Month	BDC Fund II*	S&P 500 TR	NASDAQ Comp	Dow Jones	Russell 2000 (DRI)
FYE — 2009	4.37%	5.49%	6.91%	7.37%	3.49%
FYE — 2010	73.04%	15.07%	16.91%	11.02%	26.85%
FYE — 2011	-46.38%	2.11%	-1.80%	5.53%	-4.18%
January - 2012	14.08%	4.48%	8.01%	3.40%	7.07%
February - 2012	7.47%	4.32%	5.44%	2.53%	2.39%
March - 2012	-1.80%	3.29%	4.20%	2.01%	2.56%
April - 2012	0.29%	-0.63%	-1.46%	0.01%	-1.54%
May - 2012	-6.51%	-6.01%	-7.19%	-6.21%	-6.62%
June - 2012	3.90%	4.12%	3.81%	3.93%	4.99%
July - 2012	3.60%	1.39%	0.15%	1.00%	-1.38%
August - 2012	5.72%	2.25%	4.34%	0.63%	3.33%
September - 2012	2.79%	2.58%	1.61%	2.65%	3.28%
October - 2012	0.50%	-1.85%	-4.46	-2.54	-2.17%
Year to Date	32.68%	14.29%	14.28%	7.19%	11.75%
Inception to Date	28.49%	42.41%	40.28%	34.84%	41.09%

* Fund's inception was October 1, 2009. Performance shown is net of all fees & expenses including management & performance fees. Past performance is not necessarily indicative of future performance. This material does not constitute an offer to sell (nor the solicitation of an offer to buy) interests in BDC Fund II, LP (the "Fund"). Offering is made by Private Placement Memorandum from a Principal only. The indices included above are presented only to provide a general indication of U.S. Stock market performance for the periods indicated and not as a standard of comparison because they are unmanaged, broadly based indices.

OCTOBER 2012 RESULTS

The Fund was up for a fifth month in a row: 0.50%. We managed to beat the four general stock market indices we compare ourselves against. We were higher than the NASDAQ, the S&P 500, the Russell 2000 and the venerable Dow Jones. On the month, the S&P 500 was the best performer; down 1.85%.

Turning to the year-to-date, the Fund is up 32.68%. Here we are well ahead of the stock market indices, even though the stock market is having a “very good year.” The top stock index is the S&P 500, which is ahead 14.29% in 2012. The laggard of the group is the Dow Jones up “only” 7.19%.

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The Fund's Inception To Date of 32.68% still trails the market indices over the 36-month period, but we're gaining ground.

WHAT'S HAPPENING NOW

Our apologies for writing this Outlook section so late into the month. The Newsletter was held up initially by a computer glitch at the company that Partners Admin utilizes to calculate the Fund returns for the month. Then, we were absorbed by the fast moving markets. (More on that below). Anyway, this month we thought we'd explain the Fund Manager's long term and short term investing approach in the context of the highly volatile markets which followed the results of the Presidential election, and which are likely to continue for weeks or months.

FUNDAMENTALLY SPEAKING

We look at every investment, and every sector we own in two perspectives: fundamental and tactical. Fundamental analysis is the long hard slog of reading each company's SEC filings, earnings reports, Conference Calls etc., and projecting earnings and equity values under various potential scenarios to determine if an investment is likely to make us a profit or a loss over time.

The Manager's track record in this area has been very good, if we do say so ourselves. Back in the spring of 2009, as the Recession was just ending, we projected that the BDC sector, which had just seen dividends cut in half, was going to prosper in the years ahead and that existing BDCs (with a few exceptions) would maintain or increase their earnings & dividends, and that new companies would come into the market. One example will do as an illustration: back in June 2009 industry bellwether Ares Capital's Core Earnings Per Share were $0.33, NAV $11.21 and it's dividend $0.35. Today, earnings are up 27%, NAV up 40% and the dividend payout has increased by 23%. Of course, not every company is a winner, and our fundamental analysis has helped us over the years to divest ourselves of a number of troubled BDC investments where we saw the writing on the wall early (Apollo Investments, BlackRock Kelso and MCG Capital to name three examples mentioned in our Newsletters over our history).

Even during the Euro-crisis of the latter half of 2011, when BDC stock prices dropped 28%, our analysis showed that BDC company fundamentals remained unchanged, which we repeatedly mentioned in the Newsletter. In 2012, virtually every BDC has recorded higher earnings than last year, and maintained or increased their dividend payout. Likewise last year, we foresaw that the economics of Floating Rate Loans, High Yield bonds and BDC Notes were favorable, and broadened the Fund's scope to include these assets. Subsequently, all the newly added Leveraged Debt sectors have performed as our analysis suggested.

TACTICALLY SPEAKING

We also look at each investment, sector and the portfolio on a "tactical" level, which means we seek to divine what will happen to stock prices in the short term under various potential scenarios. Our principal concern is downward price volatility. Because we use $2 of leverage for every $1 of our equity, the Fund's short-term performance is highly vulnerable to downward swings in stock prices. There are two ways we can get hurt. First, if the market value of our portfolio drops sufficiently, the result could be a margin call, which would require selling assets at fire sale prices, and "realizing" losses, before the investment asset had the opportunity to achieving the value indicated in our fundamental analysis. Second, our monthly results are impacted by the decrease in asset values even if we don't sell, as we record Unrealized Losses on our income statement.

CHANGING TACTICS

Our "tactical" track record is more mixed than our fundamental analysis because there are so many more moving parts involved, and nobody can call market turns consistently. As a result, our "tactical" approach has evolved over time. As we've discussed before, between October 2009 and the spring of 2011, we initially married an optimistic fundamental view of BDC investments with an investment tactic of maintaining a triple leveraged status in all market conditions. Despite a few short-term pullbacks, the Fund ended 2011 up 74% for the year, and 100% from Inception. We were one of the top performing funds in the country as ranked by Morningstar, but also one of the most volatile, with marked changes from month to month.

In 2011 the very high volatility which accompanied the Euro-zone crisis (the VIX reached levels not seen since the height of the Great Recession) forced the Fund to sell-off a portion of it's assets near the market bottom to maintain margin credit metrics and to protect investors against any further downside, and resulted in a 47% loss for the year. We reacted to this setback by changing the Fund's tactical approach to volatility.

From December 2011, we have sought to reduce volatility by investing across different Leveraged Debt sectors rather than BDC common stocks alone, many of which have lesser price movements than BDCs and the stock market generally. For example, since 2009 the Floating Rate Loan index has had a correlation of **0.59** with the S&P 500 and the High Yield Index **0.73**, and the BDC sector **0.89**. (Correlation measures how much one set of assets moves in comparison with another over a given period of time). Furthermore, to further dampen down volatility, we have sought to avoid the most volatile high yield investments, and increasingly invested in BDC Notes, which are very price stable. In addition, we have "shorted" a portion of our investments, with the goal of realizing gains when stock prices drop, and vice versa. Finally, at times when we are concerned about potential price drops and/or high volatility, we have sold off assets early in any market pullback, and de-leveraged the Fund by as much as a third to reduce our exposure to lower prices.

This new tactical approach has allowed the Fund (unlike many other hedge funds-which have remained bearish through 2012) to take advantage of bull rallies, and to limit losses during downswings. Thus, the Fund was "long" the Leveraged Debt market when a rebound began in December 2011, and was able to achieve returns through April 2012 substantially in excess of the regular stock market indices. However, when another stock market pullback occurred in May, the Fund's loss for the month was lower than the S&P's, and there was no pressure for a margin call, suggesting our new tactical approach was working.

Since then, the Leveraged Debt markets have been on an upswing. Let's quantify this: All the Leveraged Debt sub-sectors we are invested in have been in rally mode since either mid-May or June 1st. The Floating Rate Loan market was up 3.9% in price appreciation terms through October 31, 2012. The High Yield sector (using the price appreciation of the highly diversified ETF with the ticker JNK) is up 5.85%. The BDC sector (as measured by the sector ETF) was up 19.2% between the spring low of May 18th and October month-end.

RALLY OVER?

Still, by the end of the reporting period, the rally was sputtering. In fact, both Floating Rate Loans and the BDC sector were marginally down in October from the September level, but high yield debt was slightly up. The Fund was able to post a very minimal positive return, after all fees and expenses, principally due to the dividend and interest income received.

OUTLOOK FOR LEVERAGED DEBT SECTOR

On the other hand, on a fundamental basis, we were (and remain) bullish on the prospects for all the Leveraged Debt sectors we are invested in. Next month, we will share with you our sector by sector fundamental review. In order to keep this Newsletter at a manageable length, suffice to say all the sectors we invest in are in very good shape.

POSITIONING THE FUND: END OF OCTOBER

As usual we anticipated a range of possible outcomes. On the upside, we envisaged a potential resumption of the rally in Leveraged Debt assets. On the downside, we foresaw a potential market pullback in anticipation of "fiscal cliff" concerns and as institutions took profits. We assumed the most volatile investments could drop 3-5%, and the more stable investments 1%-2%. We assumed any pull-back would be relatively short in duration, and would coincide with uncertainty over the "fiscal cliff" details. We were fully invested with $2 of debt for every $1 of equity. However, to mitigate volatility risk we also booked offsetting short positions equal to 11% of our Long portfolio, in both BDC stocks and in high yield bonds. Moreover, during October we sold a portion of our more volatile, higher risk-return high yield bond investments and redeployed the proceeds into less volatile Floating Rate Loan and BDC Notes with equal or greater yields. This allowed the Fund to book profits and reduce volatility risk.

WHAT HAPPENED IN NOVEMBER

For the first time in months the Leveraged Debt sector faced extreme levels of volatility in November. We all know the S&P dropped after the general election. However, the BDC sector dropped earlier. BDCs peaked on November 1st and in the two weeks that followed prices dropped **9.3%** (half of that in 1 day)! For example, a very well regarded BDC company Triangle Capital dropped nearly **11%** in a few hours. This was reminiscent of the vertiginous drop in prices that occurred in July and October 2011 over two-three week periods.

Thankfully the junk bond and Floating Rate Loan segments dropped far less: **1.6%** and **1.4%** respectively, as we had anticipated. (However, a portion of our exposure to both high yield bonds and Floating Rate Loans is in the form of Closed End Funds. Because the CEFs use leverage and had run up considerably in price, many experienced very high price drops. For example, one junk bond CEF we are invested in dropped **8.5%** between November 1st and November 15th).

The result was a higher amount of volatility than we had anticipated. We reacted by an accelerated sell-off and profit taking of many of our volatile investments. Although the market for all assets moved up in the day before and after Thanksgiving, we have continued to pare down the volatility risk in our portfolio, and temporarily de-leveraged the Fund. As we did in May, when concerned about a deterioration in the Greek debt drama, we want to limit further downside by investing in the least volatile assets, shorting or going to cash. In many cases we are still able to book taxable gains on the investments sold.

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We foresee two potential benefits from de-leveraging: First, as a defensive measure, as discussed above. Second, should market prices drop again, the Fund will be well positioned to buy a number of investments at substantial discounts to fair value. Given our fundamental view on Leveraged Debt prospects is so positive, this might present the Fund with a “buying opportunity” that we have not seen in many months.

As we write this, the Fund is down on the month, courtesy of the sell-off. (We have to be realistic as a triple leveraged Fund which invests a portion of it’s assets in highly volatile investments that we are going to face months when things go down rather than up). Our relatively cautious policies, though, before and during the November pullback has limited Unrealized losses to a fraction of what they would have been under our former tactical approach. Moreover, given our lowered risk profile, and the longer-term positive outlook for Leveraged Debt, we are optimistic that we will be back in the black as early as this month, or in the next month or two when the fiscal cliff situation is resolved.

Thanks to our above-average liquidity (we have unused borrowing capacity equal to more than 100% of our equity) , and the prospect for a jump in Leveraged Debt asset values when Washington arrives at a settlement, we are optimistic about above average gains ahead. However, if Washington fails the country and a recession follows in 2013, we are very well positioned, with the bulk of our assets now invested in the most senior, most secure and most liquid loans, and our net leverage cut in half. The upside may take longer, but will be greater.

NEW EMAIL FORMAT

With the ever evolving world of tablets, iPhones, and other mobile devices, we have updated our email formatting in order to be read on any device. If you would like to download the newsletter in PDF form as previously sent out, please click on the download link located in the greeting. We hope this adds some convenience.

NEWSLETTER

Keeping investors and prospective investors updated on the activities of Southland Capital Management and BDC Fund II

Office

100 Wilshire Blvd., Ste. 950
SantaMonica, CA 90401

Tel: 800.579.1651

Nicholas Marshi
Chief Investment Officer

Email:
nmarshi@southlandcapitalmanagement.com

Bill Hansen
Chief Marketing Officer

Email:
bhansen@southlandcapitalmanagement.com

Visit Us @

www.southlandcapitalmanagement.com

Accredited investors:

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