. Information on the Public Reference Room may be obtained by calling 1-800-SEC-0330.

The Statement of Additional Information includes additional information about the Fund's Trustees and is available upon request without charge by calling 1-877-665-1287.

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HIGHLAND CREDIT STRATEGIES FUND - HCF

Annual Report - December 31, 2006

[GRAPHIC OMITTED - SHIELD]
HIGHLAND FUNDS
managed by Highland Capital Management, L.P.

www.highlandfunds.com

HLC-HCF AR-12/06

ITEM 2. CODE OF ETHICS.

- (a) The registrant, as of the end of the period covered by this report, has adopted a code of ethics that applies to the registrant's principal

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executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions, regardless of whether these individuals are employed by the registrant or a third party.

(b) Not applicable.

(c) There have been no amendments, during the period covered by this report, to a provision of the code of ethics that applies to the registrant's principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions, regardless of whether these individuals are employed by the registrant or a third party, and that relates to any element of the code of ethics description.

(d) The registrant has not granted any waivers, including an implicit waiver, from a provision of the code of ethics that applies to the registrant's principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions, regardless of whether these individuals are employed by the registrant or a third party, that relates to one or more of the items set forth in paragraph (b) of this item's instructions.

(e) Not applicable.

(f) Code of ethics filed herewith.

ITEM 3. AUDIT COMMITTEE FINANCIAL EXPERT.

As of the end of the period covered by the report, the registrant's board of trustees has determined that James Leary is qualified to serve as an audit committee financial expert serving on its audit committee and that he is "independent," as defined by Item 3 of Form N-CSR.

ITEM 4. PRINCIPAL ACCOUNTANT FEES AND SERVICES.

AUDIT FEES

(a) The aggregate fees billed from the Registrant's inception on June 29, 2006 through December 31, 2006 for professional services rendered by

the principal accountant for the audit of the registrant's annual financial statements or services that are normally provided by the accountant in connection with statutory and regulatory filings or engagements was \$42,000.

AUDIT-RELATED FEES

(b) The aggregate fees billed from the Registrant's inception on June 29, 2006 through December 31, 2006 for assurance and related services by the principal accountant that are reasonably related to the performance of the audit of the registrant's financial statements and are not reported under paragraph (a) of this Item was \$5,500. These services consisted of a review of semi-annual regulatory filing.

TAX FEES

(c) The aggregate fees billed from the Registrant's inception on June 29, 2006 through December 31, 2006 for professional services rendered by the principal accountant for tax compliance, tax advice, and tax

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planning was \$5,000. These services consisted of (i) review and/or preparation of U.S. federal, state, local and excise tax returns; and (ii) U.S. federal, state and local tax planning, advice and assistance regarding statutory, regulatory or administrative developments.

ALL OTHER FEES

(d) The aggregate fees billed from the Registrant's inception on June 29, 2006 through December 31, 2006 for products and services provided by the principal accountant, other than the services reported in paragraphs (a) through (c) of this Item was \$0.

(e) (1) Disclose the audit committee's pre-approval policies and procedures described in paragraph (c) (7) of Rule 2-01 of Regulation S-X.

The Audit Committee shall:

(a) have direct responsibility for the appointment, compensation, retention and oversight of the Fund's independent auditors and, in connection therewith, to review and evaluate matters potentially affecting the independence and capabilities of the auditors; and

(b) review and pre-approve (including associated fees) all audit and other services to be provided by the independent auditors to the Fund and all non-audit services to be provided by the independent auditors to the Fund's investment adviser or any entity controlling, controlled by or under common control with the investment adviser (an "Adviser Affiliate") that provides ongoing services to the Fund, if the engagement relates directly to the operations and financial reporting of the Fund; and

(c) establish, to the extent permitted by law and deemed appropriate by the Audit Committee, detailed pre-approval policies and procedures for such services; and

(d) consider whether the independent auditors' provision of any non-audit services to the Fund, the Fund's investment adviser or an Adviser Affiliate not pre-approved by the Audit Committee are compatible with maintaining the independence of the independent auditors.

(e) (2) The percentage of services described in each of paragraphs (b) through (d) of this Item that were approved by the audit committee pursuant to paragraph (c) (7) (i) (C) of Rule 2-01 of Regulation S-X are as follows:

(b) 100%

(c) 100%

(d) N/A

(f) The percentage of hours expended on the principal accountant's engagement to audit the registrant's financial statements for the most recent fiscal year that were attributed to work performed by persons other than the principal accountant's full-time, permanent employees was less than fifty percent.

(g) The aggregate non-audit fees billed by the registrant's accountant for services rendered to the registrant, and rendered to the registrant's

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investment adviser (not including any sub-adviser whose role is primarily portfolio management and is subcontracted with or overseen by another investment adviser), and any entity controlling, controlled by, or under common control with the adviser that provides ongoing services to the registrant for each of the last two fiscal years of the registrant was \$200,000.

- (h) The registrant's audit committee of the board of directors has considered whether the provision of non-audit services that were rendered to the registrant's investment adviser (not including any sub-adviser whose role is primarily portfolio management and is subcontracted with or overseen by another investment adviser), and any entity controlling, controlled by, or under common control with the investment adviser that provides ongoing services to the registrant that were not pre-approved pursuant to paragraph (c)(7)(ii) of Rule 2-01 of Regulation S-X is compatible with maintaining the principal accountant's independence.

ITEM 5. AUDIT COMMITTEE OF LISTED REGISTRANTS.

The Registrant has a separately-designated standing audit committee established in accordance with Section 3(a)(58)(A) of the Securities Exchange Act of 1934, as amended. It is composed of the following Directors, each of who is not an "interested person" as defined in the 1940 Act:

Timothy K. Hui
Scott F. Kavanaugh
James F. Leary
Bryan A. Ward

ITEM 6. SCHEDULE OF INVESTMENTS.

Schedule of Investments in securities of unaffiliated issuers as of the close of the reporting period is included as part of the report to shareholders filed under Item 1 of this form.

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

The Proxy Voting Policies are attached herewith.

Highland Capital Management, L.P. (the "Adviser") has adopted proxy voting guidelines (the "Guidelines") that provide as follows:

- o The Adviser votes proxies in respect of a client's securities in the client's best economic interests and without regard to the interests of the Adviser or any other client of the Adviser.
- o Unless the Adviser otherwise determines (and documents the basis for its decision) or as otherwise provided below, the Adviser votes proxies in a manner consistent with the Guidelines.
- o To avoid material conflicts of interest, the Adviser applies the Guidelines in an objective and consistent manner across client accounts. Where a material conflict of interest has been identified and the matter is covered by the Guidelines, the Adviser votes in accordance with the Guidelines. For clients that are registered investment companies, where a conflict of interest has been identified and the matter is not covered in the Guidelines, the Adviser will

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disclose the conflict and the determination of the manner in which to vote to the Fund's Board. For clients that are not investment companies, where a conflict of interest has been identified and the matter is not covered in the Guidelines, the Adviser will disclose the conflict to the client and advise the client that its securities will be voted only upon the client's written direction.

- o The Adviser also may determine not to vote proxies in respect of securities of any issuer if it determines it would be in its clients' overall best interests not to vote.

The Adviser's Guidelines address how it will vote proxies on particular types of matters such as changes in corporate government structures, adoption of options plans and anti-takeover proposals. For example, the Adviser generally will:

- o support management in most elections for directors, unless the board gives evidence of acting contrary to the best economic interests of shareholders;
- o support option plans, if it believes that they provide for their administration by disinterested parties and provide incentive to directors, managers and other employees by aligning their economic interests with those of the shareholders while limiting the transfer of wealth out of the company; and
- o oppose anti-takeover proposals unless they are structured in such a way that they give shareholders the ultimate decision on any proposal or offer.

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

(A)(1) IDENTIFICATION OF PORTFOLIO MANAGER(S) OR MANAGEMENT TEAM MEMBERS AND DESCRIPTION OF ROLE OF PORTFOLIO MANAGER(S) OR MANAGEMENT TEAM MEMBERS

The Fund's portfolio is managed by a portfolio management team. As of the date of this filing, the members of the team who are primarily responsible for the day-to-day management of the Fund's portfolio are Kurtis S. Plumer, James Dondero, Mark Okada and Patrick H. Daugherty.

KURTIS S. PLUMER, CFA - Mr. Plumer is a Partner and Senior Portfolio Manager at Highland Capital Management, L.P. ("Highland"), covering the Energy and Food sectors. Prior to joining Highland in July 1999, Mr. Plumer was a distressed high yield bond trader at Lehman Brothers in New York, where he managed a \$250

million portfolio invested in global distressed securities. While at Lehman, he also traded emerging market sovereign bonds. Prior to joining Lehman Brothers, Mr. Plumer was a corporate finance banker at NationsBanc Capital Markets, Inc. (now Bank of America Capital Markets, Inc.) where he focused on M&A and financing transactions for the bank's clients. Mr. Plumer has over 14 years of experience in distressed, high yield bond and leveraged loan products. Mr. Plumer earned a BBA in Economics and Finance from Baylor University and an MBA in Strategy and Finance from the Kellogg School at Northwestern University. Mr. Plumer has earned the right to use the Chartered Financial Analyst designation.

JAMES DONDERO, CA, CPA, CMA - Mr. Dondero is a founder and President of Highland Capital Management, L.P. ("Highland") and has served as President. Mr. Dondero is a founder and President of Highland and has served as President since 1993. Mr. Dondero is also President of the funds in the Highland Fund Complex.

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Formerly, Mr. Dondero served as Chief Investment Officer of Protective Life's GIC subsidiary and helped grow the business from concept to over \$2 billion between 1989 and 1993. His portfolio management experience includes investments in mortgage-backed securities, investment grade corporate bonds, leveraged bank loans, emerging markets, derivatives, preferred stocks and common stocks. From 1985 to 1989, he managed approximately \$1 billion in fixed income funds for American Express. Prior to American Express, he completed his financial training at Morgan Guaranty Trust Company. Mr. Dondero is a Beta Gamma Sigma graduate of the University of Virginia, 1984 with degrees in Accounting and Finance. Mr. Dondero is a Certified Public Accountant, Chartered Financial Analyst and a Certified Management Accountant

MARK OKADA, CFA - Mr. Okada is a Founder and Chief Investment Officer at Highland Capital Management, L.P. ("Highland"). He is responsible for overseeing Highland's investment activities for its various funds and has over 19 years of experience in the leveraged finance market. Before joining the Highland, Mr. Okada served as Manager of Fixed Income for Protective Life's GIC subsidiary from 1990 to 1993. He was primarily responsible for the bank loan portfolio and other risk assets. Protective was one of the first non-bank entrants into the syndicated loan market. From 1986 to 1990, he served as Vice President for Hibernia National Bank, managing over U.S.\$1 billion of high yield bank loans. Mr. Okada is an honours graduate of the University of California Los Angeles with degrees in Economics and Psychology. He completed his credit training at Mitsui and has earned the right to use the Chartered Financial Analyst designation. Mr. Okada is also Chairman of the Board of Directors of Common Grace Ministries Inc.

PATRICK H. DAUGHERTY - Mr. Daugherty is a Partner at Highland and is Head of Special Situations Investments. His responsibilities include managing the Distressed Investments Group and co-managing the Private Equity Investments Group. He has formerly served as General Counsel to Highland. Prior to joining Highland in April 1998, Mr. Daugherty served as Vice President in the Corporate Finance Group at Bank of America Capital Markets, Inc (formerly NationsBanc Capital Markets, Inc.) where he originated and structured leveraged transactions of mid-cap companies located in the Southwest. Prior to joining Bank of America, Mr. Daugherty was an Associate with the law firm of Baker, Brown, Sharman and Parker in Houston, Texas where he worked with banks and financial institutions in the liquidation of various RTC portfolios. Mr. Daugherty has over 15 years of experience in distressed, high yield and corporate restructuring. He has been involved in over 100 restructurings and held steering committee positions in over 40 bankruptcies. Mr. Daugherty currently serves on the Board of Directors of Trussway Holdings, Inc. and its affiliates (as Chairman), Home Interiors & Gifts, Inc. and its affiliates (as Chairman), Nexpak Corporation and its affiliates (as Chairman), Moll Industries and its affiliates (as Chairman), and is a former board member of Norse Merchant Group and its affiliates, Ferrimorac Holdings Limited and Mariner Health Care, Inc. He received a BBA in Finance from The University of Texas at Austin and a Juris Doctorate from The University of Houston School of Law. Mr. Daugherty's professional certifications include membership in the Texas Bar Association and admittance to the American Bar Association in 1992.

(A) (2) OTHER ACCOUNTS MANAGED BY PORTFOLIO MANAGER(S) OR MANAGEMENT TEAM MEMBER AND POTENTIAL CONFLICTS OF INTEREST

OTHER ACCOUNTS MANAGED BY PORTFOLIO MANAGER(S) OR MANAGEMENT TEAM MEMBER

The following tables provide information about funds and accounts, other than the Fund, for which the Fund's portfolio managers are primarily responsible for the day-to-day portfolio management as of December 31, 2006.

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KURTIS S. PLUMER

Type of Accounts	Total # of Accounts Managed	Total Assets (millions)	# of Accounts Managed with Performance-Based Advisory Fee	Total Ass Performan Advisory Fee
Registered Investment Companies:	2	\$1,079	1	\$7
Other Pooled Investment Vehicles:	5	\$1,618	3	\$1,0
Other Accounts:	0	\$0	0	\$0

JAMES DONDERO

Type of Accounts	Total # of Accounts Managed	Total Assets (millions)	# of Accounts Managed with Performance-Based Advisory Fee	Total A Perform Advisory F
Registered Investment Companies:	3	\$1,084	1	
Other Pooled Investment Vehicles:	10	\$4,095	9	\$4
Other Accounts:	0	\$0	0	

MARK OKADA

Type of Accounts	Total # of Accounts Managed	Total Assets (millions)	# of Accounts Managed with Performance-Based Advisory Fee	Total As Performa Advisory Fe
Registered Investment Companies:	11	\$7,714	0	\$
Other Pooled Investment Vehicles:	28	\$16,580	22	\$14
Other Accounts:	0	\$0	0	\$

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PATRICK H. DAUGHERTY

Type of Accounts	Total # of Accounts Managed	Total Assets (millions)	# of Accounts Managed with Performance-Based Advisory Fee	Total A Perform Advisory F
Registered Investment Companies:	2	\$1,079	1	
Other Pooled Investment Vehicles:	4	\$3,011	2	\$2
Other Accounts:	0	\$0	0	

POTENTIAL CONFLICTS OF INTERESTS

The Adviser has built a professional working environment, a firm-wide compliance culture and compliance procedures and systems designed to protect against potential incentives that may favor one account over another. Highland has adopted policies and procedures that address the allocation of investment opportunities, execution of portfolio transactions, personal trading by employees and other potential conflicts of interest that are designed to ensure that all client accounts are treated equitably over time. Nevertheless, the Adviser furnishes advisory services to numerous clients in addition to the Fund, and the Adviser may, consistent with applicable law, make investment recommendations to other clients or accounts (including accounts that are hedge funds or have performance or higher fees paid to the Adviser or in which portfolio managers have a personal interest in the receipt of such fees) that may be the same as or different from those made to the Fund. In addition, the Adviser, its affiliates and any of their partners, directors, officers, stockholders or employees may or may not have an interest in the securities whose purchase and sale the Adviser recommends to the Fund. Actions with respect to securities of the same kind may be the same as or different from the action that the Adviser, or any of its affiliates, or any of their partners, directors, officers, stockholders or employees or any member of their families may take with respect to the same securities. Moreover, the Adviser may refrain from rendering any advice or services concerning securities of companies of which any of the Adviser's (or its affiliates') partners, directors, officers or employees are directors or officers, or companies as to which the Adviser or any of its affiliates or the partners, directors, officers and employees of any of them has any substantial economic interest or possesses material non-public information. In addition to its various policies and procedures designed to address these issues, the Adviser includes disclosure regarding these matters to its clients in both its Form ADV and investment advisory agreements.

The Adviser, its affiliates or their partners, directors, officers and employees similarly serve or may similarly serve other entities that operate in the same or related lines of business. Accordingly, these individuals may have obligations to investors in those entities or funds or to other clients, the fulfillment of which might not be in the best interests of the Fund. As a

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result, the Adviser will face conflicts in the allocation of investment opportunities to the Fund and other funds and clients. In order to enable such affiliates to fulfill their fiduciary duties to each of the clients for which they have responsibility, the Adviser will endeavor to allocate investment opportunities in a fair and equitable manner which may, subject to applicable regulatory constraints, involve pro rata co-investment by the Fund and such other clients or may involve a rotation of opportunities among the Fund and such other clients.

While the Adviser does not believe there will be frequent conflicts of interest, if any, the Adviser and its affiliates have both subjective and objective procedures and policies in place designed to manage the potential conflicts of interest between the Adviser's fiduciary obligations to the Fund and their similar fiduciary obligations to other clients so that, for example, investment opportunities are allocated in a fair and equitable manner among the Fund and such other clients. An investment opportunity that is suitable for multiple clients of the Adviser and its affiliates may not be capable of being shared among some or all of such clients due to the limited scale of the opportunity or other factors, including regulatory restrictions imposed by the 1940 Act. There can be no assurance that the Adviser's or its affiliates' efforts to allocate any particular investment opportunity fairly among all clients for whom such opportunity is appropriate will result in an allocation of all or part of such opportunity to the Fund. Not all conflicts of interest can be expected to be resolved in favor of the Fund.

The Adviser expects to apply to the SEC for exemptive relief to enable the Fund and registered investment companies advised by the Adviser to co-invest with other accounts and funds managed by the Adviser and its affiliates in certain privately-placed securities and other situations. There are no assurances that the Adviser will receive the requested relief. If such relief is not obtained and until it is obtained, the Adviser may be required to allocate some investments solely to any of the Fund, a registered fund, or another account or fund advised by the Adviser or its affiliates. This restriction could preclude the Fund from investing in certain securities it would otherwise be interested in and could adversely affect the speed at which the Fund is able to invest its assets and, consequently, the performance of the Fund.

(A) (3) COMPENSATION STRUCTURE OF PORTFOLIO MANAGER(S) OR MANAGEMENT TEAM MEMBERS

Highland's financial arrangements with its portfolio managers, its competitive compensation and its career path emphasis at all levels reflect the value senior management places on key resources. Compensation may include a variety of components and may vary from year to year based on a number of factors including the relative performance of a portfolio managers underlying account, the combined performance of the portfolio managers underlying accounts, and the relative performance of the portfolio managers underlying accounts measured against other employees. The principal components of compensation include a base salary, a discretionary bonus, various retirement benefits and one or more of the incentive compensation programs established by Highland such as the Option It Plan and the Long-Term Incentive Plan.

BASE COMPENSATION. Generally, portfolio managers receive base compensation based on their seniority and/or their position with the firm, which may include the amount of assets supervised and other management roles within the firm.

DISCRETIONARY COMPENSATION. In addition to base compensation, portfolio managers may receive discretionary compensation, which can be a substantial portion of total compensation. Discretionary compensation can include a

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discretionary cash bonus as well as one or more of the following:

OPTION IT PLAN. The purpose of the Plan is to attract and retain the highest quality employees for positions of substantial responsibility, and to provide additional incentives to a select group of management or highly compensated employees of the Fund so as to promote the success of the Fund.

LONG TERM INCENTIVE PLAN. The purpose of the Plan is to create positive morale and teamwork, to attract and retain key talent, and to encourage the achievement of common goals. The Plan seeks to reward participating employees based on the increased value of Highland through the use of Long-term Incentive Units.

Senior portfolio managers who perform additional management functions may receive additional compensation in these other capacities. Compensation is structured such that key professionals benefit from remaining with the firm.

(A) (4) DISCLOSURE OF SECURITIES OWNERSHIP

The following table sets forth the dollar range of equity securities beneficially owned by each portfolio manager in the Fund as of December 31, 2006.

NAME OF PORTFOLIO MANAGER	DOLLAR RANGES OF EQUITY SECURITIES BENEFICIALLY OWNED BY PORTFOLIO MANAGER
Kurtis S. Plumer,	None
James Dondero	Over \$1,000,000
Mark Okada	None
Patrick H. Daugherty	None

(B) Not applicable.

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

REGISTRANT PURCHASES OF EQUITY SECURITIES

PERIOD	(A) TOTAL NUMBER OF SHARES (OR UNITS) PURCHASED	(B) AVERAGE PRICE PAID PER SHARE (OR UNIT)	(C) TOTAL NUMBER OF SHARES (OR UNITS) PURCHASED AS PART OF PUBLICLY ANNOUNCED PLANS OR PROGRAMS	(D) MAXIMUM NUMBER OF APPROXIMATE DOLLAR AMOUNTS OF SHARES (OR UNITS) YET TO BE PURCHASED UNDER SUCH PLANS OR PROGRAMS
July 1, 2006 to July 31, 2006	-	-	-	34,511,350

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August 1, 2006 to August 31, 2006	-	-	-	34,511,35
September 1, 2006 to September 30, 2006	1,505.332	\$19.27	1,505.332	34,511,35
October 1, 2006 to October 31, 2006	1,890.975	\$19.50	1,890.975	34,511,35
November 1, 2006 to November 30, 2006	1,157.746	\$19.88	1,157.746	34,511,35
December 1, 2006 to December 31, 2006	1,564.6468	\$20.10	1,564.6468	34,511,35
Total	6,118.6998	\$19.69	6,118.6998	34,511,35

Note: all purchases were made in the open market.

- a. The date each plan or program was announced: Purchases were made pursuant to an Automatic Dividend Reinvestment Plan that was last filed with the SEC on June 21, 2006.
- b. The dollar amount (or share or unit amount) approved : NONE
- c. The expiration date (if any) of each plan or program: NONE
- d. Each plan or program that has expired during the period covered by the table: NONE
- e. Each plan or program the registrant has determined to terminate prior to expiration, or under which the registrant does not intend to make further purchases.: NONE

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

There have been no material changes to the procedures by which the shareholders may recommend nominees to the registrant's board of directors, where those changes were implemented after the registrant last provided disclosure in response to the requirements of Item 407(c)(2)(iv) of Regulation S-K (17 CFR 229.407) (as required by Item 22(b)(15) of Schedule 14A (17 CFR 240.14a-101)), or this Item.

ITEM 11. CONTROLS AND PROCEDURES.

- (a) The registrant's principal executive and principal financial officers, or persons performing similar functions, have concluded that the registrant's disclosure controls and procedures (as defined in Rule 30a-3(c) under the Investment Company Act of 1940, as amended (the "1940 Act") (17 CFR 270.30a-3(c))) are effective, as of a date within 90 days of the filing date of the report that includes the disclosure required by this paragraph, based on their evaluation of these controls

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and procedures required by Rule 30a-3(b) under the 1940 Act (17 CFR 270.30a-3(b)) and Rules 13a-15(b) or 15d-15(b) under the Securities Exchange Act of 1934, as amended (17 CFR 240.13a-15(b) or 240.15d-15(b)).

(b) There were no changes in the registrant's internal control over financial reporting (as defined in Rule 30a-3(d) under the 1940 Act (17 CFR 270.30a-3(d)) that occurred during the registrant's second fiscal quarter of the period covered by this report that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.

ITEM 12. EXHIBITS.

- (a) (1) Code of ethics subject to disclosure required by Item 2 is attached hereto.
- (a) (2) Certifications pursuant to Rule 30a-2(a) under the 1940 Act and Section 302 of the Sarbanes-Oxley Act of 2002 are attached hereto.
- (a) (3) Not applicable.
- (b) Certifications pursuant to Rule 30a-2(b) under the 1940 Act and Section 906 of the Sarbanes-Oxley Act of 2002 are attached hereto.

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) HIGHLAND CREDIT STRATEGIES FUND

By (Signature and Title)* /S/ JAMES D. DONDERO

James D. Dondero, Chief Executive Officer
(principal executive officer)

Date MARCH 5, 2007

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

By (Signature and Title)* /S/ JAMES D. DONDERO

James D. Dondero, Chief Executive Officer
(principal executive officer)

Date MARCH 5, 2007

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By (Signature and Title)* /S/ M. JASON BLACKBURN

M. Jason Blackburn, Chief Financial Officer
(principal financial officer)

Date MARCH 5, 2007

* Print the name and title of each signing officer under his or her signature.