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%
FYE - 2012	28.21%	16.00%	15.19%	7.25%	16.34%
January - 2013	6.08%	5.18%	4.06%	5.77%	5.96%
February - 2013	1.45%	1.36%	0.57%	1.40%	1.33%
March - 2013	2.42%	3.75%	3.40%	3.73%	4.62%
April - 2013	2.85%	1.93%	1.88%	1.79%	-0.37%
May - 2013	-6.58%	2.34%	3.82%	1.86%	4.00%
June - 2013	-0.28%	-1.34%	-1.52%	-1.36%	-0.51%
July - 2013	3.19%	5.09%	6.56%	3.96%	7.00%
Year to Date	8.98%	19.63%	20.11%	18.29%	23.97%
Inception to Date	35.31%	72.91%	70.89%	59.58%	82.10%

* 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.

JULY 2013 RESULTS

The Fund recorded an above-average gain of +3.19% for the month. Nonetheless, we lagged the major stock market indices we compare ourselves against, most of which had their top monthly performance of the year, with the small-cap Russell 2000 up +7.00%! We were closest to the Dow Jones (up +3.96%), and also trailed the S&P 500 (up +5.09%).

Year-to-date, the Fund is up a very encouraging 8.98% in just seven months. Still, we are at the back of the pack compared to the stock market indices because of the May drop for all credit instruments, whereas regular common stock prices hit post-recession record levels.

Inception to date, which amounts to 46 months, the Fund is up +35.31%, after all fees and expenses. Our long term performance remains below the performance of the stock market indices, which have boomed since experiencing huge losses in the Great Recession. We continue to be optimistic the Fund will, over time, match or exceed the results of all the indices.

We continue to take comfort from the performance of the Fund since our change in strategy in January 2012. What has become a regular feature of our Newsletter is the chart generated by PartnersAdmin, our independent administrator, which shows the Fund's returns for the past 19 months and compare the results against the stock indices. BDC II remains up 31.41% in the period, beating the Dow and only slightly lagging the other 3 indices, except the Russell 2000, which is on a historic run-up.

Month	BDC Fund II	S&P 500	NASDAQ Comp	Dow Jones	Russell 2000 DRI
Jan. 2012 to Date	31.41%	38.77%	39.22%	26.87%	44.22%

TOUGH YEAR FOR LENDERS

Paradoxically, despite BDC II's excellent returns though July (we are annualizing a mid-teens performance for the year), 2013 has been a very hard year for credit investments of all kinds. As everybody knows, the Federal Reserve's signal in May that it intends to reduce Quantitative Easing measures that have kept long-term interest rates artificially low caused a jump in yields. (In fact, long term rates had been inching up for months before, but the May announcement grabbed the attention of the headline writers and the markets). Today, the 10 Year Treasury yield is 46% higher than at the end of 2012.

The result has been a major pull-back across all asset classes where yield is a material component of total return. A couple of months ago we pointed out that not only have long term, fixed rate bond investments been hit by the change in sentiment, but so have sectors such as high paying dividend stocks, utility stocks, Real Estate Investment Trusts, energy Master Limited Partnerships etc.

A very haggard Bill Gross of PIMCO, who co-manages the world's largest bond mutual fund, was on Bloomberg and CNBC yesterday, discussing what has happened to credit investments this year. His bond fund, which invests principally in investment grade bonds is down -2.9% YTD, greater than a full year's dividends. Bloomberg added some additional data, which we shamelessly cribbed for this Newsletter, showing the Year-To-Date performance of some other credit asset classes. Emerging Market bonds are down -11.0%, Municipal Bonds down -7.1% and Investment Grade Bonds -6.5%.

If we zoom in on the credit classes in which the Fund invests, the YTD performance is also dismal, but less so. The High Yield bond sector, as represented by the 2013 price movement of largest Exchange Traded Fund with the ticker HYG is down -3.1%. (To put that into some context HYG was up +4.05% in 2012, not including distributions). The Floating Rate Loan sector, represented by it's largest ETF with the ticker BKLN, is down -0.64% in 2013, after being +4.39% in 2012. BDC Notes, using our own data in the absence of a third-party option, are down -1.2%. Finally, BDC common stocks in 2013, and using the data from two Exchange Traded instruments that cover the sector, are down -0.4%. (Last year, the sector was up +20.54%).

HEDGE FUND IMPACT

Despite a buoyant market for stocks, the hard times in the credit markets have impacted hedge fund returns in the short and medium term. We know a monthly return really means nothing about long term performance because that's what we carried on about in last month's Newsletter. Still, we can't help pointing out that the "average" hedge fund in July (according to Reuters, quoting E-Vestment aggregated data) was up +1.2%. Stock-oriented funds were up +2.1%, which helped the average, but "credit funds inched up 0.2%". So BDC II's +3.2% July result managed to beat out even hedge funds focused on stocks, and out-performed credit funds by 16x. Year-To-Date (somewhat more useful), the average hedge fund is up +4.5%, which still trails BDC II 8.9% result by 50%.

WHY THE OUT-PERFORMANCE VERSUS OUR PEERS?

Why has the Fund performed so decently despite the unfavorable conditions for credit investments? Certainly, it's not because we claim any prescience about the direction of long term interest rates. We did not receive any early warning e-mail from the Fed about their intentions. Nor were we particularly bearish on the credit sector in general through the year. We worry most about credit quality, defaults and prospective defaults, which have been improving through 2013. Thankfully, lenders are maintaining their credit discipline despite abundant liquidity (but shaving their rates, but that's another issue). We couldn't forecast the huge drawdown in the High Yield market (-7.5% in less than 30 days-the biggest drop since November 2011).

DEFENSIVE POSITIONING

We like to use the term "positioning." Read a few of our Newsletters and you'll see the term thrown around a lot. The best

definition might be: "preparing now for something that might happen at some unknown time in the future." We're going to explain what we mean in the context of 2013's fund management.

The most important "positioning" we undertook was in minimizing our fixed rate interest rate risk. It seems obvious now that fixed rate investments are dangerous to hold, but just a few weeks ago, the markets seemed to expect low long term rates for the long term, which caused the Investment Grade ETF to reach it's highest level (and the yield it's lowest) in it's history as recently as April 29th. The High Yield Bond ETF also reached a post-recession high that same week, and the 20 Year Treasury ETF the highest level in all of 2013 on May 1st.

Nonetheless, we kept our fixed rate exposure low. Back in our February Newsletter we commented that we were focusing principally on investing in Floating Rate investments, and trimming our already minimal fixed rate investments as opportunities arose. Furthermore, we maintained a major inverse junk bond ETF position, which goes up in value as rates rise, to "hedge" a portion of our fixed rate risk. There were more subtle "positioning" strategies too: when we invested in High Yield ETF and CEF investments we generally limited ourselves to funds that specialize in short term maturities (an average of under 3 years). These are less susceptible to big price swings on interest rate increases as their bonds mature in short order.

Nonetheless, we were as surprised as anyone about the sharp change of course of interest rates in May. That's when we moved to Plan B, and sold down many of our longer dated fixed rate positions. We got out of our High Yield Bond investments early in the market rout, and at prices very close to their highs. We also divested ourselves of all our long dated BDC Note investments (up to 30 years long!). For example, we sold all our sizable position in Ares Capital's 2042 Notes in late May and early June at a price well north of $25.0, for a profit over cost. Today that investment trades -2.6% lower. We sold all our Notes with a maturity of 10 years or more and several in the 5-10 year range.

OFFENSIVE POSITIONING

That's not the end of it for "positioning." We're not just seeking to mitigate risk. We're also looking for upside opportunities. As a rule of thumb, the Fund only adds a new investment when we can invest at a discount of at least 10% to their Realizable Value.

After 4 years of economic expansion identifying under-valued stocks is not easy, and sometimes requires us to "position" ourselves a long time in advance. We have been bullish about the prospects for Floating Rate Loans for some time, but we recognize that the day when short term rates soar, which will cause Floating Rate assets to greatly increase their earnings and their market value, could be years away. Or not. To be in the right place at the right time, we've been accumulating investments in the sector, and regarding price drops this year as an opportunity, rather than a problem. Given that the borrowers in this sector are the largest in the Leveraged Debt market, and with the best credit profile and highest recovery rates when they do default, we calculate that the downside risk is limited. Conversely, the capital appreciation opportunity is high. We estimate Floating Rate Loan investments will trade 28% higher than today's levels when short term rates increase by 3%.

We also position ourselves to take advantage of opportunities brought on by the market's volatility. We assume stocks will swing up and down by 5% or more (from a recent high to low) multiple times in a year, even in the relatively benign economic and credit environments in which we're currently operating.

BUY LOW, SELL HIGH

In our more volatile investments, the Fund's investment strategy is to sell off our more successful investments as they reach up to their Realizable Value. We can then re-deploy the freed up capital into investments trading at the afore mentioned 10% or greater discount. This sometimes require a gap in time between the harvesting and the re-seeding. Sometimes we are able to sell an investment at a very full price, and buy it back a few days/weeks/months later at a much lower price. Easy to describe, hard to implement, but we've had considerable success with this approach.

MAKING MONEY ON MAIN STREET

For example, we sold a major position in May in Main Street Capital (a mid-sized BDC which we know very well) when it went on a huge run-up. Admittedly we missed selling at the highest high, but did harvest a decent gain. Between May and June MAIN's price dropped -23%. We bought back in. Starting in July, the stock began to rise again (as we anticipated based on our fundamental analysis and 5 years history of tracking the Company's strategy and performance). Late in the month and again in August we once again sold a portion of our position as

the stock reached closer to our Realizable Value. We booked a 16% gain in a matter of few weeks. As we write this MAIN's stock price has again dropped below 90% of Realizable Value and we're looking to buy back in.

Of the 37 BDCs we track, about 30 companies have performed as we expected and their stock prices have moved up and down through 2013 in a relatively narrow range, and are candidates for this type of short term positioning.

Of course, sometimes we remain bullish on a stock that we've bought at a discount, but the stock price goes nowhere. Thankfully, the Fund is paid for it's patience with the regular dividend, which averages over 10.0% per annum. Sometimes we re-value a stock downward because of new information or changing market conditions. Recently there have been very few instances of major mark-downs as earnings, Net Asset Values and market conditions have been favorable. When it does happen, though, we have a mix of investment options. If we have lost faith in the management entirely we tend to sell out our position entirely, usually in a short period of time. We have 3 BDCs in this category.

FALLEN ANGELS

If we retain faith in the Company of what we call our Fallen Angels, we will buy more stock if the price is right and we can average down our position while ultimately achieving our upside targets. If the price is not right, we just do nothing, collecting our dividend and waiting. On our BDC Buy List, there are 4 companies in this category in 2013.

POSITIONED FOR PROFITS

Assuming that the Manager is correct about the Realizable Value of the Fund's investments, we are positioned for substantial stock appreciation, to go along with the 20% plus annual dividend pace. Of course, we've got to manage volatility and our own nerves to ensure that we stay the course until we're in a position to harvest the 80+ investments we are in. As we write this, we continue to project capital appreciation on our investment assets equal to a greater than 50% of our invested capital. Of course, when we will be in a position to harvest those gains, remains unknown.

(As far as BDCs are concerned, the Manager has a pretty good track record of correctly projecting Realizable Value, at least so far. We dug out our projections from a year ago and compared them with the maximum price that each BDC achieved in the following 52 weeks. In aggregate, actual prices exceeded the estimates by 6%. Of the 21 investments, the actual price achieved exceeded our estimates in 16 cases, 5 fell below and only 2 materially, i.e. more than 5%.)

CONCLUSION

We expect the difficult conditions for credit investments to continue, along with price volatility, until long term yields reach a "normal" level. As we discussed in the prior Newsletter, this will be reflected in our monthly results, which will probably be choppy. However, given the apparent strengthening economy, low credit risks, and the Fund's "positioning" in floating rate assets likely to increase in value should short term rates rise, we're very comfortable with the disproportionate reward for a limited downside risk.

NEWSLETTER

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

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