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%
Year to Date	32.03%	16.44%	19.62%	9.99%	14.22%
Inception to Date	27.86%	45.08%	46.83%	38.65%	44.24%

* 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.

September 2012 RESULTS

The Fund was up for a fourth month in a row: 2.79%. We managed to beat three of the four general stock market indices we compare ourselves against. We were higher than the NASDAQ, the S&P 500 and the venerable Dow Jones. On the month, the small stock Russell 2000 was the best performer at 3.28%.

Turning to the year-to-date, the Fund is up 32.03%. Here we are well ahead of the stock market indices, even though the stock market is having a "very good year" (to quote a Frank Sinatra song). The top stock index is the NASDAQ (includes Apple), which is ahead 19.62% in 2012. The laggard of the group is the Dow Jones up "only" 9.99%.

Finally, the Fund closed out our landmark first three years in operation with an all-in return of 27.86%. Given that the past 3 years has included the "flash crash", the drama surrounding the extension of the U.S. Government's debt ceiling, the Japanese earthquake/tsunami, the mini-crash of 2011 due to the continuing Euro-crisis and the slowing global economy, we're pleased with the long term result. The Fund's Inception To Date returns still trails the market indices over the 36-month period, but we're gaining ground.

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MARKET OUTLOOK

As the Fund's Managers, we spend every business day from 6:30 a.m. to 1.p.m. (Pacific Time) at our computers watching the ups and downs of prices across the nearly 100 different investments in the leveraged debt universe, and inputting new data into our massive "proprietary" spreadsheet. As we sit at our desks, playing in the background to provide us with the latest news are the business news channels: CNBC and Bloomberg. Between the same dozen commercials, noisy promos and musical segues, the business news channels trot out an endless parade of analysts, experts and commentators. Without any hesitation, each "guest" reels off a projection about the outlook for the market in the days, weeks and month ahead. Some talking heads are bearish, predicting a crash of monumental proportions; others are projecting very specific, very high prices ahead. Then there is everything in-between-and all presented with the ostentatious certainty you get in a sports bar.

These modern day soothsayers are the biggest reason there has been a stampede of individual investors out of the public markets. In 2012 alone $100 billion has been pulled from equity mutual funds while all the indices (as we just discussed above) are breaking return records. The fact is that nobody knows where the stock market is headed. A few of these stock market psychics will be right on the broken clock precept, and most will be wrong. The right answer to the question on CNBC/Bloomberg: "where is the market headed" should be: "I don't know, and all your other guests don't know, so let's talk about something else".

We're having this diatribe to explain how we handle the uncertainty of the future where the Fund is concerned. We don't kid ourselves that we know whether the three leveraged debt classes we invest in will be up, down or flat in the months ahead. To do so might allow the Fund to achieve excellent returns when we guess right, but exposes us to greater risk of loss if we prove to be wrong.

INVESTING IN AN UNCERTAIN ENVIRONMENT: September 2012

Instead, we construct our portfolio of investments, and will make buy-sell-hold decisions, to reflect a range of potential future outcomes. Let's take a real life example to illustrate what we're talking about. We now know that September was yet another positive month across all the markets: besides the standard market indices, all the sectors we invest in were up. The biggest sector winner was BDC common stocks: up 2.85%. Gains in floating rate loans and bonds were more modest: under 1.0%.

If we had been clairvoyant-as many pundits claim to be-we could have "predicted" at the end of August that BDC common stocks would be the top performer, and invested all the Fund's assets accordingly. We would have been right, and achieved a very high return. In fact, one scenario we did consciously assume was that BDC stocks would continue their upward run. Our analysis of the industry's fundamentals suggested that earnings should continue to grow, defaults will drop further, and relative to other leveraged debt classes, the sector remains under-valued. However, we also assumed another potential scenario for September was a potential pull-back in the stock market if the Fed did not commit to QE3, or were the negotiations between the Euro-zone members about a Spanish bail-out to hit an unexpected snag. We also foresaw the possibility that our junk bond investments might give back some of their recent gains.

[We assume a range of scenarios, but not every potential scenario. For example, if you bought into the projection made by several "doom and gloom" commentators that there was a monumental crash coming in the weeks ahead, which would hit all asset classes, there would be no investment portfolio that could withstand such a move without material losses. The Fund would have essentially to be all-cash, or net short. With the volatility index (the VIX) at record lows, the huge volumes of liquidity being pumped into the markets by global central banks, and the favorable cash flow coverage at leveraged companies, we ruled out that prospect in our portfolio construction, knowing that we can move quickly to limit losses if that dire scenario unexpectedly began to play out].

SEPTEMBER PORTFOLIO CONSTRUCTION

We invested one-third of the portfolio in BDC common stocks, to benefit from any potential upside. We invested two-thirds of the portfolio in debt instruments, on the assumption that we'd get modest gains in an up market (as ended up happening) and only modest price depreciation if the stock market pulled back (as did not happen). We increasingly shifted debt investments from high yield bond Exchange Traded Funds (ETFs), and increased our exposure to BDC publicly traded Notes, and to floating rate loan instruments. In the case of the former, we believe BDC Notes will be less volatile than high yield ETFs when the debt markets go into reverse. In the case of the latter, we are assuming floating rate loans will increase sharply in value should interest rates begin to rise.

BUYING AND SELLING

Besides the portfolio construction, we buy and sell through the month to reflect the variety of scenarios that might affect us. We sold several positions and took profits, both in common stocks, and in certain junk bond funds, in case the rally that had occurred in both had peaked. Half of the Fund's revenues for the month consisted of Realized Gains from harvesting investment positions.

USE OF "SHORTING"

We also act, when we deem it necessary, to "short" the portfolio when we are concerned that a sustained drop in stock market prices might be underway. At one point in the month, BDC market leader Ares Capital's stock began to drop. (In May, a drop in Ares stock price had preceded a general market, and BDC sector, pullback). This time we sold Ares short to benefit were past to be prologue. After a few days, though,

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Ares stock recovered, no market adjustment occurred and we covered our short at a modest loss. Another time in the month, we shorted Medley Capital stock because we believed the company was over-valued, and foresaw the whole sector might be in for a pullback. When the Medley stock price did drop as we anticipated, but there was no general pullback in the sector, we closed the position and booked a profit.

We also utilize shorting to protect ourselves on our debt investments. Most notably, the Fund has continued to hold a major position in an inverse junk bond ETF, essentially a bet that high yield debt would peak and begin to give back some of their multi-month gains. At times during the month, when bond prices weakened, the inverse ETF mitigated or wiped out our paper losses on the day. However, over the month, our inverse ETF position dropped 1.2% in value.

SUPERIOR RETURNS

Nonetheless, the Fund achieved a positive return in September, despite the cost of our cautious approach. BDC II's return on the month at 2.8% was still 3.5x that the average hedge fund, and YTD our 32.0% gain is more than 6x the 5.1% industry average.

To sum up, we don't believe we should be making big bets about the direction of the market. We learned this from or experience in 2010 and 2011. In 2010, our triple exposure to BDC common stocks and the dividends therefrom resulted in a full year return for BDC II of 74%. However, the Fund was down -47% in 2011 when the market dropped on Euro breakup concerns. We have learned from that episode that neither the Manager nor the investors want to be subject to the level of volatility / risk that these one-way bets entail.

Instead, for nearly a year now we have modified our approach and invested with a wide range of outcomes in mind, and using a broader base of leveraged loan assets. The result is that returns will - by definition - not be optimal. On the other hand, we believe this approach has greatly reduced the prospect of major losses. We have had a very good year so far and it is our goal to preserve and protect - as well as enhance - the Fund's capital. In years ahead, we may not be able to replicate the 2010 gains with our approach, but we are still targeting gross dividend yields well above 20% per annum, and all-in returns (after dividend income, realized and unrealized gains and losses, management fees and all expenses) in the middle to high teens on annual basis. If we can achieve that lofty goal (and we're running way ahead in 2012 YTD), we believe the Fund will provide our investors one of the very best risk-adjusted returns available in a marketplace where mid single digit returns are fast becoming the norm across most asset categories.

NEWSLETTER

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

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